

Consolidated Financial Statements

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Consolidated income statements

In USD millions, for the years ended December 31	Notes	2008	2007
Revenues			
Gross written premiums and policy fees		51,894	47,456
Less premiums ceded to reinsurers ¹		(6,226)	(13,197)
Net written premiums and policy fees		45,667	34,259
Net change in reserves for unearned premiums	11	(1,560)	(495)
Net earned premiums and policy fees		44,107	33,763
Farmers management fees and other related revenues	14	2,458	2,266
Net investment result on Group investments	6	5,832	10,094
Net investment income on Group investments		8,725	8,591
Net capital gains/(losses) and impairments on Group investments		(2,893)	1,503
Net investment result on unit-linked investments	6	(21,731)	7,142
Net gain/(loss) on divestments of businesses	5	16	118
Other income		1,665	1,900
Total revenues		32,349	55,285
Benefits, losses and expenses			
Insurance benefits and losses, gross of reinsurance ¹	11	31,387	34,923
Less ceded insurance benefits and losses ¹	11	3,425	(11,632)
Insurance benefits and losses, net of reinsurance ¹	11	34,811	23,291
Policyholder dividends and participation in profits, net of reinsurance	11	(21,514)	8,526
Underwriting and policy acquisition costs, net of reinsurance	11	8,287	7,559
Administrative and other operating expense	13	6,729	6,679
Interest expense on debt	21	599	685
Interest credited to policyholders and other interest		773	957
Total benefits, losses and expenses		29,685	47,698
Net income before income taxes		2,663	7,587
Income tax expense	20	452	(1,791)
attributable to policyholders	20	1,184	83
attributable to shareholders	20	(732)	(1,874)
Net income after taxes		3,116	5,797
attributable to non-controlling interests		77	83
attributable to shareholders		3,039	5,714
in USD			
Basic earnings per share	22	21.80	39.73
Diluted earnings per share	22	21.63	39.29
in CHF			
Basic earnings per share	22	23.53	47.63
Diluted earnings per share	22	23.35	47.11

¹ In 2007, premiums ceded to reinsurers included USD 7.3 billion and ceded insurance benefits and losses included USD 7.0 billion relating to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts have been transferred to the reinsurer. This transaction had no impact on the consolidated income statement in 2008.

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

Consolidated statements of comprehensive income

in USD millions, for the years ended December 31

	Net income attributable to shareholders	Net unrealized gains/(losses) on available- for-sale investments
Notes		6
2007		
Comprehensive income for the period	5,714	(609)
Detail of movements during the period		–
Change (excluding tax, reclassification and currency translation effects and after allocation to policholders)		(686)
Reclassification to income statement		(182)
Foreign currency translation effects		33
Deferred income tax		225
2008		
Comprehensive income for the period	3,039	(3,159)
Detail of movements during the period		
Change (excluding tax, reclassification and currency translation effects and after allocation to policholders)		(6,316)
Reclassification to income statement		2,071
Foreign currency translation effects		121
Deferred income tax		965

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

	Cash flow hedges	Cumulative translation adjustment	Revaluation reserve	Net actuarial gains/(losses) on pension plans	Total other comprehensive income attributable to shareholders	Total comprehensive income attributable to shareholders	Comprehensive income attributable to non-controlling interests	Total comprehensive income
	7			23				
	(103)	561	83	468	401	6,115	90	6,205
	(25)	564	101	661	616			
	(111)	(3)	–	–	(296)			
	(7)	–	–	(6)	20			
	40	–	(17)	(188)	61			
	87	(2,725)	16	(1,115)	(6,897)	(3,858)	6	(3,852)
	60	(2,707)	21	(1,690)	(10,634)			
	54	(18)	–	–	2,107			
	(7)	–	–	114	228			
	(20)	–	(5)	461	1,401			

Consolidated balance sheets

Assets	in USD millions, as of December 31	Notes	2008	2007
Investments				
Total Group investments			179,570	193,600
Cash and cash equivalents			11,965	13,943
Equity securities			14,242	20,416
Debt securities			118,103	123,762
Real estate held for investment			7,524	7,563
Mortgage loans			12,820	12,718
Other loans			12,531	12,936
Investments in associates			220	238
Other investments			2,165	2,024
Investments for unit-linked contracts			78,203	122,092
Total investments		6	257,773	315,693
Reinsurers' share of reserves for insurance contracts ¹		8	18,595	26,970
Deposits made under assumed reinsurance contracts			2,397	1,359
Deferred policy acquisition costs		12	14,323	14,941
Deferred origination costs		12	770	1,003
Accrued investment income			2,429	2,593
Receivables		15	13,229	12,846
Other assets			4,095	3,405
Mortgage loans given as collateral		16	1,233	2,243
Deferred tax assets		20	2,901	1,682
Property and equipment		17	1,889	1,972
Goodwill		18	1,846	1,730
Other intangible assets		18	6,464	2,906
Total assets			327,944	389,342

¹ In 2007, reinsurers' share of reserves for insurance contracts included USD 7.1 billion related to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts were transferred to the reinsurer, resulting in a reduction of reinsurers' share of reserves for insurance contracts.

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

Liabilities and equity	in USD millions, as of December 31	Notes	2008	2007
Liabilities				
	Reserve for premium refunds		620	625
	Liabilities for investment contracts	9	35,979	54,485
	Deposits received under ceded reinsurance contracts		1,619	1,739
	Deferred front-end fees		4,695	5,791
	Reserves for insurance contracts ¹	8	222,179	252,740
	Obligations to repurchase securities		3,608	5,370
	Accrued liabilities		2,820	2,755
	Other liabilities	19	16,944	20,257
	Collateralized loans	16	1,233	2,243
	Deferred tax liabilities	20	3,485	4,057
	Debt related to capital markets and banking activities	21	2,527	1,663
	Senior and subordinated debt	21	8,455	8,300
	Total liabilities		304,163	360,023
Equity				
	Share capital	22	10	10
	Additional paid-in capital		10,131	10,289
	Net unrealized gains/(losses) on available-for-sale investments		(2,957)	202
	Cash flow hedges		(16)	(103)
	Cumulative translation adjustment		(1,341)	1,385
	Revaluation reserve		99	83
	Retained earnings		15,616	16,406
	Common shareholders' equity		21,542	28,273
	Preferred securities	22	561	671
	Shareholders' equity		22,103	28,945
	Non-controlling interests		1,678	374
	Total equity		23,781	29,318
	Total liabilities and equity		327,944	389,342

¹ In 2007, reserves for insurance contracts included USD 7.1 billion related to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts were transferred to the reinsurer, resulting in a reduction of reserves for insurance contracts.

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

Consolidated statements of cash flows

in USD millions, for the years ended December 31	2008	2007
Cash flows from operating activities		
Net income attributable to shareholders	3,039	5,714
Adjustments for:		
Net (gain)/loss on divestments of businesses	(16)	(118)
Share of equity in income from investments in associates	(8)	(13)
Depreciation, amortization and impairments of fixed and intangible assets	654	515
Other non-cash items	1,373	310
Underwriting activities:	(24,587)	(3,346)
Reserves for insurance contracts, gross ¹	(19,773)	2,319
Reinsurers' share of reserves for insurance contracts ¹	7,056	(6,403)
Liabilities for investment contracts	(9,486)	2,213
Deferred policy acquisition costs	(975)	(928)
Deferred origination costs	8	(166)
Deposits made under assumed reinsurance contracts	(1,307)	715
Deposits received under ceded reinsurance contracts	(110)	(1,096)
Investments:	30,373	(2,594)
Net capital (gain)/loss on investments and impairments	27,809	(5,645)
Net change in trading securities	2,069	(80)
Sales and maturities		
Debt securities ¹	67,403	70,307
Equity securities	66,830	70,725
Other (primarily other investments)	43,273	32,426
Purchases		
Debt securities	(69,913)	(64,327)
Equity securities	(63,314)	(73,044)
Other (primarily other investments)	(43,783)	(32,955)
Proceeds from sale and repurchase agreements	(443)	(865)
Movements in receivables and payables	(3,174)	350
Net changes in debt for capital markets and banking activities	1,035	(279)
Net changes in other operational assets and liabilities	509	(1,611)
Deferred income tax, net	(1,705)	357
Net cash provided by operating activities	7,050	(1,580)

¹ In 2007, the consolidated statements of cash flows included proceeds of USD 6.3 billion from the sale of debt securities, a reduction in cash and cash equivalents of USD 0.6 billion and an increase in reinsurers' share of reserves for insurance contracts of USD 7.0 billion related to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts were transferred to the reinsurer, resulting in a reduction of both the reinsurers' share of reserves for insurance contracts and gross reserves for insurance contracts.

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

in USD millions, for the years ended December 31	2008	2007
Cash flows from investing activities		
Sales of property and equipment	309	274
Purchase of property and equipment	(444)	(338)
Investments in associates, net	11	(73)
Acquisitions of companies, net of cash acquired	(1,319)	(543)
Divestments of companies, net of cash balances	(5)	58
Other acquisitions and divestments related cashflow		–
Dividends from associates	5	5
Net cash used in investing activities	(1,442)	(617)
Cash flows from financing activities		
Dividends paid	(2,104)	(1,339)
Net movement in treasury shares	(812)	(1,669)
Redemption of preferred securities and repayments to non-controlling interests	(124)	–
Issuance of debt	2,420	1,898
Payments on debt outstanding	(1,930)	(1,576)
Net cash used in financing activities	(2,551)	(2,686)
Foreign currency translation effects on cash and cash equivalents	(1,896)	640
Change in cash and cash equivalents excluding change in cash held as collateral for securities lending ¹	1,161	(4,243)
Cash and cash equivalents as of January 1, excluding cash held as collateral for securities lending	15,059	19,302
Cash and cash equivalents as of December 31, excluding cash held as collateral for securities lending	16,220	15,059
Change in cash held as collateral for securities lending	(1,700)	(1,943)
Cash and cash equivalents as of January 1, including cash held as collateral for securities lending	16,936	23,122
Cash and cash equivalents as of December 31, including cash held as collateral for securities lending	16,397	16,936
thereof:		
– cash and cash equivalents – Group Investments	11,965	13,943
– cash and cash equivalents – unit linked	4,431	2,993
Other supplementary cash flow disclosures		
Other interest income received	8,859	8,519
Dividend income received	2,943	3,136
Other interest expense paid	(1,478)	(1,603)
Income tax paid	(1,253)	(1,998)

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

As of December 31, 2008 and 2007, cash and cash equivalents restricted as to use were USD 1,097 million and USD 1,150 million, respectively. Cash and cash equivalents held for the benefit of policyholders in connection with unit-linked products amounted to USD 4,431 million and USD 2,993 million as of December 31, 2008 and 2007, respectively.

in USD millions, as of December 31		2008	2007
Cash and cash equivalents	Cash and cash equivalents comprise the following:		
	Cash at bank and in hand	7,737	5,567
	Cash equivalents	8,482	9,492
	Cash held as collateral for securities lending	177	1,877
	Total	16,397	16,936

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

Consolidated statements of changes in equity

in USD millions	Share capital	Additional paid-in capital	Net unrealized gains/(losses) on available-for-sale investments
Balance as of December 31, 2006, as previously reported	10	10,448	819
Total adjustments due to restatement	–	–	(8)
Balance as of December 31, 2006, as restated	10	10,448	811
Issuance of share capital	–	147	–
Dividends to shareholders	–	–	–
Share-based payment transactions	–	30	–
Treasury share transactions ¹	–	(335)	–
<i>of which: share buy-back program</i>	–	(208)	–
Total comprehensive income for the period, net of tax	–	–	(609)
<i>Net income</i>	–	–	–
<i>Net unrealized gains/(losses) on available-for-sale investments</i>	–	–	(609)
<i>Cash flow hedges</i>	–	–	–
<i>Cumulative translation adjustment</i>	–	–	–
<i>Revaluation reserve</i>	–	–	–
<i>Net actuarial gains/(losses) on pension plans</i>	–	–	–
Net changes in capitalization and non-controlling interests	–	–	–
Balance as of December 31, 2007	10	10,289	202
Balance as of December 31, 2007, as previously reported	10	10,289	195
Total adjustments due to restatement	–	–	7
Balance as of December 31, 2007, as restated	10	10,289	202
Issuance of share capital	–	1	–
Dividends to shareholders	–	–	–
Redemption of preferred securities	–	(14)	–
Share-based payment transactions	–	48	–
Treasury share transactions ¹	–	(194)	–
<i>of which: share buy-back program</i>	–	(245)	–
Total comprehensive income for the period, net of tax	–	–	(3,159)
<i>Net income</i>	–	–	–
<i>Net unrealized gains/(losses) on available-for-sale investments</i>	–	–	(3,159)
<i>Cash flow hedges</i>	–	–	–
<i>Cumulative translation adjustment</i>	–	–	–
<i>Revaluation reserve</i>	–	–	–
<i>Net actuarial gains/(losses) on pension plans</i>	–	–	–
Net changes in capitalization and non-controlling interests	–	–	–
Balance as of December 31, 2008	10	10,131	(2,957)

¹ Please refer to table 22.3 for information regarding treasury share transactions.

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

	Cash flow hedges	Cumulative translation adjustment	Revaluation reserve	Retained earnings	Common shareholders' equity	Preferred securities	Shareholders' equity	Non-controlling interests	Total equity
	–	823	–	12,816	24,917	671	25,588	517	26,105
	–	–	–	64	55	–	55	–	55
	–	823	–	12,880	24,972	671	25,643	517	26,161
	–	–	–	–	147	–	147	–	147
	–	–	–	(1,293)	(1,293)	(46)	(1,339)	(10)	(1,349)
	–	–	–	–	30	–	30	–	30
	–	–	–	(1,317)	(1,652)	–	(1,652)	–	(1,652)
	–	–	–	(817)	(1,025)	–	(1,025)	–	(1,025)
	(103)	561	83	6,136	6,070	46	6,115	90	6,205
	–	–	–	5,668	5,668	46	5,714		
	–	–	–	–	(609)	–	(609)		
	(103)	–	–	–	(103)	–	(103)		
	–	561	–	–	561	–	561		
	–	–	83	–	83	–	83		
	–	–	–	468	468	–	468		
	–	–	–	–	–	–	–	(223)	(223)
	(103)	1,385	83	16,406	28,273	671	28,945	374	29,318
	(103)	1,385	101	16,254	28,132	671	28,804	374	29,177
	–	–	(17)	152	141	–	141	–	141
	(103)	1,385	83	16,406	28,273	671	28,945	374	29,318
	–	–	–	–	1	–	1	–	1
	–	–	–	(2,064)	(2,064)	(32)	(2,096)	(8)	(2,104)
	–	–	–	–	(14)	(110)	(124)	–	(124)
	–	–	–	–	48	–	48	–	48
	–	–	–	(618)	(812)	–	(812)	–	(812)
	–	–	–	(800)	(1,045)	–	(1,045)	–	(1,045)
	87	(2,725)	16	1,892	(3,890)	32	(3,858)	6	(3,853)
	–	–	–	3,007	3,007	32	3,039		
	–	–	–	–	(3,159)	–	(3,159)		
	87	–	–	–	87	–	87		
	–	(2,725)	–	–	(2,725)	–	(2,725)		
	–	–	16	–	16	–	16		
	–	–	–	(1,115)	(1,115)	–	(1,115)		
	–	–	–	–	–	–	–	1,307	1,307
	(16)	(1,341)	99	15,616	21,542	561	22,103	1,678	23,781

Zurich Financial Services and its subsidiaries (collectively the "Group") are an insurance-based financial services provider with a global network. The Group also distributes non-insurance products, such as mutual funds, mortgages and other financial services products, from selected third-party providers. The Group operates mainly in Europe, the USA and Asia Pacific through subsidiaries, branch offices and representations.

Zurich Financial Services, a Swiss corporation, is the holding company of the Group and is listed on the SIX Swiss Exchange. Zurich Financial Services was incorporated on April 26, 2000, in Zurich, Switzerland. It is recorded in the Commercial Register of the canton of Zurich under its registered address at Mythenquai 2, 8002 Zurich.

On February 4, 2009 the Board of Directors of Zurich Financial Services authorized these consolidated financial statements for issue. These financial statements will be submitted for approval to the Annual General Meeting of Shareholders to be held on April 2, 2009.

1. Basis of presentation

General information

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law. Where IFRS does not contain clear guidance governing the accounting treatment of certain transactions including those that are specific to insurance products, IFRS permits reference to another comprehensive body of accounting principles that uses a similar conceptual framework. In these cases, the Group typically refers to accounting principles generally accepted in the United States of America (US GAAP) for guidance.

Disclosures under IFRS 4 "Insurance Contracts" and IFRS 7 "Financial Instruments: Disclosures" relating to the nature and extent of risks, and capital disclosures under IAS 1 "Presentation of Financial Statements" have been included in the "Risk Review" on pages 90 to 126, and they form an integral part of the consolidated financial statements.

Significant subsidiaries included in the scope of consolidation are disclosed on pages 240 to 243.

Certain amounts recorded in the consolidated financial statements reflect estimates and assumptions made by management about insurance liability reserves, investment valuations, interest rates and other factors. Critical accounting judgments and estimates are discussed in note 4. Actual results may differ from the estimates made.

During the year, the presentation of certain items in the consolidated financial statements has been amended in order to better reflect their economic substance. These changes in presentation have no effect on the previously reported net income or shareholders' equity and comparative amounts have been amended accordingly. Material changes in presentation are described as follows:

- Investments held by investment companies, previously reported under other investments and amounting to USD 1,827 million as of December 31, 2007 are now presented under equity securities at fair value through profit or loss, as this presentation better reflects the nature and measurement basis of these investments. This change in presentation is reflected in the consolidated balance sheet, consolidated statement of cash flows, note 6 and note 25.
- Recurring payments made to distributors of life products after the initial sale, over the lifetime of the policy, are now presented as part of administrative and other operating expense. They were previously reported as part of underwriting and policy acquisition costs and amounted to USD 266 million for the year ended December 31, 2007. This change in presentation is reflected in the consolidated income statement, note 11 and note 13.
- Income from profit participation relating to life reinsurance contracts are now presented as part of other income. This was previously reported as part of underwriting and policy acquisition costs and amounted to USD 133 million for

the year ended December 31, 2007. This change in presentation is reflected in the consolidated income statement and note 11.

- Amortization charges for deferred origination costs, previously reported as part of administrative and other operating expense and amounting to USD 103 million for the year ended December 31, 2007, are now included in underwriting and policy acquisition costs. This change in presentation is reflected in the consolidated income statement, note 11 and note 13.
- Amortization and impairments of intangible assets, previously reported separately in the consolidated income statement and amounting to USD 302 million for the year ended December 31, 2007, are now included in administrative and other operating expense. This change in presentation is also reflected in note 13.
- Movements shown in the development tables throughout the consolidated financial statements have been translated at average rather than end-of-period foreign exchange rates as they were presented in previous years.

The Group's balance sheet is not presented using a current/non-current classification. However, the following balances are generally considered to be current: cash and cash equivalents, short-term investments, deferred policy acquisition costs on general insurance contracts, accrued investment income, receivables, reserve for premium refunds, accrued liabilities and obligation to repurchase securities.

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

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

Maturity tables have been provided for the following balances: reserves for insurance contracts (table 13 in "Risk Review"), liabilities for investment contracts (table 14 in "Risk Review"), debt securities (table 6.4), derivative assets and derivative liabilities (tables 7.1 and 7.2), collateralized loans (table 16) and outstanding debt (table 21.3).

All amounts in the consolidated financial statements are shown in USD millions, rounded to the nearest million unless otherwise stated with the consequence that the rounded amounts may not add to the rounded total in all cases.

The table below summarizes the principal exchange rates that have been used for translation purposes. Net gains on foreign currency transactions included in the consolidated income statements were USD 26 million and USD 131 million for the years ended December 31, 2008 and 2007, respectively. Foreign currency exchange forward and swap losses included in these amounts were USD (801) million and USD (249) million for the years ended December 31, 2008 and 2007, respectively.

Table 1.1

Principal exchange rates	USD per foreign currency unit, as of or for the year ended December 31			
	Balance sheets		Income statements and cash flows	
	2008	2007	2008	2007
Euro	1.3924	1.4601	1.4719	1.3706
Swiss franc	0.9371	0.8822	0.9265	0.8341
British pound sterling	1.4620	1.9849	1.8556	2.0019

Change in accounting policies in 2008

The accounting policy for three run-off blocks of disability business in Centre, included in Other Businesses, has been changed by exercising the option in IFRS 4 to remeasure designated insurance liabilities using current financial and non-financial assumptions. All financial assets related to these insurance liabilities are designated as "at fair value through profit or loss." This is a better reflection of the way these blocks of business are managed. As a consequence of this change in accounting policy, prior year figures have been restated to ensure comparability as shown in the following tables.

Table 1.2

in USD millions, unless otherwise stated	As reported	Amount of restatement	As restated
as of December 31, 2007			
Total equity	29,177	141	29,318
Reserves for insurance contracts	252,886	(146)	252,740
Reinsurers' share of reserves for insurance contracts	26,977	(7)	26,970
Deferred tax assets	1,678	4	1,682
Deferred tax liabilities	4,055	2	4,057
for the year ended December 31, 2007			
Net capital gains/(losses) and impairments on Group Investments	1,498	5	1,503
Insurance benefits and losses, net of reinsurance	23,378	87	23,465
Income tax expense	1,787	(4)	1,783
Net income attributable to shareholders	5,626	88	5,714
Basic earnings per share in CHF	46.88	0.75	47.63
Diluted earnings per share in CHF	46.37	0.74	47.11

Table 1.3

in USD millions	As reported	Amount of restatement	As restated
as of December 31, 2006			
Total equity	26,105	56	26,161
Reserves for insurance contracts	240,648	(55)	240,593
Reinsurers' share of reserves for insurance contracts	20,063	(3)	20,060
Deferred tax assets	2,336	4	2,340
Deferred tax liabilities	4,804	-	4,804

Significant transactions and events

Transfer of UK annuity business

The Group entered into a reinsurance agreement to transfer the risk associated with a significant annuities portfolio effective as of January 1, 2007. In 2007 premiums ceded to reinsurers and ceded insurance benefits and losses increased by USD 7.3 billion and USD 7.0 billion, respectively. The transaction resulted in a net loss after tax of USD 59 million. In the consolidated balance sheets, total investments and associated other assets decreased by USD 7.4 billion and reinsurer's share of reserves for insurance contracts increased by USD 7.1 billion. In April 2008, the UK High Court approved as a second step of this transaction the collective novation of all policies of this significant annuity portfolio, which became effective as of June 30, 2008. As a result the underlying contracts have been transferred to the reinsurer. This had no further impact on the income statement, but resulted in a reduction of reinsurers' share of reserves for insurance contracts of USD 7.1 billion and a corresponding reduction in the reserves for insurance contracts.

Sale of North America Commercial Small Business Solutions (SBS)

On June 13, 2008, effective on June 1, 2008, the Group completed the sale of the rights to access renewals of its North America Commercial Small Business Solutions (SBS) book of business to Truck Insurance Exchange (TIE), one of the Farmers Exchanges, which the Group manages but does not own. As part of the transaction, the Group has entered into a 100% quota share reinsurance agreement for the in-force business as of June 1, 2008. This resulted in the Group paying TIE the balance of unearned premium reserve related to the business ceded to TIE of USD 425 million and TIE compensating the Group for its deferred acquisition cost balance as of the effective date of the transaction by paying a ceding commission of USD 120 million. In addition, the management of the in-force SBS book of business has been transferred together with certain assets and liabilities to Farmers Group, Inc. This transaction had no impact on the scope of consolidation.

Changes in the German Insurance Supervisory Law

Effective January 1, 2008, the German Insurance Supervisory Law changed its requirements for policyholder participations for life insurance. While, in the past, it was required that a minimum of 90 percent of the gross surplus was allocated to the policyholder, a more specific allocation is now required. A minimum of 90 percent of the total investment return less 100 percent of the minimum guaranteed interest on the policyholder account, a minimum of 75 percent of the risk profits and a minimum of 50 percent of the positive expense result is now allocated to the policyholder. In 2008, the Group has recognized a gain of USD 357 million net of income taxes as a result of this change in the law.

Segment information

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

- General Insurance serves the property-casualty insurance needs of a wide range of customers, from individuals to small and medium-size businesses, commercial enterprises and major multinational corporations.
- Global Life pursues a customer-focused strategy with market-leading propositions in unit-linked and protection products through global distribution and proposition pillars to develop leadership positions in its chosen segments.
- Farmers Management Services which through Farmers Group, Inc. and its subsidiaries (FGI) provides non-claims related management services to the Farmers Exchanges, are prominent writers of personal lines and small commercial lines business in the United States. FGI receives fee income for the provision of services to the Farmers Exchanges, which we manage, but do not own, and to their customers.
- Other Businesses includes Farmers Re which provides reinsurance to the Farmers Exchanges, Centre and capital markets and banking activities. This segment also includes certain businesses which are centrally managed and are not considered to be core businesses of the Group.
- Corporate Functions includes Group holding and financing companies, Corporate Center operations and certain alternative investments.

To be consistent with the Group's management structure, the following immaterial transfer between primary segments has been made for 2008 financial reporting:

- Zurich Eurolife S.A. from Other Businesses to Global Life

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

- North America
- Europe

- International Businesses, and
- Central Region

To be consistent with the Group's geographic structure, the following immaterial transfer between secondary segments has been made for 2008 financial reporting:

- Zurich Eurolife S.A. from Central Region to Europe

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

2. Implementation of new accounting standards and amendments to published accounting standards

Standards published and effective as of January 1, 2008 and relevant for the Group's operations

IFRIC 14 "IAS 19 – The limit on a defined benefit asset, minimum funding requirements and their interaction" has been implemented for the financial year beginning January 1, 2008 and had no significant impact on the Group's financial position or performance.

Amendments effective as of July 1, 2008 and relevant for the Group's operations

In October 2008, the IASB issued amendments to IAS 39 "Financial Instruments: Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures". The amendments in IAS 39 permit an entity to reclassify certain non-derivative financial assets out of the "fair value through profit or loss" and "available-for-sale" categories in limited circumstances. The amendment to IFRS 7 requires additional disclosures for such non-derivative financial assets reclassified out of the "fair value through profit or loss" and "available-for-sale" categories. The Group has not made any such reclassifications.

Standards and amendments early adopted by the Group

In September 2007, the IASB issued the revised IAS 1 "Presentation of Financial Statements". The revised standard is mandatory for reporting periods beginning on or after January 1, 2009. The main objective of revising the standard is to aggregate information in financial statements on the basis of shared characteristics and introduce a statement of comprehensive income. The revised standard requires an entity to present, in a statement of changes in equity, all owner changes in equity. All non-owner changes in equity (comprehensive income) are required to be presented in one statement of comprehensive income or in two statements (a separate income statement and statement of comprehensive income). The Group has opted to present comprehensive income in two statements.

Standards, amendments and interpretations issued that are not yet effective

The following standards, amendments and interpretations of existing published standards are not yet effective but will be relevant to the Group's operations. The Group is currently evaluating the impact of adopting these standards, amendments and interpretations.

In November 2006, the IASB issued IFRS 8 "Operating Segments". IFRS 8 is mandatory for reporting periods beginning on or after January 1, 2009. The standard sets out the requirements for disclosure of an entity's operating segments on the same basis as internal reporting used by management for decision making, as well as disclosures of the entity's products and services, the geographical areas in which it operates, and its major customers.

In March 2007, the IASB issued amendments to IAS 23 "Borrowing Costs". The amendments are mandatory for reporting periods beginning on or after January 1, 2009. The amendments eliminate the option to recognize all borrowing costs immediately as an expense.

In January 2008, the IASB issued the revised IFRS 3 "Business Combinations". The standard is mandatory for reporting periods beginning on or after July 1, 2009. The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt and subsequently re-measured at fair value through the income statement. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs must be expensed.

In January 2008, the IASB issued amendments to IAS 27 "Consolidated and Separate Financial Statements". The amendments are mandatory for reporting periods beginning on or after July 1, 2009. The amended standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer give rise to goodwill or gains and losses.

In February 2008, the IASB issued amendments to IAS 32 "Financial Instruments: Presentation" and to IAS 1 "Presentation of Financial Statements - Puttable Financial Instruments and Obligations Arising on Liquidation". The amendments are mandatory for reporting periods beginning on or after January 1, 2009. The amended standards require entities to classify as equity all puttable financial instruments, and instruments or components of instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation, provided such financial instruments have particular features and meet specific conditions.

In July 2008, the IASB issued amendments to IAS 39 "Eligible Hedged Items". The amendments are mandatory for reporting periods beginning on or after July 1, 2009. The amendments clarify how the principles that determine whether a hedged risk or portion of cash flows is eligible for hedge designation should be applied in particular situations.

In January 2008, the IASB issued amendments to IFRS 2 "Vesting Conditions and Cancellations". The amendments are mandatory for reporting periods beginning on or after January 1, 2009. The amended standard clarifies that vesting conditions are service conditions and performance conditions only. Other features of a share-based payment are not vesting conditions. These features would need to be included in the grant date fair value for transactions with employees and others providing similar services; they would not impact the number of awards expected to vest or the valuation thereof subsequent to the date of grant. All cancellations, whether by the entity or by other parties, should receive the same accounting treatment.

Additionally, the IASB issued several minor amendments as part of the IASB's annual improvements project. The amendments are mandatory for reporting periods beginning on or after January 1, 2009 with the exception of the amendment regarding IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" which is mandatory for reporting periods beginning on or after July 1, 2009.

In June 2007, IFRIC 13 "Customer Loyalty Programmes" was issued. IFRIC 13 is mandatory for reporting periods beginning on or after July 1, 2008. The interpretation explains how entities that grant loyalty award credits should account for their obligations to provide free or discounted goods or services ('awards') to customers who redeem award credits.

In November 2008, IFRIC 17 "Distributions of Non-cash Assets to Owners" was issued. IFRIC 17 is mandatory for reporting periods beginning on or after July 1, 2009. The interpretation clarifies when a dividend payable should be recognized and how distributions of assets other than cash should be measured when an entity pays dividends to its owners.

3. Summary of significant accounting policies

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

a) Consolidation principles

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

Investments in associates and partnerships where the Group has the ability to exercise significant influence but not control, as well as joint ventures where there is joint control, are accounted for using the equity method. Significant influence is presumed to exist when the Group owns, directly or indirectly, between 20 percent and 50 percent of the

voting rights. Under the equity method of accounting, investments in associates, partnerships or joint ventures are initially recognized at cost and adjusted thereafter for the post-acquisition change in the Group's share of net assets of the investment.

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

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

IFRS does not provide specific guidance on all aspects of recognition and measurement of insurance and reinsurance contracts. The Group's accounting policies for insurance and reinsurance contracts are therefore based on those developed by the Group before the adoption of IFRS 4. At the time of adoption, the Group primarily considered the US GAAP pronouncements issued by the Financial Accounting Standards Board (FASB) on insurance and reinsurance contracts in areas where IFRS4 did not include specific requirements.

Classification

Insurance and reinsurance contracts are those contracts that transfer significant insurance risk. These contracts may also transfer financial risk. Significant insurance risk is defined as the possibility of paying significantly more in a scenario where the insured event occurs than in a scenario where the insured event does not occur. Scenarios considered include those which have commercial substance.

Investment contracts are those contracts that transfer financial risk with no significant insurance risk.

A number of insurance and investment contracts contain DPF which entitle the contract holder to receive, as a supplement to guaranteed benefits, additional benefits or bonuses:

- that are likely to be a significant portion of the total contractual benefits;
- the amount or timing of which is contractually at the discretion of the Group; and
- that are contractually based on:
 - the performance of a specified pool of contracts or a specified type of contract;
 - realized and/or unrealized investment returns on a specified pool of assets held by the issuer; or
 - the net income of the company, fund or other entity that issues the contract.

The Group applies the same accounting policies for the recognition and measurement of obligations arising from insurance contracts and from investment contracts with DPF. These recognition and measurement criteria apply to obligations arising from the contract, deferred acquisition costs and other related intangible assets.

The Group also issues products containing an embedded option to the policyholder to switch all or part of the current and future invested funds into another product issued by the Group, usually from a unit-linked product into a unitized with-profits contract or similar. Certain of these products allow policyholders to switch back to the previous product at their convenience. Where this results in the reclassification of an investment product to a product that meets the definition of an insurance contract, the previously held reserve and the related deferred origination costs are also reclassified and are accounted for in accordance with the accounting policies for such products on a prospective basis.

As a consequence, no gain or loss is recognized as a result of the reclassification of a contract from investment to insurance.

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

Premiums

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

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

Amounts collected as premiums from investment type contracts such as universal life, unit-linked and unitized with-profits contracts are reported as deposits. Revenue from these contracts consists of policy fees for the cost of insurance, administration and surrenders during the period. Front-end fees are recognized over the estimated life of the contracts.

Deferred policy acquisition costs (DAC)

The costs of acquiring new business, including commissions, underwriting and policy issue expenses, which vary with and are directly related to the production of new business, are deferred. Certain direct response marketing costs for efforts which solicit a direct response that is specific and quantifiable are also deferred, when it can be demonstrated that such marketing results in future economic benefits. Future investment income is taken into account in assessing recoverability.

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

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

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

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

The DAC asset is adjusted to equal the effect that realization of unrealized gains or losses on investments would have had on its measurement. This change is recorded as a direct offset to unrealized gains or losses at the balance sheet date (shadow accounting).

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

Unamortized DAC associated with internally replaced contracts that are, in substance, contract modifications, continue to be deferred and amortized. Costs associated with internally replaced contracts that are, in substance, new contracts, are written down at the time of replacement.

Liability adequacy tests

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

For life contracts, the net premium reserve, calculated on a locked-in basis and reduced by the unamortized balance of DAC or present value of future profits of acquired insurance contracts (PVFP) is compared with the gross premium reserve, calculated on a best-estimate basis as of the valuation date. If there is a deficiency, the DAC or PVFP is written down to the extent of the deficiency. If, after writing down the DAC or PVFP to nil (for the respective portfolio of contracts), a deficiency still exists, the net liability is increased by the amount of the remaining deficiency.

Reserves for losses and loss adjustment expenses

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

Future life policyholders' benefits and policyholders' contract deposits

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

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

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

For traditional life insurance policies, interest rate assumptions can vary by country, year of issuance and product. The mortality rate assumptions are based on published mortality tables and are adjusted for actual experience by geographic area and modified to allow for variations in policy form. The surrender assumptions are based on actual experience by geographic area and modified to allow for variations in policy form.

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

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

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

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

For products containing discretionary participation features the amount of the discretionary participation feature is deemed to be the investment return on all related assets where the apportionment between the shareholder and the policyholder has not yet been determined. The liability includes certain elements of net unrealized gains/(losses) and portions of retained earnings attributable to the DPF, based on the mandated rates applied to these gains and earnings on the assumption that they had been realized as of the balance sheet date.

The minimum mandated amounts, which are to be paid to policyholders plus any declared additional benefits, are recorded in liabilities. The remainder of any undeclared discretionary balances are not included in the liability but are included in shareholders' equity until such time as the discretionary element of a bonus is determined and declared.

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

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

Reinsurance

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

Reinsurance assets are assessed for impairment on a regular basis for any events that may trigger impairment. Triggering events may include legal disputes with third parties, changes in capital and surplus levels, change in credit ratings of a counterparty and historical experience regarding collectibility from specific reinsurers.

If there is objective evidence that a reinsurance asset is impaired, the carrying amount of the asset is reduced to its recoverable amount. An impairment is considered to have taken place if it is probable that the Group will not be able to collect the amounts expected from reinsurers. The carrying amount of a reinsurance asset is reduced through the use of an allowance account, and the amount of any impairment loss is recognized in income.

In addition to assessing whether significant insurance risk has been transferred, reinsurance contracts are further assessed to ensure that underwriting risk, defined as the reasonable possibility of significant loss, and timing risk, defined as the reasonable possibility of a significant variation in the timing of cash flows, are transferred by the ceding or assuming company to the reinsurer. Those contracts that do not transfer both risks, referred to in total as insurance risk, are accounted for using the deposit method. A deposit asset or liability is recognized based on the consideration paid or received less any explicitly identified premiums or fees to be retained by the ceding company. Deposits for contracts that transfer only significant underwriting risk are subsequently measured based on the unexpired portion of coverage until a loss is incurred, after which the present value of expected future cash flows under the contract is added to the remaining unexpired portion of coverage. Changes in the deposit amount are recorded in the consolidated income statements as an incurred loss. Interest on deposits that transfer only timing risk, or no risk at all, are accounted for using the effective interest rate method. Future cash flows are estimated to calculate the effective yield, and revenue and expense are recorded as interest income or expense. Premiums paid under retroactive contracts are included in reinsurance recoverables in the balance sheet. If the amount of gross claims provisions reinsured is higher than the premium paid, reinsurance receivables are increased by the difference, and the gain is deferred and amortized over the period in which the underlying claims are paid.

c) Investment contracts (without DPF)

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

Liabilities for investment contracts (unit-linked)

These represent portfolios maintained to meet specific investment objectives of policyholders who bear the credit and market and liquidity risks related to those investments. The liabilities are carried at fair value, with fair value of the liabilities determined by reference to the underlying financial assets. The related assets held under unit-linked investments contracts are classified as designated at fair value through profit or loss in order to reduce measurement inconsistencies. Changes in the fair value of the assets and liabilities are recorded in income. The costs of policy administration, investment management, surrender charges and certain policyholder taxes assessed against the policyholders' account balances are included in policy fee revenue.

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

Liabilities for investment contracts (amortized cost)

Liabilities for investment contracts with fixed and guaranteed terms are measured at amortized cost, using the effective interest rate method. Transaction costs are deducted from the initial amount and form part of the effective yield. Future assumptions, except for the effective interest rate, are reviewed as of each reporting date. Changes in the liability due to changes in future assumptions are recognized in income.

Measurement of investment contracts

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

The Group's main valuation techniques incorporate all factors that market participants would consider and are based on observable market data. If market data is not observable, the Group uses assumptions based on its own experience. The fair value of a unit-linked financial liability is determined using the current unit values that reflect the fair values of the financial assets contained within the Group's unitized investment funds linked to the financial liability, multiplied by the number of units attributed to the contract holder at the balance sheet date.

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

The effective interest rate method applies an interest rate (the effective interest rate) that exactly discounts the estimated future cash payments or receipts to the net carrying amount of the financial liability, through the expected life of the financial instrument or, when appropriate, a shorter period if the holder has the option to redeem the instrument before maturity.

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

Deferred origination costs (DOC)

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

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

d) Other revenue recognition

Fees for the provision of non-claims related management services by FGI to the Farmers Exchanges are calculated primarily as a percentage of gross premiums earned by the Farmers Exchanges. FGI provides non-claims related management services to the Farmers Exchanges, including risk selection, preparation and mailing of policy forms and invoices, premium collection, management of the investment portfolios and certain other administrative and managerial functions. The Farmers Exchanges are directly responsible for their own claims functions, including the settlement and payment of claims and claims adjustment expenses, as well as for the payment of agent commissions and bonuses and the payment of premium and income taxes.

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

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

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

e) Net investment income

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

Investment income primarily consists of dividend income on equity securities, interest income on financial assets other than equity securities, rental income earned on real estate held for investment and income earned on investments that are accounted for by using the equity method of accounting.

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

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

Rental income earned on real estate held for investment is recognized on an accruals basis.

Investment expenses consist of operating expenses for real estate held for investment and other investment expenses, including investment management fees. These expenses are recognized on an accruals basis.

f) Investments

Investments include cash and cash equivalents, non-derivative financial instruments, real estate held for investment, investments in associates and short-term investments.

Categories of non-derivative financial instruments

Non-derivative financial instruments are classified as financial assets at fair value through profit or loss, financial assets held-to-maturity, loans and receivables, and financial assets available-for-sale. The classification depends on the purpose for which the investments were acquired. Management determines the classification of these investments at initial recognition with reference to its long-term investment objectives.

Financial assets at fair value through profit or loss are sub-classified into financial assets held for trading and those designated at fair value through profit or loss at inception.

Financial assets held for trading are debt and equity securities which the Group buys with the principal intention to resell in the near term.

Financial assets designated at fair value through profit or loss at inception are mainly financial assets backing unit-linked insurance and unit-linked investment contracts. Reserves relating to unit-linked insurance contracts and liabilities for unit-linked investment contracts are carried at fair value, which is determined by reference to these assets with changes in the fair value of both the asset and liability recognized in income. The designation of these assets at fair value through profit or loss eliminates or significantly reduces a measurement inconsistency that would otherwise arise from measuring assets or from recognizing the resultant gains and losses on them on a different basis to the liability. The fair value designation, once made, is irrevocable.

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

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Group intends to sell in the short term or that it has designated at fair value through profit or loss or is holding as available-for-sale. Loans and receivables include loans where money is provided directly to the borrower, such as mortgage loans, policyholder loans and other loans.

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

Measurement of investments

General

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

Financial assets are initially recognized at fair value plus, in the case of all financial assets not carried at fair value through profit or loss, transaction costs that are directly attributable to their acquisition.

Held-to-maturity financial assets

Held-to-maturity financial assets are subsequently carried at amortized cost using the effective interest rate method, less any provision for impairment. The amortization of premium and accretion of discount on held-to-maturity investments recognized in the current period is included in investment income.

Financial assets carried at fair value through profit or loss

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

Investments backing certain life insurance policies with participation features are held as at fair value through profit or loss in order to reduce measurement inconsistencies. Movements in the carrying value of these assets recognized in investment income are offset by equivalent movements attributable to policyholders.

Loans and receivables

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

Available-for-sale financial assets

Available-for-sale financial assets are subsequently carried at fair value, with changes in fair values recognized in shareholders' equity until the securities are either sold or impaired. The cumulative unrealized gains or losses recorded in shareholders' equity are net of cumulative deferred income taxes, certain life policyholder liabilities and deferred acquisition costs. Realized gains or losses on sale are based on the difference between the proceeds received and the carrying value of the investment plus any unrealized gains or losses on the investment recorded in shareholders' equity using the specific identification method. When available-for-sale financial assets are sold, impaired or otherwise disposed of, the cumulative gains or losses previously recognized in shareholders' equity are recognized in income. The amortization of premium and accretion of discount on available-for-sale debt securities is computed using the effective interest method and is recognized in income.

Unrealized gains and losses on securities classified as available-for-sale are analyzed between differences resulting from foreign currency translation, differences resulting from changes in the amortized cost and other fair value changes. Foreign currency translation differences on monetary available-for-sale investments, such as debt securities, are recognized in income. Foreign currency translation differences on non-monetary assets, such as equity securities, are recognized directly in shareholders' equity. Other unrecognized gains and losses on available-for-sale investments are recognized directly in equity.

Dividends on available-for-sale equity instruments are recognized in income when the Group's right to receive payments is established. Dividends are included in the investment income line.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active, the Group establishes fair value by using valuation techniques. These include the use of recent arms length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis and pricing models making maximum use of market inputs and relying as little as possible on entity specific inputs.

Other items

Cash and cash equivalents are short-term highly liquid investments that are readily convertible into cash. This includes cash in hand, deposits held at call with banks, other short-term investments with original maturities of three months or less. Cash and cash equivalents also includes cash received as collateral for securities lending. Cash and cash equivalents are stated at face value.

Short-term investments are investments with an original maturity date between three months and twelve months. The carrying values of short-term investments approximate to fair values.

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

Impairments of non-derivative financial instruments

General

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group about the following events:

- a) significant financial difficulty of the issuer or debtor;
- b) a breach of contract, such as a default or delinquency in payments;

- c) it becomes probable that the issuer or debtor will enter bankruptcy or other financial reorganization;
- d) the disappearance of an active market for that financial asset because of financial difficulties; or
- e) observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in that group, including:
 - adverse changes in the payment status of issuers or debtors in that group; or
 - national or local economic conditions that correlate with defaults on the assets in that group.

The Group first assesses whether objective evidence of impairment exists for financial assets that are individually significant. If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

Financial assets carried at amortized cost

For held-to-maturity financial assets as well as loans and receivables, impairment is considered to have taken place if it is probable that the Group will not be able to collect principal and/or interest due according to the contractual terms of the instrument. When impairment is determined to have occurred, the carrying amount of the held-to-maturity financial assets, policyholders' loan or other loans is decreased through a charge to income. The impairment for held-to-maturity financial assets is measured as the difference between the carrying amount of the assets and the present value of estimated future cash flows, using the original effective interest rate for the financial assets. The carrying amount of mortgage loans or receivables is reduced through the use of an allowance account, and the movement in the impairment allowance is recognized as an impairment loss in income. The allowance is determined using an analytical method based on knowledge of each loan group or receivable. The method is usually based on historical statistics, adjusted for known or anticipated trends in the group of financial assets or individual accounts. If the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment loss was recognized, the impairment loss is reversed through income. This reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed.

Financial assets carried at fair value

When a decline in the fair value of an available-for-sale equity security has been recognized directly in shareholders' equity and there is objective evidence that the security is impaired, the cumulative loss already recognized directly in shareholders' equity is recognized in income. Such an impairment arises when the fair value of the security has been significantly below the weighted-average cost, usually considered to be more than 50 percent for any period of time. Additionally, the Group considers an available-for-sale equity security for impairment when the fair value has been below the weighted-average cost by more than 20 percent for more than 12 months. The amount of the cumulative loss that is removed from shareholders' equity and recognized in current period income is the difference between acquisition cost and current fair value, less any impairment loss on that security previously recognized in income. Impairment losses recognized in income on equity securities classified as available-for-sale are not reversed through income. When a previously impaired equity security increases in fair value, unrealized gains will be recognized through shareholders' equity. Any subsequent losses, including any portion attributable to foreign currency changes, are also reclassified from shareholders' equity to income as impairments until the equity instrument is derecognized.

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

increases in a subsequent period, and the increase can be objectively related to an event occurring after the impairment loss was recognized in income, the impairment loss is reversed through income. This reversal would be recognized in income only up to the amount of the previously recognized impairment loss, adjusted for any amortization already recognized in income. Any subsequent gains are recognized directly in shareholders' equity. Any subsequent losses, to the extent they do not represent impairment losses, are also recognized in shareholders' equity.

g) Derivative financial instruments

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

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

Derivative financial instruments, except those qualifying for hedge accounting are classified as held for trading assets or liabilities and carried at fair value on the balance sheet with changes in fair value recognized in income.

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

Derivative financial instruments that qualify for hedge accounting

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

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

Fair value hedges

Gains or losses from re-measuring the derivatives that are designated and qualify as fair value hedges are recognized immediately in the same line item of the consolidated income statement as the offsetting change in fair value of the risk being hedged. Offsetting gains or losses on the fair value of the hedged item attributable to the hedged risk are adjusted against the carrying amount of the hedged item and recognized in income.

Cash flow hedges

In a cash flow hedge relationship the effective portion of the gain or loss on the re-measurement of the cash flow hedging instrument is recognized directly in shareholders' equity. The ineffective portion is recognized immediately in income. The accumulated gains and losses on the hedged instrument in shareholders' equity are transferred to income in the same period in which gains or losses on the item hedged are recognized in income.

Discontinued hedges

Where hedge accounting is applied, the Group formally documents all relationships between hedging instruments and hedged items, including the risk management objectives and strategy for undertaking hedge transactions. At inception of a hedge and on an ongoing basis, the hedge relationship is formally assessed in order to determine whether the hedging instruments that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items attributable to the hedged risk. The Group discontinues hedge accounting prospectively in the following circumstances:

- it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including forecast transactions);
- the derivative expires or is sold, terminated, or exercised;
- the derivative is no longer designated as a hedging instrument because it is unlikely that the forecast transaction will occur; or
- the Group otherwise determines that designation of the derivative as a hedging instrument is no longer appropriate.

When the Group discontinues fair value hedge accounting because it determines that the hedging instrument no longer qualifies as an effective fair value hedge, the hedging instrument will be carried separately on the consolidated balance sheet at its fair value, and the value of the hedged asset or liability will no longer be adjusted for changes in fair value attributable to the hedged risk. Interest-related fair value adjustments made to the underlying hedged items will be amortized in income over the remaining life of the hedged item. Any unamortized interest-related fair value adjustment is recorded in income upon sale or extinction of the hedged asset or liability, respectively. Any other fair value hedge adjustments remain part of the carrying amount of the hedged asset or liability and are recognized in income as part of the gain or loss on disposal of the hedged item.

When hedge accounting is discontinued for a cash flow hedge, the net gain or loss will remain in comprehensive income within shareholders' equity and be reclassified to income in the same period or periods during which the formerly hedged transaction is reported in income. When the Group discontinues hedge accounting because the forecast transaction is no longer expected to occur the hedging instrument will continue to be carried on the consolidated balance sheet at its fair value, and any related accumulated gains and losses that were previously recorded in comprehensive income from the period when the hedge was effective are recognized in income. The forecast transaction may still be expected to occur, but may no longer be highly probable, in which case the related cumulative gains and losses on the hedging instrument remain in comprehensive income within shareholders' equity until the forecast transaction occurs or is no longer expected to occur. At that point, the gains and losses will be treated as described above.

h) Derecognition of financial assets and liabilities

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

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

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

i) Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognized amounts and there is an intention to settle on a net basis, or to settle the asset and settle the liability simultaneously.

j) Securities lending

Certain entities within the Group participate in securities lending arrangements whereby specific securities are loaned to other institutions, primarily banks and brokerage firms, for short periods of time. Under the terms of the securities lending agreements, the Group retains substantially all the risks and rewards of ownership of these loaned securities, and also retains contractual rights to cash flows therefrom. These securities are therefore not derecognized from the Group's balance sheet. Cash received as collateral for loaned securities is recorded as an asset and a corresponding liability is established.

k) Repurchase and reverse repurchase transactions

Securities sold under agreements to repurchase at a certain later date (Repurchase agreements) and securities purchased under agreements to resell (Reverse repurchase agreements) are generally accounted for as collateralized financing transactions. The securities sold under the repurchase agreement are not derecognized from the balance sheet, when all or substantially all of the risk and rewards are retained. The proceeds of the sale are reported as a liability under Obligation to repurchase securities. Interest expense is charged to income using the effective interest rate method over the life of the agreement.

In a reverse repurchase agreement, the securities that serve as a collateral are not recognized on the balance sheet, as long as the risk and rewards of ownership have not been obtained by the Group. The cash delivered is derecognized and a corresponding receivable is recorded. Interest income is recognized in income using the effective interest rate method over the life of the agreement.

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

l) Borrowings

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

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

m) Interest expense

Interest expense for all financial instruments except for those classified as held for trading or designated at fair value is recognized in income using the effective interest method.

n) Goodwill and other intangible assets

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the acquisition date. Goodwill on acquisition of subsidiaries is included in intangible assets. Goodwill on acquisition of associates is included in investments in associates and is tested for impairment as part of the overall measurement of the carrying amount of those investments.

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use of that group of assets (the 'cash generating unit' (CGU)), and that is largely independent of the cash inflows of other assets or groups of assets. The Group's CGUs, on which impairment losses are assessed, represent the lowest level at which goodwill is monitored for internal management purposes.

The test for goodwill impairment is performed annually or whenever there is an indication that the cash generating unit may be impaired. Goodwill is carried at cost less accumulated impairment losses. Impairments are recorded in income if the recoverable amount is less than the carrying amount including goodwill of the CGU. Gains and losses on the divestment of an entity are calculated including the carrying amount of any goodwill relating to the entity sold.

The recoverable amount of a cash generating unit is the higher of its fair value less costs to sell and its value in use. Fair value less costs to sell is based on the best information available to reflect the amount that the Group could obtain, as of the balance sheet date, from the disposal of the cash generating unit on an arm's length basis between knowledgeable, willing parties, after deducting the costs of disposal.

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

Other intangible assets

Other intangible assets include customer relationships and contracts, affinity partnerships, distributions agreements, computer software licenses and capitalized software development costs.

Intangible assets acquired in a business combination are recognized separately from goodwill at the acquisition date if their fair values can be measured reliably, the assets are separable or arise from contractual or other legal rights, and they are controlled by the entity.

The useful lives of customer relationships and contracts, affinity partnerships and distribution agreements extend up to 30 years and are estimated based on the period of time over which they are expected to provide economic benefits and taking into account all relevant economic and legal factors such as usage of the assets, typical product life cycles, potential obsolescence, stability of the industry, competitive position and the period of control over the assets.

The useful lives of computer software licenses and capitalized software development costs generally do not exceed 5 years. In some exceptional circumstances, capitalized software development costs may be amortized over a period of up to 10 years, taking into account the effects of obsolescence, technology, competition and other economic and legal factors.

Other intangible assets are amortized using the straight-line method over their useful life. They are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

An impairment loss is recorded in income when the carrying value of the asset exceeds its recoverable amount. The recoverable amount is the higher of the fair value less selling costs of an asset and its value in use.

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

On the acquisition of life insurance businesses a customer contract intangible asset representing the present value of future profits from the acquired insurance contracts is determined. This asset is amortized over the expected life of the policies acquired, based on a constant percentage of the present value of estimated gross profits (margins) expected to be realized, or over the premium recognition period, as appropriate. PVFP is reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recovered.

Attorney-in-fact relationships (AIF)

The AIF reflects the ability of the Group to generate future revenues based on the Group's relationship with the Farmers Exchanges. In determining that these relationships have an indefinite useful life, the Group considered the organizational structure of inter-insurance exchanges, under which subscribers exchange contracts with each other and appoint an attorney-in-fact to provide certain management services and the historical AIF between FGI and the Farmers Exchanges. AIF is not subject to amortization but is tested for impairment annually and whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

o) Income taxes

The Group provides current tax expense according to the tax laws of each jurisdiction in which it operates. Deferred income taxes are recognized using the asset and liability method. Deferred income taxes are recorded for temporary differences, which are based on the difference between financial statement carrying amounts and income tax bases of assets and liabilities using enacted income tax rates and laws. Losses for tax purposes are treated as deferred tax assets

to the extent it is probable that the losses can offset future taxable income and is allowed by the applicable local tax laws and regulations.

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

Taxes payable by either the company or its subsidiaries on expected distributions to the holding company of the profits of subsidiaries are not recognized as deferred income taxes unless a distribution of those profits is intended in the foreseeable future.

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

p) Employee benefits

Retirement benefits

The operating companies in the Group provide employee retirement benefits through both defined benefit plans providing specified benefits and defined contribution plans. The assets of these plans are generally held separately from the Group's general assets in trustee-administered funds. Defined benefit plan obligations and contributions are determined annually by qualified actuaries using the projected unit credit method. The Group's expense related to these plans is accrued over the employees' service periods based upon the actuarially determined cost for the period.

Actuarial gains and losses are recognized in full in the period in which they occur and are presented on a separate line in the statement of comprehensive income. Actuarial gains and losses result from experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred during the accounting period), changes in actuarial assumptions since the previous balance sheet date, and differences between the expected and actual returns on plan assets. Unrecognized past service costs represent non-vested benefits on the date of a change in the amount of benefits following an amendment to the plan and are amortized on a straight-line basis over the average vesting period.

Other post-employment benefits

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

q) Share-based compensation and cash incentive plans

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

The total amount to be expensed over the vesting period is determined by reference to the fair value of the shares and/or options granted. Non-market vesting conditions (for example, profitability and premium income growth targets) are included in assumptions about the number of shares and/or options that are expected to be issued or become exercisable. At each balance sheet date, the Group revises its estimates of the number of shares and/or options that are expected to be issued or become exercisable. It recognizes the impact of the revision to original estimates, if any, in income with a corresponding adjustment to equity. However, no subsequent adjustment to total equity is made after the vesting date.

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

Under the Group's cash-settled, share-based payment compensation plan, the Group allows participants to take their option award in the form of Share Appreciation Rights (SAR). Hence, the Group incurs a liability which is measured at the fair value of the SAR. As the fair value of the options which the Group uses for its employee schemes cannot be compared to the ones in the market, the Group estimates the fair value using the Black-Scholes model. This model requires inputs such as share price, exercise price, implied volatility, risk-free interest rate, expected dividend rate and the expected life of the option. The liability is measured at initial recognition and at each balance sheet date until settled thereby taking into account the terms and conditions on which the SAR were granted, and the extent to which the participants have rendered service to date. The fair value of the participants' services received in exchange for the SAR is recognized as an expense in income over the vesting period and measured by reference to the fair value of the liability.

r) Property and equipment

Own use property is defined as property held by the Group for use in the supply of services or for administrative purposes. Buildings held for own use and equipment are carried at cost less accumulated depreciation and any accumulated impairment loss. These assets are depreciated usually on a straight-line basis to income over the following estimated useful lives:

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

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

Maintenance and repair costs are charged to income as incurred. The costs of IT systems purchased from third party vendors are capitalized and amortized over expected useful lives. Gains and losses on the disposal of property and equipment are determined by comparing the proceeds with the carrying amounts and are recorded in other income or administrative and other operating expense, respectively.

Assets that have an indefinite useful life, for example land, are not subject to amortization and are tested regularly for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the carrying value of the asset exceeds its expected recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use. Assets are grouped on a cash generating unit level if the recoverable amount cannot be separately determined.

s) Finance and operating leases

Agreements which transfer to counterparties substantially all the risks and rewards incidental to the ownership of assets, but not necessarily legal title, are classified as finance leases. Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to income on a straight-line basis over the period of the lease, unless another systematic basis is representative of the time pattern of the user's benefit even if the payments are not on that basis.

t) Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is more likely than not that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are discounted when the effect of the time value of money is considered material.

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

u) Treasury shares

Zurich Financial Services shares held by the Group are classified as treasury shares and are deducted from share capital at nominal value. The difference between the nominal value and the amount paid for acquiring, or received for disposing of treasury shares, is recorded as an adjustment to additional paid-in capital to the extent that additional paid-in capital is available. Any premium or discount above the available additional paid-in capital is recorded directly in retained earnings.

v) Foreign currency translation and transactions

Foreign currency translation

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

Foreign currency transactions

Foreign currency monetary items and foreign currency non-monetary items, which are carried at fair value, are translated at end-of-period exchange rates. Foreign currency non-monetary items which are carried at historical cost are translated at historical exchange rates. The resulting exchange differences are recorded in income, except when the gain or loss on a non-monetary item measured at fair value is recognized directly in equity in which case any exchange component of that gain or loss is also recognized directly in equity. Revenues and expenses are translated using the exchange rate at the date of the transaction or, for practical reasons, a weighted average rate, if exchange rates do not fluctuate significantly.

4. Critical accounting judgements and estimates

Critical accounting estimates are those which involve the most complex or subjective judgments or assessments, and relate to general insurance and life insurance reserves, the determination of fair value for financial asset and liabilities, impairment charges, the determination of fair values of assets and liabilities attributable to business combinations, deferred policy acquisition costs, deferred taxes, retirement and other defined benefit post-employment plans and share-based compensation and cash incentive plans. In each case, the determination of these items requires management to make informed judgments based on information and financial data that may change in future periods. Because of the uncertainties involved in such judgments, actual outcomes and results may differ from assumptions and estimates made by management.

The Group has given proper consideration to the current economic environment and the impact it has across these areas. Management has ensured, inter alia, that economic assumptions, used in determination of insurance and investment contract assets and liabilities and in preparation of cash flow forecasts for the purposes of testing financial and non-financial assets for impairment, have been properly updated to reflect the current economic outlook; fair values of financial instruments reflect the current market conditions, including liquidity risk and current credit spreads; and long-term rates of return and discount rates, used in calculating the defined benefit pension plans assets and respective liabilities, have been updated accordingly.

a) Reserves for losses and loss adjustment expenses

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

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

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

The time required to learn of and settle claims is an important consideration in establishing the Group's reserves. Short-tail claims, such as for automobile and property damage, are normally reported soon after the incident and are generally settled within months following the reported incident. Long-tail claims, such as bodily injury, pollution,

asbestos and product liability, can take years to develop and additional time to settle. For long-tail claims, information concerning the event, such as the required medical treatment for bodily injury claims and the measures and costs required to clean up pollution, may not be readily available. Accordingly, the reserving analysis of long-tail lines of business is generally more difficult and subject to greater uncertainties than for short-tail claims.

Since the Group does not establish reserves for catastrophes in advance of the occurrence of such events, these events may cause volatility in the levels of its incurred losses and reserves, subject to the effects of reinsurance recoveries. This volatility may also be contingent upon political and legal developments after the occurrence of the event.

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

Refer to notes 8 and 11 for further information on reserves for losses and loss adjustment expenses.

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

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

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

Refer to notes 8 and 11 for further information on future life policyholders' benefits and policyholders' contract deposits and other funds.

c) Fair value of financial assets and liabilities

As described in note 3, all financial assets and liabilities are recorded initially at fair value. Subsequently, derivative financial instruments, financial assets classified as held for trading, designated at fair value, available-for-sale and financial liabilities designated at fair value are carried at fair value. While all the other financial instruments are carried at amortized cost, their fair values are disclosed in note 26.

The determination of fair value for financial assets and liabilities is based generally on quoted market prices or broker/dealer price quotations. If prices are not readily available, fair value is based on either internal valuation models (for example, discounted cash flow models) or management estimates of amounts that could be realized under current market conditions.

Fair values of debt and equity securities are based on quoted market prices when available. If such prices are not available, then fair values are estimated on the basis of pricing models, discounted cash flow models or other recognized valuation techniques or information from external pricing sources.

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

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

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

Fair value of liabilities related to unit-linked investment contracts equals the fair value of financial assets backing these liabilities. Fair values of liabilities related to other investment contracts are determined using discounted cash flow models. A variety of factors are considered in the Group's valuation techniques, including credit risk, embedded derivatives (such as unit-linking features), volatility factors (including contract holder behavior), servicing costs and surrenders of similar instruments.

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

The Group makes extensive use of third party pricing providers in determining fair values of invested assets and only in rare cases places reliance on prices that are derived from internal models. The Group's control environment and the process of selection of pricing providers ensures that fair values of invested assets are sourced only from independent, reliable and reputable third party pricing providers.

The Group employs third party asset managers who manage a significant percentage of assets on behalf of the Group, but are not responsible for determining the fair values used in the financial statements. Investment accounting and operations functions, are completely independent from those responsible for buying and selling the assets, and are responsible for receiving, challenging and verifying values provided by third parties to ensure that fair values are reliable and comply with the applicable accounting and valuation policies. The quality control procedures used depend on the nature and complexity of the invested assets and include regular reviews of valuation techniques and inputs used by pricing providers (for example, default rates of collateral for asset backed securities), variance and stale price analysis and comparisons with fair values of similar instruments and with alternative values obtained from asset managers and brokers.

In cases where significant reliance is placed on an independent price provider, the Group has engaged with that price provider to ensure that the control environment conforms to the high standards that the Group expects. In addition, the Group ensures that independently sourced prices are determined based on valuation techniques that incorporate all factors that market participants would consider in setting a price and are consistent with best practice methodologies for pricing financial instruments. Such models make maximum use of market inputs such as benchmark yields, reported trades and broker/dealer quotes. The Group holds certain asset classes that are not actively traded, in particular hedge funds and private equity investments. Fair values of such instruments are based on regular reports from the issuing hedge funds and private equity funds. Performance of these investments and determination of their fair value are monitored closely by the Group's in-house investment professionals.

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

d) Impairment of assets

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

A financial asset is considered impaired if there is objective evidence of impairment as a result of a loss event that has an impact on the estimated future cash flows of the financial asset.

For a non-derivative financial asset, the decision to record an impairment is based on a review of objective evidence, such as the issuer's current financial position and future prospects and the national or economic conditions that may correlate with defaults on the asset, as well as the availability of an active financial market for that financial asset. For a quoted available-for-sale asset the impairment decision is further based on an assessment of the probability that the current market price will recover to former levels within the foreseeable future. The recoverable amount is determined by reference to the market price. For non-quoted available-for-sale financial assets, the recoverable amount is determined by applying recognized valuation techniques.

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

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

For attorney-in-fact (AIF) relationships, the recoverable amount of AIF relationship is determined on the basis of value-in-use calculations. These calculations use cash flow projections based on business plans and the surplus development in the Farmers Exchanges. Business plans are approved by management and typically cover a 5-year period. Cash flows beyond that 5-year period are extrapolated for 20 years assuming zero growth.

Refer to notes 3, 6, 15, 17 and 18 for further information on impairments of assets.

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

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

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

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

f) Deferred policy acquisition costs

Deferred policy acquisition costs generally consist of commissions, underwriting expenses and policy issuance costs. The amount of acquisition costs to be deferred is dependent on judgments as to which issuance costs are directly related to and vary with the acquisition. The related asset is amortized over the premium earning pattern for non-life and certain traditional life products. For most life products, amortization is based on the estimated profitability of the contract throughout its life. The estimation of profitability considers both historical and future experience as regards assumptions, such as expenses, lapse rates or investment income.

Refer to note 12 for further information on deferred policy acquisition costs.

g) Deferred taxes

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

Refer to note 20 for further information on deferred taxes.

h) Employee benefits

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

Refer to note 23 for further information on employee benefits.

i) Share-based compensation and cash incentive plans

The Group has adopted various share-based compensation and cash incentive plans to attract, retain and motivate executives and employees. Share-based compensation plans include plans under which shares and options to purchase shares, based on the performance of the businesses, are awarded. The fair value of options granted are estimated using the Black-Scholes option pricing model. The key factors involve, but are not limited to, the expected share price volatility, expected change in dividend rate and contracted option life. These assumptions may differ from actual results due to changes in economic conditions.

Refer to note 24 for further information on share-based compensation and cash incentives plans.

5. Acquisitions and divestments

Transactions in 2008

Acquisitions

During 2008, the Group completed several acquisitions that were accounted for as business combinations. The acquisitions indicated in the following table were individually significant to the Group and are therefore presented separately. The other acquisitions are presented in aggregate.

Table 5.1

Business combinations¹

in USD millions	TEB Sigorta	Caixa Sabadell	Banco Sabadell	Other	Total
Book value of net assets prior to acquisition	22	140	202	104	468
Fair value of net tangible assets acquired	35	140	190	102	468
Identifiable intangible assets, net of deferred tax	76	548	1,762	219	2,606
Goodwill	253	–	–	66	320
Non-controlling interests	–	(344)	(976)	(77)	(1,397)
Total acquisition costs	364	344	976	311	1,996
Cash consideration	363	343	968	254	1,928
Transaction costs	1	1	8	2	12
Present value of deferred payments	–	–	–	55	55
Cash and cash equivalents acquired	48	172	337	64	621

¹ The purchase price allocations shown in the table are provisional.

“TEB Sigorta” sets out the acquisition of 100 percent of TEB Sigorta A.Ş., a general insurer based in Turkey, from TEB Mali Yatırımlar A.Ş. (TEB Mali), which the Group completed on March 31, 2008. Total acquisition costs amounted to USD 364 million and, based on the initial purchase price allocation, include net tangible assets acquired of USD 35 million and identifiable intangible assets, net of deferred tax, of USD 76 million (USD 94 million before tax, mainly relating to distribution arrangements with TEB Mali subsidiaries including Türk Ekonomi Bankası A.Ş. (TEB) for the distribution of general insurance products in Turkey on an exclusive basis). The residual goodwill of USD 253 million represents expected growth opportunities from the banc-assurance partnership with TEB and the expansion of other sales channels.

“Caixa Sabadell” sets out the acquisition of 50 percent of both the life and general insurance companies CaixaSabadell Vida, S.A. de Seguros y Reaseguros (CSV) and CaixaSabadell Companyia d’Assegurances Generals, S.A. (CSG), both of them based in Spain, from Caixa d’Estalvis de Sabadell (Caixa Sabadell), which the Group completed on August 14, 2008. Total acquisition costs for CSV amounted to USD 300 million and, based on the initial purchase price allocation, include net tangible assets acquired of USD 128 million and identifiable intangible assets, net of deferred tax, of USD 472 million (USD 674 million before tax, mainly relating to the life insurance distribution agreement with Caixa Sabadell of USD 552 million and to the present value of profits of acquired insurance contracts of USD 122 million). Total acquisition costs for CSG amounted to USD 45 million and, based on the initial purchase price allocation, include net tangible assets acquired of USD 13 million and identifiable intangible assets, net of deferred tax, of USD 77 million (USD 109 million before tax, relating to the general insurance distribution agreement with Caixa Sabadell). 50 percent of net tangible assets acquired and of identifiable intangible assets, net of deferred tax, reflect non-controlling interests in CSV and CSG, amounting to USD 344 million. The Group has management control of the jointly owned companies and fully consolidates them.

“Banco Sabadell” sets out the acquisition of 50 percent of life insurance, pension and general insurance operations of Banco Sabadell S.A. (Banco Sabadell), all based in Spain, which the Group completed on September 18, 2008. Total acquisition costs for BanSabadell Vida S.A. de Seguros y Reaseguros (BSV) and BanSabadell Pensiones E.G.F.P., S.A. (BSP) amounted to USD 832 million and, based on the initial purchase price allocation, include net tangible assets

acquired of USD 181 million and identifiable intangible assets, net of deferred tax, of USD 1,483 million (USD 2,117 million before tax, mainly relating to the life insurance and pension distribution agreement with Banco Sabadell of USD 1,665 million and the present value of profits of acquired insurance contracts of USD 449 million). Total acquisition costs for BanSabadell Seguros Generales, S.A. de Seguros y Reaseguros (BSG) amounted to USD 145 million and, based on the initial purchase price allocation, include net tangible assets acquired of USD 10 million and identifiable intangible assets, net of deferred tax, of USD 280 million (USD 396 million before tax, mainly relating to the general insurance distribution agreement with Banco Sabadell). 50 percent of net tangible assets acquired and of identifiable intangible assets, net of deferred tax, reflect non-controlling interests in BSV, BSP and BSG, amounting to USD 976 million. The Group has management control of the three jointly owned companies and fully consolidates them.

“Other” sets out in aggregate the acquisition of 100 percent of the Italian life insurer DWS Vita S.p.A. (DWS Vita), completed on June 3, 2008, the acquisition of 50 percent of Can Soluciones Integrales S.A. (Can Soluciones), a general insurance company based in Spain, completed on June 20, 2008, and the acquisition of 100 percent of Baden-Badener Versicherung Aktiengesellschaft (Baden-Badener), an accident insurer based in Germany, completed on August 5, 2008. Further details of these acquisitions are given below.

Total acquisition costs for DWS Vita amounted to USD 138 million and, based on the initial purchase price allocation, include net tangible assets acquired of USD 64 million and identifiable intangible assets, net of deferred tax, of USD 75 million (USD 110 million before tax, relating to the present value of profits of acquired insurance contracts of USD 69 million and a distribution agreement of USD 41 million which DWS Vita entered into with Finanza & Futuro Banca S.p.A. for the distribution of life insurance products as part of the transaction).

Total acquisition costs for Can Soluciones amounted to USD 133 million, including the present value of an expected earn-out payment of USD 55 million, and, based on the initial purchase price allocation, include net tangible assets acquired of USD 14 million and identifiable intangible assets, net of deferred tax, of USD 140 million (USD 199 million before tax, relating to a distribution agreement with Caja de Ahorros y Monte de Piedad de Navarra). The residual goodwill of USD 56 million represents expected synergies from the efficiencies gained through a service level agreement with Can Soluciones relating to the management and administration of the business. 50 percent of net tangible assets acquired and of identifiable intangible assets, net of deferred tax, reflect non-controlling interests in Can Soluciones, amounting to USD 77 million. The Group has management control of the jointly-owned company, which is therefore fully consolidated.

Total acquisition costs for Baden-Badener amounted to USD 40 million and, based on the initial purchase price allocation, include net tangible assets acquired of USD 25 million, identifiable intangible assets, net of deferred tax, of USD 5 million (USD 6 million before tax), and residual goodwill of USD 10 million, representing expected synergies and growth opportunities.

Table 5.1 does not include the acquisition of the remaining 34 percent of Zurich Retail Insurance Company Ltd., Russia, for USD 203 million which the Group completed on November 20, 2008. The acquisition had no material impact on the Group's financial statements and did not affect its scope of consolidation, as the present value of the estimated deferred consideration for the 34 percent was recognized in 2007.

The acquisition of 87.35 percent of Companhia de Seguros Minas Brasil, a general insurer based in Brazil, and of 100 percent of Minas Brasil Seguradora Vida e Previdência S.A., a life insurer based in Brazil, from Banco Mercantil do Brasil S.A. (Banco Mercantil) and two private investors was completed on November 28, 2008. As part of this transaction, the Group entered into an exclusive distribution agreement with Banco Mercantil for both life and general insurance products. The initial purchase price for both companies including the consideration for the distribution agreement amounted to USD 127 million. In addition, an earn-out component of up to USD 21 million based on future performance under the distribution agreement has been agreed. The Group is currently in the process of preparing the initial accounting and, therefore, as of December 31, 2008, the initial purchase price was recorded as an unconsolidated investment in other assets and is not included in table 5.1.

The impact of the acquisitions on current period income statement is immaterial.

Divestments

During the year ended December 31, 2008, the Group sold all of its shares in Financial Lifestyle Solutions Pty Ltd based in Australia, of Nova Scotia Company, a Canadian investment holding company, and of Zurich Insurance (Guam), Inc., recording in aggregate a pre-tax gain on disposal of USD 16 million. Total cash and net assets divested in 2008 were USD 19 million and USD 12 million, respectively. The total consideration received in 2008, net of transaction costs of USD 2 million, amounted to USD 13 million.

Transactions in 2007

Acquisitions

On January 2, 2007, the Group purchased all of the remaining shares in the insurance intermediary Endsleigh Limited (Endsleigh) in the UK for a total of USD 84 million including transaction costs. Since 2002 the Group had owned 45 percent of Endsleigh. An asset revaluation surplus arose from revaluation of tangible and intangible assets of Endsleigh acquired by the Group in 2002 to the fair values of the initial accounting in 2007. Residual goodwill arose in this business combination in the amount of USD 90 million due to the expected growth opportunities and synergies within the Group. Identifiable intangibles net of deferred tax amounted to USD 63 million the major part of which related to contractual relationships.

On March 5, 2007, the Group purchased 100 percent of the surety writer ACC Seguros y Reaseguros de Daños, S.A. in Spain. Total acquisition costs amounted to USD 41 million with residual goodwill generated of USD 9 million.

On April 4, 2007, the Group purchased 66 percent of the insurance company OOO "NASTA" in Russia, which was subsequently renamed Zurich Retail Insurance Company Ltd., Russia, with an agreed path to 100 percent ownership by 2010. The total consideration for the acquisition of 100 percent interest in Nasta was composed of an initial cash payment of USD 260 million plus a deferred payment estimated to amount to a present value of USD 178 million at the initial acquisition date. Residual goodwill arising from the initial accounting of this acquisition amounted to USD 370 million, representing the expected growth opportunities for the Group in the Russian market. Identifiable intangible assets have been valued at USD 28 million, mainly representing the Nasta distribution network.

On July 2, 2007, the Group acquired a 24.51 percent equity interest in Best Harmonious Insurance Brokers Company, Ltd., a nationally licensed Chinese insurance brokerage firm domiciled in Beijing for a total consideration of USD 11 million. This interest corresponds to a profit share of 91.44 percent and gives the Group effective control. The residual goodwill related to this acquisition amounts to USD 2 million.

On July 3, 2007, the Group, through its fully owned subsidiary FGI completed the acquisition of 100 percent of Bristol West Holdings, Inc. (Bristol West) in the US. As part of this transaction, FGI sold the underlying insurance business, consisting of non-standard auto insurance, to the Farmers Exchanges (which FGI manages but does not own). Net of the business sold to the Farmers Exchanges, FGI incurred total acquisition costs of USD 353 million (including transaction costs of USD 9 million). Net assets acquired amounted to negative USD 32 million due to the assumption of a debt obligation of USD 50 million. The residual goodwill arising from the acquisition amounted to USD 385 million and reflects the economic benefit of the management services which remained with FGI. This transaction did not affect the Group's scope of consolidation.

On September 5, 2007, the Group acquired 100 percent of Wrightway Underwriting Limited, an underwriting agency in Ireland, for a consideration of USD 27 million plus expected earn-out payments depending on the acquired company's performance. Total acquisition costs amounted to USD 29 million and identifiable intangible assets, net of deferred tax, amounted to USD 12 million. The residual goodwill of USD 15 million represents expected growth opportunities and synergies.

On November 29, 2007, the Group acquired 100 percent of Real Garant Versicherung AG, a car warranty insurer based in Germany. Total acquisition costs amounted to USD 43 million, tangible assets acquired to USD 23 million and intangible assets net of deferred tax were identified in the amount of USD 4 million. The residual goodwill of USD 16 million represents, among others, expected growth opportunities and synergies.

Divestments

The Group divested all of its shares in Truckwriters, Inc., Valiant Insurance Company, and Risk Enterprise Management Limited all based in the United States. The Group sold Finium Trustee Limited and the Zurich Master Super Fund and sold its interest in Lonsdale Financial Group Limited and Wrap Account Limited all based in Australia.

In 2007, the Group recorded a gain on divestments before tax of USD 118 million. This gain included an amount of USD 32 million for a purchase price adjustment related to contractually agreed profit participation from the sale of Zurich Atrium BV in the Netherlands in 2004. Total cash and net assets divested in 2007 were USD 64 million and USD 52 million, respectively. The total consideration received in 2007, net of transaction costs of USD 9 million, amounted to USD 175 million.

6. Investments

Table 6.1a

Investment result for total investments	in USD millions, for the years ended December 31					
	Net investment income		Net capital gains/(losses) on investments and impairments		Investment result	
	2008	2007	2008	2007	2008	2007
Cash and cash equivalents	647	621	(60)	27	588	648
Equity securities	2,971	3,134	(25,444)	6,934	(22,473)	10,068
Debt securities	6,598	6,151	(1,887)	(746)	4,711	5,406
Real estate held for investment	933	927	(1,596)	(419)	(664)	508
Mortgage loans	647	580	(29)	(10)	618	570
Other loans	616	575	2	4	617	579
Investments in associates	8	13	(4)	(1)	4	12
Other investments	333	366	1,209	(145)	1,542	221
<i>Short-term investments</i>	84	115	(37)	1	47	116
<i>Other¹</i>	248	251	1,246	(146)	1,494	105
Investment result, gross	12,752	12,366	(27,809)	5,645	(15,056)	18,011
Investment expenses	(842)	(775)	–	–	(842)	(775)
Investment result, net	11,910	11,591	(27,809)	5,645	(15,898)	17,236

¹ Including net capital gains/(losses) on derivative financial instruments of USD 1,241 million and USD (147) million for the years ended December 31, 2008 and 2007, respectively, of which net capital gains/(losses) on derivatives attributable to cash flow hedge ineffectiveness amounted to USD 5 million and USD (9) million for the years ended December 31, 2008 and 2007, respectively.

Rental operating expenses for real estate held for investment included in investment expenses for total investments amounted to USD 179 million and USD 170 million for the years ended December 31, 2008 and 2007, respectively.

Table 6.1b

Investment result for Group investments	in USD millions, for the years ended December 31					
	Net investment income		Net capital gains/(losses) on investments and impairments		Investment result	
	2008	2007	2008	2007	2008	2007
Cash and cash equivalents	493	590	1	(4)	494	586
Equity securities	604	708	(2,827)	1,897	(2,223)	2,604
Debt securities	6,066	5,773	(1,573)	(455)	4,494	5,318
Real estate held for investment	491	438	210	101	700	539
Mortgage loans	647	580	(29)	(10)	618	570
Other loans	616	575	2	4	617	579
Investments in associates	8	13	(4)	(1)	4	12
Other investments	62	162	1,327	(29)	1,389	133
<i>Short-term investments</i>	30	71	–	1	30	72
<i>Other¹</i>	32	92	1,327	(30)	1,359	61
Investment result, gross for Group investments	8,987	8,838	(2,893)	1,503	6,094	10,342
Investment expenses for Group investments	(261)	(247)	–	–	(261)	(247)
Investment result, net for Group investments	8,725	8,591	(2,893)	1,503	5,832	10,094

¹ Including net capital gains/(losses) on derivative financial instruments of USD 1,352 million and USD (33) million for the years ended December 31, 2008 and 2007, respectively, of which net capital gains/(losses) on derivatives attributable to cash flow hedge ineffectiveness amounted to USD 5 million and USD (9) million for the years ended December 31, 2008 and 2007, respectively.

Impairment charges on Group investments included in net capital losses amounted to USD 2,457 million and USD 136 million for the years ended December 31, 2008 and 2007, respectively, of which impairment charges on mortgage loans and other investments comprised USD 49 million and USD 12 million for the years ended December 31, 2008 and 2007, respectively.

Table 6.1c

Investment result for unit-linked contracts

in USD millions, for the years ended December 31

	Net investment income		Net capital gains/(losses) on investments		Investment result	
	2008	2007	2008	2007	2008	2007
Cash and cash equivalents	154	31	(60)	31	94	62
Equity securities	2,367	2,426	(22,617)	5,037	(20,250)	7,463
Debt securities	532	379	(314)	(290)	218	88
Real estate held for investment	442	489	(1,806)	(520)	(1,364)	(31)
Other investments	271	204	(118)	(116)	152	88
<i>Short-term investments</i>	55	44	(38)	–	17	44
<i>Other</i> ¹	216	159	(80)	(116)	135	43
Investment result, gross for unit-linked contracts	3,766	3,528	(24,916)	4,142	(21,150)	7,670
Investment expenses for unit-linked contracts	(581)	(528)	–	–	(581)	(528)
Investment result, net unit-linked contracts	3,185	3,000	(24,916)	4,142	(21,731)	7,142

¹ Including net capital losses on derivative financial instruments of USD 111 million and USD 114 million for the years ended December 31 2008 and 2007, respectively.

Table 6.2

Net capital gains, losses and impairments on equity and debt securities – total investments

in USD millions, for the years ended December 31

	Equity securities		Debt securities		Total	
	2008	2007	2008	2007	2008	2007
Securities at fair value through profit or loss:	(23,672)	5,835	(511)	(331)	(24,183)	5,504
<i>of which: trading securities</i>						
Net capital gains/(losses) on Group investments	(319)	229	(23)	(10)	(343)	219
<i>of which: securities designated at FV</i>						
Net capital gains/(losses) on Group investments	(736)	569	(173)	(31)	(909)	538
Net capital gains/(losses) for unit-linked contracts	(22,617)	5,037	(314)	(290)	(22,931)	4,747
Available-for-sale securities:	(1,772)	1,099	(1,307)	(413)	(3,078)	686
Realized capital gains on Group investments	556	1,273	458	482	1,013	1,755
Realized capital losses on Group investments	(1,130)	(130)	(622)	(813)	(1,752)	(944)
Impairments on Group investments	(1,197)	(44)	(1,142)	(81)	(2,340)	(125)
Held-to-maturity securities	–	–	(69)	(1)	(69)	(1)
Total net capital gains/(losses) and impairments	(25,444)	6,934	(1,887)	(746)	(27,331)	6,189

Details of total investments by category

Table 6.3a
as of December 31

	Total investments			
	2008		2007	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	16,397	6.4	16,936	5.4
Equity securities:				
Fair value through profit or loss	65,089	25.3	106,786	33.8
<i>of which: trading</i>	1,358	0.5	2,652	0.8
<i>of which: trading equity portfolios in capital markets and banking activities</i>	786	0.3	1,606	0.5
Available-for-sale	9,307	3.6	13,807	4.4
Total equity securities	74,397	28.9	120,593	38.2
Debt securities:				
Fair value through profit or loss	16,319	6.3	18,954	6.0
<i>of which: trading</i>	159	0.1	616	0.2
Available-for-sale	105,875	41.1	109,278	34.6
Held-to-maturity	5,244	2.0	5,642	1.8
Total debt securities	127,438	49.4	133,874	42.4
Real estate held for investment	11,601	4.5	15,386	4.9
Mortgage loans	12,820	5.0	12,718	4.0
Other loans	12,533	4.9	12,938	4.1
Investments in associates	220	0.1	238	0.1
Other investments:				
Short-term investments	2,307	0.9	2,929	0.9
Other	61	0.0	80	0.0
Total other investments	2,369	0.9	3,009	1.0
Total investments	257,773	100.0	315,693	100.0

Details of Group investments by category	Group investments			
	2008		2007	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	11,965	6.7	13,943	7.2
Equity securities:				
Fair value through profit or loss	4,935	2.7	6,609	3.4
<i>of which: trading</i>	1,358	0.8	2,652	1.4
<i>of which: trading equity portfolios in capital markets and banking activities</i>	786	0.4	1,606	0.8
Available-for-sale	9,307	5.2	13,807	7.1
Total equity securities	14,242	7.9	20,416	10.5
Debt securities:				
Fair value through profit or loss	6,984	3.9	8,843	4.6
<i>of which: trading</i>	159	0.1	616	0.3
Available-for-sale	105,875	59.0	109,278	56.4
Held-to-maturity	5,244	2.9	5,642	2.9
Total debt securities	118,103	65.8	123,762	63.9
Real estate held for investment	7,524	4.2	7,563	3.9
Mortgage loans	12,820	7.1	12,718	6.6
Other loans	12,531	7.0	12,936	6.7
Investments in associates	220	0.1	238	0.1
Other investments:				
Short-term investments	2,103	1.2	1,944	1.0
Other	61	0.0	80	0.0
Total other investments	2,165	1.2	2,024	1.0
Total Group investments	179,570	100.0	193,600	100.0

Cash and investments with a carrying value of USD 5,235 million and USD 4,617 million were deposited on behalf of regulatory authorities as of December 31, 2008 and 2007, respectively.

Short-term investments primarily consist of available-for-sale securities with original maturities between three months and one year.

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

As of December 31, 2008 and 2007, investments included USD 2,917 million and USD 12,204 million, respectively, of loaned securities. These loaned securities were mainly debt securities. Cash and cash equivalents included USD 177 million and USD 1,877 million of cash received as collateral for loaned securities as of December 31, 2008 and 2007, respectively. Liabilities for cash collateral received for securities lending comprised USD 182 million and USD 1,889 million as of December 31, 2008 and 2007, respectively. Non-cash collaterals received for loaned securities comprised USD 3,274 million and USD 10,911 million as of December 31, 2008 and 2007, respectively. Non-cash collaterals comprised mainly equity and debt securities. The Group can sell or repledge the collateral only in the event of a default by a counterparty.

As of December 31, 2008 and 2007, respectively, debt securities with a carrying value of USD 3,608 million and USD 5,370 million have been sold to financial institutions under short-term sale and repurchase agreements. These securities continue to be recognized as investments in the balance sheets. Obligations to repurchase these securities comprised USD 3,608 million and USD 5,370 million as of December 31, 2008 and 2007, respectively.

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

Details of investments held for unit-linked contracts

	Investments for unit-linked contracts			
	2008		2007	
	USD millions	% of total	USD millions	% of total
Cash and cash equivalents	4,431	5.7	2,993	2.5
Equity securities	60,154	76.9	100,178	82.1
Debt securities	9,335	11.9	10,112	8.3
Real estate held for investment	4,077	5.2	7,823	6.4
Other loans	2	0.0	2	0.0
Short-term investments	204	0.3	985	0.8
Total investments for unit-linked contracts	78,203	100.0	122,092	100.0

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

Debt securities maturity schedule (total investments)

	Held-to-maturity		Available-for-sale		Fair value through profit or loss	
	2008	2007	2008	2007	2008	2007
	Total	5,244	5,642	105,875	109,278	16,319
Debt securities:						
< 1 year	571	413	7,294	6,614	2,183	1,985
1 to 5 years	1,190	1,257	34,314	33,241	3,297	3,858
6 to 10 years	1,220	1,181	22,245	23,445	4,632	5,199
> 10 years	2,263	2,791	19,991	20,164	4,769	5,699
Subtotal	5,244	5,642	83,845	83,462	14,881	16,743
Mortgage and asset-backed securities:						
< 1 year	–	–	759	983	68	254
1 to 5 years	–	–	4,891	5,118	307	227
6 to 10 years	–	–	5,392	6,214	323	398
> 10 years	–	–	10,988	13,501	741	1,332
Subtotal	–	–	22,030	25,816	1,438	2,211

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

Available-for-sale securities

Table 6.5

in USD millions, as of December 31

	Cost or amortized cost ¹		Gross unrealized gains		Gross unrealized losses		Fair value	
	2008	2007	2008	2007	2008	2007	2008	2007
Equity securities								
Common stock	5,052	8,325	352	1,508	(1,015)	(832)	4,389	9,000
Unit trusts	5,556	4,348	157	383	(944)	(136)	4,769	4,595
Non-redeemable preferred stock	190	206	–	11	(40)	(4)	149	212
Total equity securities	10,798	12,878	509	1,902	(1,999)	(973)	9,307	13,807
Debt securities								
Swiss federal and cantonal governments	3,657	4,815	212	26	(1)	(54)	3,868	4,788
United Kingdom government	5,743	8,271	397	92	(2)	(24)	6,138	8,339
United States government	5,221	4,038	484	173	(38)	(82)	5,667	4,130
Other governments and supra-nationals	24,945	27,218	1,042	169	(207)	(702)	25,780	26,686
Corporate securities	44,625	40,249	1,098	744	(3,373)	(1,567)	42,351	39,425
Mortgage and asset-backed securities	24,412	25,953	310	197	(2,692)	(334)	22,030	25,816
Redeemable preferred stocks	56	92	–	3	(15)	–	41	95
Total debt securities	108,661	110,637	3,542	1,404	(6,328)	(2,763)	105,875	109,278

¹ Net of impairments. For details reference is made to table 6.2.

Fair value through profit or loss securities

Table 6.6

as of December 31

	Group investments				Investments for unit-linked products		Total investments	
	2008		2007		2008	2007	2008	2007
	USD millions	% of total	USD millions	% of total	USD millions	USD millions	USD millions	USD millions
Equity securities								
Common stock	4,341	36.4%	5,869	38.0%	33,068	62,225	37,409	68,094
<i>of which: trading equity portfolios in capital markets and banking activities</i>	786	6.6%	1,606	10.4%	–	–	786	1,606
<i>of which: common stock portfolios backing participating with profit policyholder contracts</i>	630	5.3%	1,274	8.2%	–	–	630	1,274
Unit trusts	594	5.0%	740	4.8%	27,069	37,935	27,663	38,675
Non-redeemable preferred stock	–	0.0%	–	0.0%	17	17	17	17
Total equity securities	4,935	41.4%	6,609	42.8%	60,154	100,178	65,089	106,786
Debt securities								
Debt securities	5,804	48.7%	6,960	45.0%	9,077	9,783	14,881	16,743
<i>of which: trading debt securities in capital markets and banking activities</i>	121	1.0%	117	0.8%	–	–	121	117
Mortgage and asset-backed securities	1,180	9.9%	1,882	12.2%	258	329	1,438	2,211
Total debt securities	6,984	58.6%	8,843	57.2%	9,335	10,112	16,319	18,954
Total	11,919	100.0%	15,451	100.0%	69,489	110,289	81,408	125,741

Table 6.7

as of December 31

Held-to-maturity debt securities

	2008		2007	
	USD millions	% of total	USD millions	% of total
Swiss federal and cantonal governments	1,590	30.3	1,498	26.6
United States government	1,669	31.8	1,598	28.3
Other governments and supra-nationals	819	15.6	901	16.0
Corporate securities	1,165	22.2	1,645	29.2
Total held-to-maturity debt securities	5,244	100.0	5,642	100.0

Financial instruments of interest in the current economic environment

As a consequence of current market conditions, certain asset types (i.e. mortgage and other asset-backed securities, collateralized debt obligations, hedge funds and private equity funds), have received increased interest from both the Group's management and external stakeholders.

Mortgage and other asset-backed securities

The majority of mortgage and other asset-backed securities and collateralized debt obligations are valued by external pricing providers, based on market prices and models that take into account market inputs (including observed transactions, indexes and market research reports), cash flow projections, based on, for example, observed prepayment and default rates, and interest rate spreads that reflect the type and risks of underlying collateral. As of December 31, 2008 and 2007, the Group had investments in mortgage and other asset-backed securities with a fair value of USD 23.2 billion and USD 27.7 billion, respectively.

Table 6.8

Exposure to asset-backed securities for Group investments by rating category	in USD millions, unless otherwise stated, as of December 31, 2008					Total fair value
	AAA	AA	A	BBB	< BBB	
US mortgage-backed securities	97.7%	0.5%	1.2%	0.2%	0.4%	15,696
US other asset-backed securities	87.0%	2.0%	5.0%	4.9%	1.1%	3,056
UK asset-backed securities	88.0%	4.5%	2.9%	4.2%	0.4%	2,406
German asset-backed securities	74.5%	0.8%	24.7%	–	–	334
Swiss asset-backed securities	100.0%	–	–	–	–	642
Other	90.0%	4.5%	4.6%	0.8%	0.1%	1,077
Total asset-backed securities	94.7%	1.3%	2.3%	1.3%	0.5%	23,210

Table 6.9

Exposure to asset-backed securities for Group investments by rating category	in USD millions, unless otherwise stated, as of December 31, 2007					Total fair value
	AAA	AA	A	BBB	< BBB	
US mortgage-backed securities	98.5%	0.7%	0.8%	–	–	17,547
US other asset-backed securities	86.0%	2.5%	6.1%	5.4%	–	3,088
UK asset-backed securities	84.8%	6.2%	3.8%	4.7%	0.5%	4,625
German asset-backed securities	64.6%	4.3%	31.1%	–	–	517
Swiss asset-backed securities	100.0%	–	–	–	–	635
Other	82.6%	6.8%	5.8%	2.3%	2.6%	1,285
Total asset-backed securities	93.5%	2.2%	2.7%	1.5%	0.2%	27,698

Only a small portion of the US mortgage-backed securities were below investment grade as of December 31, 2008. USD 8.8 billion of these securities are backed by Fannie Mae and Freddie Mac, which have both received significant support from the US Government.

Asset-backed securities included USD 155 million and USD 289 million as of December 31, 2008 and 2007, respectively, of exposure directly to US sub-prime mortgages. 93% (100% in 2007) of these asset-backed securities remain investment grade and only USD 12 million relates to mortgages issued in 2006, which was characterized by less stringent lending standards.

Collateralized debt obligations

The Group's exposure to collateralized debt obligations (CDOs) was USD 694 million and USD 384 million as of December 31, 2008 and 2007, respectively. These securities include no exposure to sub-prime mortgages and no significant impairments were recorded on CDOs during 2008 or 2007.

Hedge funds

The Group has investments in external hedge funds of USD 2.3 billion and USD 3.3 billion as of December 31, 2008 and 2007, respectively. The Group does not have any in-house hedge funds. Investments in hedge funds are classified as financial assets at fair value through profit or loss and gains and losses are, therefore, reported immediately in income. All the hedge fund exposure is invested with third party managers, who are subject to a thorough due diligence processes. A dedicated team of in-house investment professionals monitor closely the hedge funds' performance and valuation. The Group actively manages the exposure to hedge funds by up-grading, de-risking and tactically redeeming portions of the hedge fund portfolio. These hedge funds are invested in funds with approximately 20 different strategies. USD (397) million and USD 231 million in 2008 and 2007 respectively of (losses)/gains were included in income.

Private equity funds

The Group has investments in private equity funds of USD 1.3 billion and USD 1.0 billion as of December 31, 2008 and 2007, respectively. These investments are managed in external funds and the majority of them are classified as available-for-sale securities. These private equity investments are also widely diversified. Private equity investments are carried at values determined based on the latest available financial statements. These valuations are reviewed by a team of in-house investment professionals and may be adjusted based on their understanding of the circumstances relating to each specific private equity stake.

Table 6.10

Real estate held for total investments

in USD millions	Total	
	2008	2007
As of January 1	15,386	15,281
Additions and improvements	664	325
Disposals	(1,061)	(210)
Market value revaluation	(1,823)	(685)
Transfer from/(to) assets held for own use	(45)	6
Foreign currency translation effects	(1,520)	671
As of December 31	11,601	15,386

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

Table 6.11

Investments in associates

in USD millions, as of December 31	Carrying value		Share in profit		Ownership interest	
	2008	2007	2008	2007	2008	2007
	DKN Financial Group Limited	50	63	2	–	31.84%
MCIS Zurich Insurance Berhad	37	37	2	1	40.00%	40.00%
Euclid Office, L.P. ¹	25	24	1	1	99.00%	99.00%
Other	109	114	3	11	n/m	n/m
Total	220	238	8	13	n/m	n/m

¹ This entity is not consolidated as it is not controlled by the Group.

Net unrealized gains/(losses) on investments included in shareholders' equity	in USD millions, as of December 31	
	Total	
	2008	2007
Equity securities: available-for-sale	(1,490)	929
Debt securities: available-for-sale	(2,786)	(1,359)
Other	(7)	49
Less: net unrealized gains/(losses) on investments attributable to:		
Life policyholder dividends and other policyholder liabilities	236	459
Life deferred acquisition costs	256	78
Deferred income taxes	837	(48)
Non-controlling interests	(18)	(8)
Total	(2,973)¹	99

¹ The unrealized losses include net losses arising on cash flow hedges of USD 16 million and USD 103 million as of December 31, 2008 and 2007, respectively.

7. Derivative financial instruments and hedge accounting

The Group uses derivative financial instruments mostly for economic hedging purposes in order to mitigate the risks posed to the Group resulting from changes in foreign exchange rates, interest rates, equity prices, the credit quality of its assets and liabilities and third parties from which the Group has commitments that give rise to credit risk. In certain circumstances these instruments may meet the requirements of an effective hedge for accounting purposes. Where this is the case, hedge accounting may be applied. Details of the accounting for these instruments are set out in note 3, with table 7.1 disclosing notional and maturity of derivative instruments including those qualifying for hedge accounting. Table 7.2 sets out further details for instruments where hedge accounting has been applied. The notional principal amounts indicate the volume of transactions outstanding at the balance sheet date and are used to express the extent of the Group's involvement in derivative transactions. These do not represent amounts at risk.

Derivative assets are included in other assets and derivative liabilities are included in other liabilities in the consolidated balance sheets.

The following table sets out the details of the outstanding positions of the Group:

	Maturity profile			Notional principal amounts		Fair values	
	< 1 year	1 to 5 years	> 5 years	2008	2007	2008	2007
Swaps							
Interest rate swaps	60	335	882	1,277	1,468	145	24
Currency swaps	–	–	2,185	2,185	2,497	175	329
Total return equity swaps	–	–	74	74	80	(2)	(3)
Other swaps	49	727	–	776	1,122	85	2
Options							
Purchased call options	394	1,006	4,458	5,858	6,433	491	176
Purchased put options	735	1,387	2,477	4,599	8,254	442	240
Written call options	617	427	257	1,301	2,496	(40)	(121)
Written put options	1	1,084	1,596	2,681	2,245	(320)	84
Futures/forwards							
Purchased futures/forwards	3,188	–	–	3,188	8,159	55	30
Written futures/forwards	13,083	–	–	13,083	4,026	(695)	18
Total	18,126	4,966	11,929	35,022	36,780	336	779
<i>of which:</i>							
<i>financial assets</i>	–	–	–	–	–	1,724	1,055
<i>financial liabilities</i>	–	–	–	–	–	(1,388)	(276)

Swaps

Interest rate swaps consist mostly of fixed rate receiver swaps to manage asset liability mismatch and to hedge risks from a decrease in interest rates. The notional principal amounts of interest rate swaps decreased by USD 191 million due to exchange rate effects and matured positions.

The notional principal amounts of currency swaps include cross currency interest rate swaps. Other swaps include credit default swaps with notional principal amounts of USD 557 million and USD 803 million as of December 31, 2008 and 2007, respectively, which protect certain of the Group's assets exposed to credit risk. USD 219 million and USD 126 million, as of December 31, 2008 and 2007 respectively, are credit default swaps embedded in purchased credit linked notes.

Options

Purchased call options principally include long receiver swaptions and long interest rate caps used to economically hedge interest rate related risks and purchased equity call options hedging equity risks embedded in guaranteed equity bonds issued.

Purchased put options consist of long equity put options to hedge the Group's equity investments against a decline in equity market prices, as well as long payer swaptions to hedge risks from an increase in interest rates. The change in notional principal amounts of purchased put options between December 31, 2008 and December 31, 2007 is mainly driven by the expiration of long equity put options, which were not replaced.

Written call options relate to equity collars entered into to manage the risk return profile of equity exposures of some with-profit funds and to written equity call options embedded in the above mentioned guaranteed equity bond issues.

Written put options include written equity put options, which are mostly offset by purchased equity put options. Written put options also include stable value options. Stable value options (SVO) have been provided by the Group to certain bank and corporate customers (policyholders) in the US, in respect of the investment returns which arise on investments underlying Bank Owned Life Insurance (BOLI) and Company Owned Life Insurance (COLI) policies. Premiums received from policyholders under these policies are invested in separate account portfolios. Throughout the life of the policies, policyholders are entitled, in addition to mortality cover, to tax-exempt investment returns linked to the performance of the underlying investments. The policies are long duration contracts providing charges and benefits over a policy life that can be greater than 45 years. SVO reduce the volatility of the policyholders' investment returns. In the event that a policy is surrendered, the policyholder would be entitled to recover the excess of the notional SVO derived value over the market value of the underlying investments. Certain policy features as well as certain regulations provide disincentives for surrender. We monitor and manage the risk of surrender on an ongoing basis and consider the likelihood of surrender as one input factor to the model to determine the fair value of SVO. The fair value of the derivative liability recognized in respect of SVO, included in written put options, was USD 23 million and USD 5 million as of December 31, 2008 and 2007, respectively. The difference between the notional SVO derived value and market value of the underlying investments for BOLI/COLI policies was USD 929 million and USD 207 million as of December 31, 2008 and 2007, respectively, which would have been the total net market value loss after surrender charges if all policies would have been surrendered on those dates.

Futures/forwards

Purchased futures/forwards and written futures/forwards mainly consist of foreign exchange forward contracts with the principal notional amounts of USD 15,613 million and USD 11,867 million as of December 31, 2008 and 2007, respectively. Foreign exchange forwards are used to economically hedge the Group's foreign currency exposures. Due to higher hedging volumes and foreign currency translation effects, the notional principal amounts of foreign exchange forwards increased by USD 3,746 million from December 31, 2007 to December 31, 2008.

The following table sets out the details of the fair value and cash flow hedges:

Table 7.2							
Maturity profile of notional principal amounts and fair values of derivative financial instruments	in USD millions, as of December 31			Notional principal amounts		Fair values	
	Maturity profile			2008	2007	2008	2007
	< 1 year	1 to 5 years	> 5 years				
Fair value hedges:							
Cross currency interest rate swaps		975		975	1,022	141	118
Total fair value hedges		975		975	1,022	141	118
Cash flow hedges:							
Options on interest rate swaps			3,373	3,373	3,176	209	58
Currency swaps			1,114	1,114	1,168	63	153
Total cash flow hedges			4,487	4,487	4,344	272	211
<i>of which:</i>							
<i>assets</i>						413	329
<i>liabilities</i>						-	-

Fair value hedges

Designated fair value hedges consist of cross currency interest rate swaps used to protect the Group against changes in foreign currency exposure and interest rate exposure of Euro-denominated debt held by the Group. Changes in the fair value of the derivatives designated as fair value hedges and changes in the fair value of the hedged item in relation to the risk being hedged are recognized in income.

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

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

Gains and losses arising from fair value hedges are as follows:

Table 7.3				
Gains/(losses) arising from fair value hedges	in USD millions, as of December 31		2008	2007
	Gains/(losses)			
	<i>on hedging instruments¹</i>		21	72
	<i>on hedged debt issued attributable to the hedged risk</i>		(26)	(71)

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

Cash flow hedges

Designated cash flow hedges, such as options on interest rate swaps are used to protect the Group against variability of future cash flows due to changes in interest rates associated with expected future purchases of debt securities (during the years 2011, 2016, 2021 and 2026) required for certain life insurance policies. The effective portion of the gains and losses on these swaps are initially recognized in comprehensive income. Subsequently the gains or losses will be recycled to income when the underlying investments are purchased and recognized on the balance sheet and affect income through the recognition of interest income between the years ended December 31, 2011 and 2036. The gains and losses relating to the ineffective portion of these hedges are recognized immediately in income within net capital gains/(losses) on investments and impairments.

The Group also uses currency swaps for cash flow hedging to protect against exposures to variability of cash flows due to movements in the Euro exchange rate against the USD, the presentational currency of the Group, on 80 percent of the 4.5% EUR 1 billion debt issued by Zurich Finance (USA), Inc (see note 21). The change in the fair value of the hedging instrument is recognized directly in comprehensive income. The ineffective portion of the change in fair value is recognized directly in income within administrative and other expense. The effective portion, related to spot rate changes in fair value of the hedging instrument, is reclassified to income within administrative and other operating expense as an offset to the foreign currency revaluation on the underlying hedged debt. This hedge relationship is expected to remain in place until the maturity of the debt in September 2014.

The net loss deferred in shareholders' equity on derivatives designated as cash flow hedges was USD 107 million and USD 144 million before tax for the years ended December 31, 2008 and 2007, respectively. During 2008, the portion recognized in income was a loss of USD 54 million and a gain of USD 111 million before tax for the years ended December 31, 2008 and 2007, respectively, as an offset to the foreign currency revaluation on the underlying hedged debt. A net gain of USD 2 million and net loss of USD 9 million for the years ended December 31, 2008 and 2007, respectively, was recognized due to hedge ineffectiveness.

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

Table 8.1

Reserves for insurance contracts	in USD millions, as of December 31		2008	2007
	Gross			
Reserves for losses and loss adjustment expenses			65,218	67,890
Reserves for unearned premiums			16,399	15,941
Future life policyholders' benefits ¹			76,218	80,147
Policyholders' contract deposits and other funds			17,047	18,687
Reserves for unit-linked contracts			47,297	70,075
Total reserves for insurance contracts, gross			222,179	252,740
Ceded				
Reserves for losses and loss adjustment expenses			(12,232)	(13,179)
Reserves for unearned premiums			(1,889)	(1,720)
Future life policyholders' benefits ¹			(1,873)	(9,258)
Policyholders' contract deposits and other funds			(2,690)	(2,976)
Reinsurers' share of reserves for insurance contracts, gross²			(18,684)	(27,133)
Net				
Reserves for losses and loss adjustment expenses			52,986	54,712
Reserves for unearned premiums			14,510	14,221
Future life policyholders' benefits			74,345	70,889
Policyholders' contract deposits and other funds			14,357	15,711
Reserves for unit-linked contracts			47,297	70,075
Total reserves for insurance contracts, net			203,495	225,607

¹ In 2007, ceded future life policyholders' benefits include an amount of USD 7.1 billion related to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts have been transferred to the reinsurer, resulting in a reduction of gross and ceded future life policyholders' benefits.

² Gross of allowance for uncollectible amounts of USD 89 million and USD 164 million as of December 31, 2008, and 2007, respectively.

Table 8.2

Development of reserves for losses and loss adjustment expenses	in USD millions		Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007	2008	2007
As of January 1	67,890	64,535	(13,179)	(13,722)	54,712	50,814		
Losses and loss adjustment expenses incurred:								
Current year	28,296	25,798	(2,879)	(2,424)	25,416	23,374		
Prior years	(1,354)	(847)	83	(372)	(1,271)	(1,219)		
Total	26,942	24,951	(2,796)	(2,796)	24,145	22,155		
Losses and loss adjustment expenses paid:								
Current year	(10,190)	(9,007)	591	388	(9,599)	(8,619)		
Prior years	(15,080)	(14,613)	2,528	3,375	(12,551)	(11,237)		
Total	(25,269)	(23,619)	3,119	3,763	(22,150)	(19,856)		
Acquisitions/(divestments) of companies and businesses	105	57	(28)	(6)	77	51		
Foreign currency translation effects	(4,450)	1,967	653	(419)	(3,798)	1,548		
As of December 31	65,218	67,890	(12,232)	(13,179)	52,986	54,712		

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

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

Table 8.2 shows the development of reserves for losses and loss adjustment expenses during the year. Of the decrease in the total net reserves during the year, USD 1,271 million has arisen due to favourable development emerging from reserves established in prior years. The positive development arose across a number of countries and lines of business primarily from our General Insurance business.

Table 8.3 presents changes in the historical non-life reserves, net of reinsurance, that the Group established in 2001 and subsequent years. Reserves are presented by financial year, not by accident year. The reserves (and the development thereon) are for all accident years in that financial statement year. The top line of the table shows the estimated gross reserves for unpaid losses and loss adjustment expenses as of each balance sheet date, which represents the estimated amount of future payments for losses incurred in that year and in prior years. The cumulative paid portion of the table presents the cumulative amounts paid through each subsequent year in respect of the reserves established at each year end. The net reserves re-estimated portion of the table shows the re-estimation of the initially recorded reserve as of each succeeding year end. Reserve development is shown in each column. Changes to estimates are made as more information becomes known about the actual losses for which the initial reserves were established. The cumulative deficiency or redundancy is equal to the initial net reserves less the liability re-estimated as of December 31, 2008. It is the difference between the initial net reserve estimate and the last entry of the diagonal. Conditions and trends that have affected the development of our reserves for losses and loss adjustment expenses in the past may or may not necessarily occur in the future, and accordingly, conclusions about future results may not be derived from the information presented in the table below.

Development of insurance losses, net

Table 8.3

in USD millions, as of	2001	2002	2003	2004	2005	2006	2007	2008
Gross reserves for losses and loss adjustment expenses	37,694	45,306	51,068	57,765	60,425	64,535	67,890	65,218
Reinsurance recoverable	(13,605)	(14,940)	(14,055)	(14,279)	(14,231)	(13,722)	(13,179)	(12,232)
Initial net reserves for losses and loss adjustment expenses	24,089	30,366	37,013	43,486	46,194	50,814	54,712	52,986
Cumulative paid as of:								
<i>One year later</i>	(7,976)	(8,923)	(9,930)	(9,464)	(11,423)	(11,237)	(12,551)	
<i>Two years later</i>	(12,855)	(14,472)	(15,550)	(16,273)	(18,044)	(18,362)		
<i>Three years later</i>	(16,698)	(18,001)	(20,407)	(21,234)	(23,077)			
<i>Four years later</i>	(19,255)	(21,390)	(23,941)	(24,945)				
<i>Five years later</i>	(21,634)	(23,814)	(26,616)					
<i>Six years later</i>	(23,471)	(25,799)						
<i>Seven years later</i>	(24,849)							
Net reserves re-estimated as of:								
<i>One year later</i>	26,908	32,239	38,977	43,627	45,976	49,594	53,441	
<i>Two years later</i>	28,471	34,471	40,413	45,006	45,827	48,642		
<i>Three years later</i>	30,636	36,118	42,004	45,325	45,297			
<i>Four years later</i>	31,784	37,691	42,254	45,294				
<i>Five years later</i>	33,326	37,880	42,470					
<i>Six years later</i>	33,799	38,282						
<i>Seven years later</i>	34,004							
Cumulative (deficiency) / redundancy	(9,915)	(7,916)	(5,457)	(1,808)	897	2,171	1,271	
Cumulative (deficiency) / redundancy as a percentage of initial net reserves	(41.2%)	(26.1%)	(14.7%)	(4.2%)	1.9%	4.3%	2.3%	
Gross reserves re-estimated as of December 31, 2008	51,569	56,223	59,056	60,916	60,509	62,430	66,536	
Cumulative (deficiency) / redundancy	(13,875)	(10,917)	(7,988)	(3,151)	(84)	2,105	1,354	
Cumulative (deficiency) / redundancy as a percentage of initial gross reserves	(36.8%)	(24.1%)	(15.6%)	(5.5%)	(0.1%)	3.3%	2.0%	

Management has considered asbestos, environmental and latent injury claims and claims expenses in establishing the reserves for losses and loss adjustment expenses. The Group continues to be advised of claims asserting injuries from toxic waste, hazardous materials and other environmental pollutants and alleged damages to cover the clean-up costs of hazardous waste dump sites relating to policies written in prior years and indemnity claims asserting injuries from asbestos. Coverage and claim settlement issues, such as determination that coverage exists and the definition of an occurrence, together with increased medical diagnostic capabilities and awareness have often caused actual loss development to exhibit more variation than in other lines. Such claims require specialized reserving techniques and the uncertainty of the ultimate cost of these types of claims has tended to be greater than the uncertainty relating to standard lines of business.

Uncertainties also arise from changes or potential changes in various laws or the interpretation of laws. While the Group believes that it has made adequate provision for these claims, it is possible that future adverse development

could have a material effect on the Group's results of operations, cash flows and financial position. The net reserve amounts related to such claims were USD 2,800 million and USD 3,564 million as of December 31, 2008 and 2007, respectively. The development of these reserves is shown below.

Table 8.4

Development of reserves for losses and loss adjustment expenses for asbestos and environmental claims	in USD millions	2008		2007	
		Gross	Net	Gross	Net
Asbestos					
As of January 1		3,799	3,238	3,499	3,142
Losses and loss adjustment expenses incurred		240	196	454	180
Losses and loss adjustment expenses paid		(339)	(278)	(188)	(109)
Divestments, commutations, settlements and other		–	–	–	(18)
Foreign currency translation effects		(699)	(632)	33	43
As of December 31		3,001	2,523	3,799	3,238
Environmental					
As of January 1		394	326	433	366
Losses and loss adjustment expenses incurred		(11)	–	22	8
Losses and loss adjustment expenses paid		(57)	(51)	(60)	(48)
Foreign currency translation effects		6	2	(1)	–
As of December 31		332	277	394	326

Table 8.5

Development of future life policyholders' benefits	in USD millions	Gross		Ceded		Net	
		2008	2007	2008	2007	2008	2007
		As of January 1	80,147	76,448	(9,258)	(1,482)	70,889
Premiums and claims	(9,583)	(5,959)	6,913	(6,609)	(2,670)	(12,568)	
Interest and bonuses credited to policyholders	2,983	2,915	(252)	(161)	2,730	2,754	
Change in assumptions	(344)	1,240	349	(1,014)	5	226	
Acquisitions/transfers	6,737	–	(288)	–	6,450	–	
(Decrease)/increase recorded in shareholders' equity	(11)	(526)	–	5	(11)	(520)	
Foreign currency translation effects	(3,712)	6,029	664	3	(3,049)	6,030	
As of December 31	76,218	80,147	(1,873)	(9,258)	74,345	70,889	

In 2007, ceded future life policyholders' benefits included an amount of USD 7.1 billion related to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts have been transferred to the reinsurer, resulting in a reduction of gross and ceded future life policyholders' benefits.

Long-duration contract liabilities included in future life policyholders' benefits result primarily from traditional participating and non-participating life insurance products. Short-duration contract liabilities are primarily accident and health insurance products.

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

The impact of changes in assumptions on net future life policyholders' benefits was USD 5 million and USD 226 million for the years ended December 31, 2008 and 2007, respectively. The net changes include the following significant movements:

- interest rate assumptions increased the benefits by USD 229 million in 2008 and by USD 361 million in 2007;
- expense assumptions reduced the benefits by USD 4 million in 2008 and by USD 40 million in 2007;
- longevity assumptions increased the benefits by USD 85 million in 2008 and reduced them by USD 62 million in 2007;
- morbidity assumptions reduced the benefits by USD 192 million in 2008 and by USD 46 million in 2007;
- investment return assumptions reduced the benefits by USD 118 million in 2008 and increased them by USD 6 million in 2007.

Table 8.6

in USD millions, as of December 31		2008	2007
Policyholders' contract deposits and other funds gross	Annuities	2,393	2,451
	Universal life and other contracts	10,365	10,510
	Policyholder dividends	4,289	5,725
	Total	17,047	18,687

Table 8.7

in USD millions	Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007
As of January 1	18,687	18,934	(2,976)	(3,258)	15,711	15,676
Premiums and claims	(871)	(1,323)	384	411	(487)	(912)
Interest and bonuses credited to policyholders	(385)	1,215	(105)	(120)	(490)	1,095
Change in assumptions	(2)	(1)	1	–	(1)	(1)
Acquisitions/transfers	16	–	(9)	–	7	–
(Decrease)/increase recorded in shareholders' equity	188	(1,101)	–	5	188	(1,095)
Foreign currency translation effects	(585)	962	14	(15)	(571)	947
As of December 31	17,047	18,687	(2,690)	(2,976)	14,357	15,711

Table 8.8

in USD millions	Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007
As of January 1	70,075	66,008	–	–	70,075	66,008
Premiums and claims	(1,901)	(1,714)	–	–	(1,901)	(1,714)
Interest and bonuses credited/(charged) to policyholders	(12,223)	4,275	–	–	(12,223)	4,275
Acquisitions/transfers	833	–	–	–	833	–
Foreign currency translation effects	(9,486)	1,506	–	–	(9,486)	1,506
As of December 31	47,297	70,075	–	–	47,297	70,075

Guarantees arising from minimum death benefits (GMDB) and retirement income benefits (GRIB) Certain products for which policyholders bear in full the credit and market risks associated with the underlying invested funds selected by them contain guarantees for which liabilities have been recorded for additional benefits and minimum guarantees. These arise primarily in the subsidiary Kemper Investors Life Insurance Company which has written variable annuity contracts that provide policyholders with certain guarantees related to minimum death and income benefits. The determination of these liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates, annuitization elections and mortality experience. After 2001 the Group no longer issued new policies with such features.

Table 8.9

Information on guaranteed liabilities	in USD millions (except average attained age)	
	2008	2007
Account balance for products with guarantee features as of December 31		
Gross	1,966	4,112
Ceded	(187)	(374)
Net	1,778	3,738
Amount at risk from minimum death benefits (GMDB) as of December 31		
Gross	1,744	539
Ceded	(290)	(186)
Net	1,453	353
Average attained age of policyholders (in years)	64	64

The net amount at risk is the present value of payouts exceeding the current policyholder account balance assuming the payout criteria in all policies would have been collectively triggered as of the balance sheet date. The net amount at risk is not the same as the fair value of these benefits, as it does not fully take the option value accruing to the policyholder into account. In determining the excess benefit reserve, the Group follows the guidance in the US Statement of Principle 03-1 "Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts". Under this guidance a benefit ratio (determined based on expected policyholder excess payouts and expected policyholder assessments) to excess payout and assessment experience to date is applied to determine the new reserve level. The liability for future life policyholder benefits net of reinsurance includes an excess benefit reserve of USD 513.2 million and USD 123.7 million as of December 31, 2008 and 2007, respectively.

9. Liabilities for investment contracts with and without discretionary participation features (DPF)

Table 9.1

Liabilities for investment contracts	in USD millions, as of December 31	
	2008	2007
Liabilities related to unit-linked investment contracts	30,397	48,187
Liabilities related to investment contracts (amortized cost)	122	117
Liabilities related to investment contracts with DPF	5,461	6,182
Total	35,979	54,485

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

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

Table 9.2

Development of liabilities for investment contracts	in USD millions	
	2008	2007
As of January 1	54,485	50,705
Premiums and claims	(838)	(1,080)
Interest and bonuses charged/(credited) to policyholders	(8,647)	3,324
Divestments/transfers	790	(514)
Increase/(decrease) recorded in shareholders' equity	9	(31)
Foreign currency translation effects	(9,819)	2,081
As of December 31	35,979	54,485

10. Equity component relating to contracts with DPF

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

Table 10

Development of the equity component relating to contracts with DPF	in USD millions	
	2008	2007
As of January 1	1,309	1,414
Net unrealized (losses)/gains on investments	(371)	(226)
Current period profit	230	17
Foreign currency translation effects	53	104
As of December 31	1,221	1,309

11. Gross and ceded insurance revenues and expenses

Table 11.1

Insurance benefits and losses	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007
Losses and loss adjustment expenses	26,942	24,951	(2,796)	(2,796)	24,145	22,155
Life insurance death and other benefits	11,315	11,903	(778)	(1,065)	10,538	10,837
Increase/(decrease) in future life policyholders' benefits	(6,870)	(1,931)	6,999	(7,770)	128	(9,701)
Total insurance benefits and losses¹	31,387	34,923	3,425	(11,632)	34,811	23,291

¹ In 2007, ceded insurance benefits and losses included USD 7.0 billion relating to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts have been transferred to the reinsurer. This transaction had no impact on the income statement in 2008.

Table 11.2

Policyholder dividends and participation in profits	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007
Change in policyholders' contract deposits and other funds	(602)	1,134	40	(13)	(562)	1,121
Change in reserves for unit-linked products	(13,239)	4,077	–	–	(13,239)	4,077
Change in liabilities for investment contracts – unit-linked	(8,384)	3,165	–	–	(8,384)	3,165
Change in liabilities for investment contracts – other	147	180	–	–	147	180
Change in unit-linked liabilities related to UK capital gains tax	524	(16)	–	–	524	(16)
Total policyholder dividends and participation in profits	(21,554)	8,540	40	(13)	(21,514)	8,526

Table 11.3

Underwriting and policy acquisition costs	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007
Underwriting and policy acquisition costs	9,285	8,358	(998)	(799)	8,287	7,559

Table 11.4

Change in reserves for unearned premiums	in USD millions, for the years ended December 31					
	Gross		Ceded		Net	
	2008	2007	2008	2007	2008	2007
Change in reserves for unearned premiums	1,781	286	(220)	209	1,560	495

12. Deferred policy acquisition costs and deferred origination costs

Table 12.1

Development of deferred policy acquisition costs	General Insurance		Global Life		Other segments ¹		Total	
	2008	2007	2008	2007	2008	2007	2008	2007
	in USD millions							
As of January 1	3,306	2,959	11,547	10,113	89	124	14,941	13,197
Acquisition costs deferred and transfers	2,918	2,594	1,736	1,567	316	35	4,970	4,197
Amortization	(2,851)	(2,375)	(1,028)	(804)	(87)	(65)	(3,967)	(3,244)
Amortization charged/(credited) to shareholders' equity	–	–	128	154	2	(5)	130	149
Foreign currency translation effects	(125)	127	(1,631)	517	4	(1)	(1,752)	643
As of December 31	3,247	3,306	10,752	11,547	324	89	14,323	14,941

¹ Net of eliminations from intersegment transactions.

Table 12.2

Development of deferred origination costs	in USD millions	
	2008	2007
As of January 1	1,003	815
Origination costs deferred	119	271
Amortization	(122)	(103)
Foreign currency translation effects	(230)	19
As of December 31	770	1,003

13. Administrative and other operating expenses

Table 13

Administrative and other operating expenses	in USD millions, for the years ended December 31	
	2008	2007
Wages and salaries	2,504	2,330
Other employee benefits	453	452
Amortization and impairments of intangible assets	437	302
Rent, leasing and maintenance	369	290
Marketing costs	372	401
IT costs	816	759
Other	1,778	2,146
Total	6,729	6,679

14. Farmers management fees and other related revenues

Table 14		2008	2007
Farmers management fees and other related revenues	in USD millions, for the years ended December 31		
	Farmers management fees and other related revenues	2,458	2,266

FGI, through its AIF relationship with the Farmers Exchanges, which the Group manages but does not own, is contractually permitted to receive a management fee of up to 20% (25% in the case of the Fire Insurance Exchange) of the gross premiums earned by the Farmers Exchanges. To enable the Farmers Exchanges to maintain appropriate capital and surplus while offering competitive insurance rates, FGI has historically charged a lower management fee than the maximum allowed. The range of fees has varied by line of business over time and from year to year. During the past five years, aggregate management fees have averaged between 12% and 13% of gross premiums earned by the Farmers Exchanges. The gross earned premiums of the Farmers Exchanges were USD 16,541 million and USD 15,547 million for the years ended December 31, 2008 and 2007, respectively.

15. Receivables

Table 15.1		2008	2007
Receivables	in USD millions, as of December 31		
	Receivables from policyholders	3,107	2,972
	Receivables from insurance companies, agents, brokers and intermediaries	6,348	5,972
	Receivables arising from ceded reinsurance	1,166	1,372
	Other receivables	3,066	3,084
	Allowance for impairments ¹	(457)	(554)
	Total	13,229	12,846

¹ Allowance for impairments includes USD 206 million and USD 239 million as of December 31, 2008, and 2007, respectively, for receivables arising from ceded reinsurance.

Receivables are generally settled within one year.

Table 15.2		2008	2007
Development of allowance for impairments (deducted from receivables)	in USD millions		
	As of January 1	(554)	(468)
	Decrease/(increase) in allowance for impairments	11	(83)
	Recoveries	(6)	2
	Amounts written-off against receivables	68	3
	Foreign currency translation effects	24	(8)
	As of December 31	(457)	(554)

16. Mortgage loans given as collateral and collateralized loans

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

Impairment charges of USD 1 million on mortgage loans given as collateral were recorded in income for both years ended December 31, 2008 and 2007.

The table below shows the maturity schedule of collateralized loans as of December 31, 2008 and 2007, respectively.

Table 16			
Maturity schedule of collateralized loans	in USD millions, as of December 31		
		2008	2007
	< 1 year	125	259
	1 to 2 years	121	325
	2 to 3 years	556	287
	3 to 4 years	181	622
	4 to 5 years	127	269
	> 5 years	123	480
	Total	1,233	2,243

17. Property and equipment

Table 17.1

Property and equipment	in USD millions					
	Land held for own use	Buildings held for own use	Furniture and fixtures	Computer equipment	Other equipment	Total
Gross carrying value as of January 1, 2008	393	1,577	436	765	615	3,787
Less: accumulated depreciation/impairments	(1)	(571)	(359)	(561)	(324)	(1,815)
Net carrying value as of January 1, 2008	392	1,006	78	204	292	1,972
Additions, improvements and transfers	1	61	36	130	217	445
Disposals and transfers	(31)	(152)	1	(28)	(56)	(265)
Depreciation and impairments	–	(45)	(23)	(87)	(63)	(218)
Foreign currency translation effects	(3)	(20)	(5)	–	(17)	(44)
Net carrying value as of December 31, 2008	359	851	86	219	374	1,889
Plus: accumulated depreciation/impairments	–	547	351	548	361	1,808
Gross carrying value as of December 31, 2008	359	1,398	438	767	735	3,697

Table 17.2

Property and equipment	in USD millions					
	Land held for own use	Buildings held for own use	Furniture and fixtures	Computer equipment	Other equipment	Total
Gross carrying value as of January 1, 2007	385	1,500	398	666	577	3,525
Less: accumulated depreciation/impairments	–	(537)	(322)	(484)	(277)	(1,621)
Net carrying value as of January 1, 2007	385	962	76	182	299	1,905
Additions, improvements and transfers	3	95	30	95	114	336
Disposals and transfers	(24)	(70)	–	(3)	(76)	(173)
Depreciation and impairments	–	(50)	(33)	(76)	(55)	(214)
Foreign currency translation effects	28	69	4	6	10	118
Net carrying value as of December 31, 2007	392	1,006	78	204	292	1,972
Plus: accumulated depreciation/impairments	1	571	359	561	324	1,815
Gross carrying value as of December 31, 2007	393	1,577	436	765	615	3,787

The fire insurance value of the Group's own-use property and equipment totalled USD 3,676 million and USD 3,973 million as of December 31, 2008 and 2007, respectively.

18. Goodwill and other intangible assets

Table 18.1

Intangible assets –
current period

in USD millions					
	Goodwill	Present value of profits of acquired insurance contracts	Other intangible assets	Attorney-in-fact relationships	Total
Gross carrying value as of January 1, 2008	1,754	2,392	2,787	1,025	7,957
Less: accumulated amortization/impairments	(24)	(1,612)	(1,687)	–	(3,323)
Net carrying value as of January 1, 2008	1,730	780	1,100	1,025	4,636
Additions and transfers	337	640	3,655	–	4,631
Divestments and transfers	–	–	(22)	–	(22)
Amortization	–	(56)	(299)	–	(354)
Amortization charged to shareholders' equity	–	50	–	–	50
Impairments	(14)	(64)	(5)	–	(83)
Foreign currency translation effects	(206)	(97)	(244)	–	(548)
Net carrying value as of December 31, 2008	1,846	1,252	4,186 ¹	1,025	8,310
Plus: accumulated amortization/impairments	38	1,364	1,880	–	3,282
Gross carrying value as of December 31, 2008	1,884	2,617	6,066	1,025	11,593

¹ Other intangible assets include software of USD 1'156 million as well as intangible assets at fair value on acquisitions.

USD 339 million additions to goodwill, USD 640 million additions to present value of profits of acquired insurance contracts, and USD 3,069 million additions to other intangible assets resulted from the acquisitions in 2008 as disclosed in note 5. Thereof, USD 285 million additions to present value of profits of acquired insurance contracts and USD 1,462 million additions to other intangible assets relate to non-controlling interests.

Table 18.2

Intangible assets
by segment –
current period

in USD millions, as of December 31, 2008					
	Goodwill	Present value of profits of acquired insurance contracts	Other intangible assets	Attorney-in-fact relationships	Total
General Insurance	895	–	1,303	–	2,199
Global Life	565	1,252	2,503	–	4,320
Farmers Management Services	382	–	182	1,025	1,589
Other Businesses	–	–	13	–	13
Corporate Functions	5	–	185	–	190
Net carrying value as of December 31, 2008	1,846	1,252	4,186 ¹	1,025	8,310

¹ Other intangible assets include software of USD 1'156 million as well as intangible assets at fair value on acquisitions.

Table 18.3

Intangible assets –
prior period

in USD millions

	Goodwill	Present value of profits of acquired insurance contracts	Other intangible assets	Attorney-in-fact relationships	Total
Gross carrying value as of January 1, 2007	672	2,329	2,041	1,025	6,068
Less: accumulated amortization/impairments	(12)	(1,554)	(1,415)	–	(2,981)
Net carrying value as of January 1, 2007	660	775	626	1,025	3,086
Additions and transfers	1,015	–	733	–	1,748
Divestments and transfers	(12)	–	(59)	–	(71)
Amortization	–	(56)	(200)	–	(256)
Amortization charged to shareholders' equity	–	26	–	–	26
Impairments	(12)	–	(34)	–	(46)
Foreign currency translation effects	79	35	34	–	148
Net carrying value as of December 31, 2007	1,730	780	1,100 ¹	1,025	4,636
Plus: accumulated amortization/impairments	24	1,612	1,687	–	3,323
Gross carrying value as of December 31, 2007	1,754	2,392	2,787	1,025	7,957

¹ Other intangible assets include software of USD 907 million as well as intangible assets at fair value on acquisitions.

Table 18.4

Intangible assets
by segment –
prior period

in USD millions, as of December 31, 2007

	Goodwill	Present value of profits of acquired insurance contracts	Other intangible assets	Attorney-in-fact relationships	Total
General Insurance	706	–	538	–	1,244
Global Life	635	780	284	–	1,698
Farmers Management Services	385	–	171	1,025	1,582
Other Businesses	–	–	13	–	13
Corporate Functions	5	–	94	–	99
Net carrying value as of December 31, 2007	1,730	780	1,100 ¹	1,025	4,636

¹ Other intangible assets include software of USD 907 million as well as intangible assets at fair value on acquisitions.

In 2008 impairment charges of USD 83 million were recorded in income comprising impairment of PVFP of USD 64 million in the UK and German Life operations, impairment of goodwill of USD 14 million as a result of updated cash flow assumptions in the German Life operations and other intangible assets of USD 5 million relating to impairments on capitalized software.

In 2007 impairment charges of USD 46 million were recorded in income comprising impairment of other intangible assets of USD 34 million mainly relating to software capitalized in the UK Life business and impairment of goodwill of USD 12 million as a result of updated cash flow assumptions in the Spanish Life operations.

19. Other liabilities

Table 19.1

in USD millions, as of December 31		2008	2007
Other liabilities	Other financial liabilities		
	Amounts due to reinsurers, agents and other insurance companies	1,778	1,712
	Amounts due to life policyholders	559	722
	Liabilities for cash collateral received for securities lending	182	1,889
	Derivative liabilities	1,388	276
	Liabilities for defined benefit plans	2,294	908
	Other liabilities for employee benefit plans	105	110
	Other liabilities	8,233	11,449
	Other non-financial liabilities		
	Current tax payables	1,025	1,643
	Restructuring provisions	88	162
	Other liabilities	1,291	1,387
	Total other liabilities	16,944	20,257

The undiscounted amounts of the financial liabilities as of December 31, 2008 and 2007 are not materially different from the carrying amounts. Financial liabilities other than those related to defined benefit plans of USD 1,110 million and USD 1,284 million as of December 31, 2008 and 2007 respectively, had a maturity greater than one year.

Table 19.2

in USD millions		2008	2007
Restructuring provisions	As of January 1	162	128
	Provisions made during the period	141	110
	Provisions used during the period	(200)	(81)
	Provisions reversed during the period	(2)	(4)
	Foreign currency translation effects	(10)	9
	Other changes	(2)	–
	As of December 31	88	162

During the year ended December 31, 2008, the Group entered into four main restructuring programs, recording a total charge to income of USD 141 million. The UK General Insurance Business recorded restructuring costs totalling approximately USD 66 million, of which, USD 53 million related to a restructuring program aligned to the operational transformation strategy of the Group. The remainder related to a decision to close all retail outlets of one of the UK subsidiaries in order to focus on internet based sales.

The Group's North America Commercial business division also entered into an operational transformation program. The impact is predominantly headcount related, with costs approximating USD 24 million. A further USD 32 million restructuring charge was recorded, to cover costs associated with the sale of Zurich American Insurance Company's Commercial Small Business Solutions book of business to Truck Insurance Exchange, one of the Farmers Exchanges. The costs are mainly related to IT infrastructure but also include severance payments.

During the year ended December 31, 2007, a total of USD 110 million restructuring charges were recorded. USD 92 million related to a restructuring program in the Group's German operations, across both Life and General Insurance, of which USD 80 million was paid during 2008. The program involved an organisational restructure to facilitate strengthened customer focus as well as a more effective integrated distribution channel. The provision is expected to be fully utilised during 2009.

20. Income taxes

in USD millions, for the years ended December 31		2008	2007
Income tax expense – current/deferred split	Current	737	1,515
	Deferred	(1,189)	275
	Total income tax expense	(452)	1,791

in USD millions, for the years ended December 31		2008	2007
Income tax expense – policyholder/shareholder attribution	Total income tax expense attributable to policyholders	(1,184)	(83)
	Total income tax expense attributable to shareholders	732	1,874
	Total income tax expense	(452)	1,791

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

in USD millions, for the years ended December 31		Rate	2008	Rate	2007
Expected and actual income tax expense	Net income before income taxes		2,663		7,587
	Less: income tax (expense)/benefit attributable to policyholders		1,184		83
	Net income before income taxes attributable to shareholders		3,847		7,671
	Expected income tax expense attributable to shareholders computed at the Swiss statutory tax rate	22.0%	846	22.0%	1,688
	Increase/(reduction) in taxes resulting from:				
	<i>Tax rate differential in foreign jurisdictions</i>		164		231
	<i>Tax exempt and lower taxed income</i>		(10)		(123)
	<i>Non-deductible expenses</i>		98		74
	<i>Tax losses previously unrecognized or no longer recognized</i>		(262)		(185)
	<i>Prior year adjustments and other</i>		(104)		189
	Actual income tax expense attributable to shareholders	19.0%	732	24.4%	1,874
	Plus: income tax expense/(benefit) attributable to policyholders		(1,184)		(83)
	Actual income tax expense	(17.0%)	(452)	23.6%	1,791

The table above sets out the factors that cause the actual income tax expense to differ from the expected expense. In 2007, the expected to actual tax expense reconciliation was performed using the expected weighted average statutory income tax rate derived from the weighted average of the tax rates of the various jurisdictions in which the Group operates. In 2008 the Swiss Statutory tax rate of 22 percent was used instead. This is the rate applicable in the jurisdiction where the ultimate parent company is resident. This presentation is considered to be more relevant for the Group as it will produce greater comparability of the components of the income tax expenses in the future. Comparatives have been amended accordingly. The change had no impact on the actual tax rate applied in 2007.

Table 20.4			
Current tax receivables and payables		in USD millions, as of December 31	
		2008	2007
	Current tax receivables	621	743
	Current tax payables	(1,025)	(1,643)
	Net current tax payables	(404)	(900)

Table 20.5			
Deferred tax assets and liabilities		in USD millions, as of December 31	
		2008	2007
	Deferred tax assets	2,901	1,682
	Deferred tax liabilities	(3,485)	(4,057)
	Net deferred tax liabilities	(583)	(2,375)

Table 20.6			
Development of net deferred tax liabilities		in USD millions	
		2008	2007
	As of January 1	(2,375)	(2,030)
	Net change recognized in the income statement	1,189	(275)
	Net change recognized in equity	1,380	58
	Net changes due to acquisitions/(divestments)	(1,029)	7
	Foreign currency translation effects	253	(135)
	As of December 31	(583)	(2,375)

The cumulative amount of deferred tax credited to shareholders' equity, net of foreign currency translation effects, amounted to USD 1,720 million and USD 340 million for the years ended December 31, 2008 and 2007, respectively.

USD 1,029 million increase in deferred tax liabilities resulted from the acquisitions in 2008 as disclosed in note 5, of which USD 485 million relates to non-controlling interests.

Table 20.7			
Deferred taxes – policyholder/ shareholder attribution		in USD millions, as of December 31	
		2008	2007
	Net deferred tax assets/(liabilities) attributable to policyholders	544	(566)
	Net deferred tax assets/(liabilities) attributable to shareholders	(1,128)	(1,809)
	Net deferred tax liabilities	(583)	(2,375)

Table 20.8

**Deferred tax
assets/(liabilities)
analysis
by source**

in USD millions, as of December 31

	2008		2007	
	Assets	Liabilities	Assets	Liabilities
Gross deferred tax				
Deferred acquisition and origination costs	65	(584)	134	(605)
Depreciable and amortizable assets	22	(43)	32	(8)
Life policyholders' benefits and deposits ¹	20	–	11	–
Unrealized (gains)/losses on available-for-sale investments and cash flow hedges	965	(332)	284	(288)
Accruals & deferred income	239	–	109	–
Reserves for losses and loss adjustment expenses	569	(46)	585	–
Reserves for unearned premiums	744	(253)	700	(296)
Pensions and other employee benefits	384	–	228	–
Other assets/liabilities	658	(30)	652	(31)
Tax loss carryforwards	691	–	568	–
Gross deferred tax assets/(liabilities) before valuation allowance	4,357	(1,289)	3,303	(1,228)
Valuation allowance	(167)	–	(393)	–
Gross deferred tax assets/(liabilities) after valuation allowance	4,190	(1,289)	2,910	(1,228)
Deferred tax assets	2,901		1,682	
Deferred acquisition and origination costs	22	(2,330)	10	(2,130)
Depreciable and amortizable assets	191	(1,592)	131	(1,817)
Life policyholders' benefits and deposits ¹	421	(816)	176	(578)
Unrealized (gains)/losses on available-for-sale investments and cash flow hedges	710	(355)	218	(285)
Accruals & deferred income	66	(125)	92	(132)
Reserves for losses and loss adjustment expenses	268	(575)	5	(683)
Reserves for unearned premiums	201	(53)	218	–
Deferred front-end fees	629	–	669	–
Pensions and other employee benefits	435	(21)	364	(36)
Other assets/liabilities	970	(1,706)	386	(591)
Tax loss carryforwards	183	–	20	–
Gross deferred tax assets/(liabilities) before valuation allowance	4,095	(7,573)	2,289	(6,252)
Valuation allowance	(6)	–	(94)	–
Gross deferred tax assets/(liabilities) after valuation allowance	4,089	(7,573)	2,195	(6,252)
Deferred tax liabilities		(3,485)		(4,057)
Net deferred tax liabilities		(583)		(2,375)

¹ Includes reserves for unit-linked contracts.

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

As of December 31, 2008 the aggregate amount of temporary differences associated with investments in subsidiaries, branches and associates and interests in joint ventures, for which deferred tax liabilities have not been recognized

approximated USD 17 billion. In the remote scenario in which these temporary differences were to reverse simultaneously, the resulting tax liabilities would be very limited due to participation exemption rules.

Table 20.9

**Tax losses
carryforwards
and tax credits**

in USD millions, as of December 31	2008	2007
For which deferred tax assets have been recognized, expiring		
< 5 years	42	17
> 5 and < 20 years	1,399	765
> 20 years or with no time limitation	1,715	110
Subtotal	3,156	892
For which deferred tax assets have not been recognized, expiring		
> 5 and < 20 years	203	1,226
Subtotal	203	1,226
Total	3,359	2,118

The tax rates applicable to tax losses for which a deferred tax asset has not been recognized are 35 percent for both the years 2008 and 2007.

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

Management assesses the recoverability of the deferred tax assets carrying values based on future years taxable income projections and believes that the carrying values of the deferred tax assets as of December 31, 2008, are recoverable.

21. Debt

Table 21.1		2008	2007
Debt	in USD millions, as of December 31		
a) Debt related to capital markets and banking activities			
Zurich Capital Markets	Various debt instruments payable within 1 year	2,079	800
	Various debt instruments payable in more than 1 year	–	48
Zurich Financial Services			
EUB Holdings Limited	Various debt instruments payable within 1 year	447	814
	Various debt instruments payable in more than 1 year	1	1
Debt related to capital markets and banking activities		2,527	1,663
b) Senior debt			
Zurich Finance (USA), Inc.	3.50% CHF 300 bond, due July 2008	–	264
	3.50% CHF 300 bond, due November 2011 ¹	283	–
	4.50% EUR 1,000 bond, due September 2014 ²	1,395	1,441
Kemper Corporation	Various debt instruments, due in 2009	23	26
Zurich Insurance Company	3.875% CHF 1,000 bond, due July 2011	938	884
	3.75% CHF 500 bond, due September 2013	463	–
	Various debt instruments payable within 1 year	100	50
Other	Various debt instruments payable within 1 year	1	54
	Various debt instruments payable in more than 1 year	156	111
Senior debt		3,358	2,830
c) Subordinated debt			
Zurich Finance (UK) plc	6.625% GBP 450 bond, undated notes ³	648	879
Zurich Finance (USA), Inc.	5.75% EUR 500 bond, due October 2023	687	720
	4.5% EUR 500 bond, due June 2025 ⁴	691	670
ZFS Finance (USA) Trust I	Series I 6.15% USD 600 ECAPS, due December 2065	569	595
ZFS Finance (USA) Trust II	Series II 6.45% USD 700 ECAPS, due December 2065	672	690
ZFS Finance (USA) Trust III	Series III Floating Rate USD 400 ECAPS, due December 2065	318	397
ZFS Finance (USA) Trust IV	Series IV 5.875% USD 500 Trust Preferred Securities, due May 2062	498	497
ZFS Finance (USA) Trust V	Series V 6.5% USD 1,000 Trust Preferred Securities, due May 2067	994	994
Other	Various debt instruments payable in more than 1 year	21	29
Subordinated debt		5,096	5,471
Total senior and subordinated debt		8,455	8,300
Total debt		10,981	9,963

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

² The bond is part of a qualifying cash flow hedge (80% of the total) and fair value hedge (20% of the total). (see note 7)

³ The holders of these notes benefit from the Replacement Capital Covenant which states that if Series IV and V Fixed/Floating Trust Preferred Securities, issued by ZFS Finance (USA) Trusts IV and V, are called before 2042 and 2047 respectively, the Group will issue a replacement debt instrument with terms and provisions that are as or more equity-like than the replaced notes.

⁴ This bond is part of a qualifying fair value hedge relationship. (see note 7)

None of the debt instruments listed above were in default as of December 31, 2008 and 2007.

a) Debt related to capital markets and banking activities

Debt related to capital markets and banking activities increased from USD 1,663 million as of December 31, 2007 to USD 2,527 million as of December 31, 2008. This is largely due to ZCM Holdings having increased its debt by USD 1.2 billion, of which USD 700 million was lent to our banking operation and classified as operational debt. This funding was used to finance increased banking activity and to replace corporate and interbank deposits which decreased from USD 815 million to USD 448 million.

b) Senior debt

The Group's Euro Medium Term Note Programme (EMTN Programme) allows for the issuance of senior and subordinated notes up to a maximum of USD 10 billion. All issuances are guaranteed by Zurich Insurance Company, Zurich Finance (USA), Inc., Zurich Finance (UK) p.l.c. and Zurich Insurance Company, are issuing entities under the EMTN Programme and all entities have debt outstanding as of December 31, 2008.

CHF 300 million of senior bonds matured on July 22, 2008. On September 23, 2008 CHF 300 million of senior bonds were issued by Zurich Finance (USA), Inc. with a fixed coupon of 3.5 percent and a maturity of November 2011. On September 23, 2008 CHF 500 million of senior bonds were issued by Zurich Insurance Company with a fixed coupon of 3.75 percent and a maturity of September 2013. Both issues were made under the existing EMTN Programme.

c) Subordinated debt

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

On March 27, 2008, Zurich Holding Company of America (ZHCA), a subsidiary of the Group, purchased USD 80.5 million of Series III Floating Rate ECAPS. This purchase resulted in the Group recognizing a pre-tax gain of USD 18 million. On December 18, 2008 ZHCA purchased USD 28 million of Series I 6.15 percent ECAPS and USD 20 million of Series II 6.45 percent ECAPS. This purchase resulted in the Group recognizing a pre-tax gain of USD 23 million.

No new subordinated debt issuances took place in 2008.

Table 21.2

Description and features of significant subordinated debt	in USD millions			
	Description	Coupon conditions	Call/ redemption date	Redemption conditions ³
	6.625% GBP 450 bond, undated notes	6.625% payable annually up to October 2, 2022 and then reset every 5 years to the reset rate of interest. ¹	Every five years on or after October 2, 2022	Redeemable in whole every five years at par plus any accrued interest.
	5.75% EUR 500 bond, due October 2023	5.75% payable annually up to October 2, 2013 and then reset quarterly to 3-month EURIBOR plus 2.67%.	Quarterly on or after October 2, 2013	Redeemable in whole quarterly at par plus any accrued interest.
	4.5% EUR 500 bond, due June 2025	4.5% payable annually up to June 15, 2015 and then reset quarterly to 3-month EURIBOR plus 2.20%.	Quarterly on or after June 15, 2015	Redeemable in whole quarterly at par plus any accrued interest.
	Series I 6.15% Fixed/Adjustable Rate USD 600 ECAPS, due December 2065	6.15% payable semi-annually until December 15, 2010 and then reset quarterly to the adjustable rate plus 1.75%. ²	Quarterly on or after December 15, 2010	Redeemable in whole or in part at par plus any accumulated and unpaid distributions.
	Series II 6.45% Fixed/Adjustable Rate USD 700 ECAPS, due December 2065	6.45% payable semi-annually until June 15, 2016 and then reset quarterly to the adjustable rate plus 2.00%. ²	Quarterly on or after June 15, 2016	Redeemable in whole or in part at par plus any accumulated and unpaid distributions.
	Series III Floating Rate USD 400 ECAPS, due December 2065	3-month LIBOR plus 1.15% reset quarterly until December 15, 2010 and then 3-month LIBOR plus 2.15%.	Quarterly on or after December 15, 2010	Redeemable in whole or in part at par plus any accumulated and unpaid distributions.
	Series IV 5.875% USD 500 Fixed/Floating Trust Preferred Securities, due May 2062	5.875% payable semi-annually until May 9, 2012 and then reset quarterly to 3-month LIBOR plus 1.815%.	Quarterly on or after May 9, 2012	Redeemable in whole or in part at par plus any accumulated and unpaid distributions.
	Series V 6.5% USD 1,000 Fixed/Floating Trust Preferred Securities, due May 2067	6.5% payable semi-annually until May 9, 2017 and then reset quarterly to 3-month LIBOR plus 2.285%.	Quarterly on or after May 9, 2017	Redeemable in whole or in part at par plus any accumulated and unpaid distributions.

¹ Reset rate of interest is equal to the gross redemption yield on the benchmark five-year Gilt as determined by the Calculation bank, plus 2.85% per annum.

² Adjustable rate is equal to the greatest of (i) the 3-month LIBOR rate; (ii) the 10-year Treasury CMT (Constant Maturity Treasury) Rate; and (iii) the 30-year Treasury CMT Rate, subject to a maximum under (ii) and (iii) of 13.25% Series I and 13% for Series II.

³ All subordinated debt instruments are also subject to mandatory redemption as a result of various tax, default or other events.

Maturity schedule of outstanding debt

Table 21.3

in USD millions, as of December 31

	2008		2007	
	Carrying value	Undiscounted cash flow	Carrying value	Undiscounted cash flow
< 1 year	2,650	3,139	1,983	2,449
1 to 2 years	11	446	76	541
2 to 3 years	1,237	1,659	10	453
3 to 4 years	13	392	884	1,329
4 to 5 years	463	835	1	415
5 to 10 years	1,513	2,857	1,541	3,415
> 10 years	5,096	7,123	5,469	8,811
Total	10,981	16,451	9,963	17,413

Debt maturities shown in table 21.3 reflect original contractual dates without taking early redemption options into account. For call/redemption dates, refer to table 21.2. The total notional amount of debt due in each period is not materially different from the total carrying amount disclosed in table 21.3. Undiscounted cash flows include interest and principal cash flows on debt outstanding as at December 31, 2008 and December 31, 2007. All debt is assumed to mature within 20 years of the balance sheet date without refinancing and where the Group has the option to repay the debt, the option is assumed to expire. Floating rates of interest are assumed to be constant as at December 31, 2008 (December 31, 2007 respectively) going forward. The aggregated cash flows are converted into USD at the balance sheet date.

Table 21.4

in USD millions, for the years ended December 31

Interest expense on debt

	2008	2007
Debt related to capital markets and banking activities	127	148
Senior debt	141	132
Subordinated debt	331	404
Total	599	685

Interest expense on debt

Interest expense on debt decreased from USD 685 million to USD 599 million. This was predominantly due to prior year interest expense on subordinated debt including a one-off charge of USD 55 million related to the early redemption of USD 1 billion of Capital Trust Securities in May 2007 and related refinancing at lower interest rates.

Credit facilities

The Group has access to a syndicated revolving credit facility of USD 3 billion that terminates in 2012. Zurich Group Holding, together with Zurich Insurance Company and Farmers Group, Inc. are guarantors of the facility and can draw up to USD 1.25 billion, USD 1.5 billion and USD 250 million, respectively. No borrowings were outstanding under this facility as of December 31, 2008.

Dunbar Bank and Zurich Bank have access to various committed credit facilities totaling GBP 405 million and GBP 230 million, respectively. As of December 31, 2008, GBP 50 million had been drawn under these credit facilities.

In addition, ZIC has access to a USD 300 million credit facility expiring in 2010 for the sole purpose of financing surplus notes issued by the Leschi Life Assurance Company (Leschi), a special purpose reinsurer owned by Farmers New World Life (FNWL) and to which FNWL cedes business subject to Regulation XXX (Triple X). As of December 31, 2008, USD 100 million had been drawn under this credit facility.

Financial debt

Financial debt consists of all debt items that are included in financial leverage calculations of rating agencies. As of December 31, 2008 and December 31, 2007 financial debt consisted of the following components.

Table 21.5

Financial debt	in USD millions, as of December 31	2008	2008	2008	2007
		Reported	Adjustments	Financial Debt	Financial Debt
	Debt related to capital markets and banking activities	2,527	(1,148)	1,379	848
	Senior debt	3,358	(200)	3,158	2,680
	Subordinated debt	5,096	–	5,096	5,471
	Total	10,981	(1,348)	9,633	8,999

The USD 1,148 million adjustment relates to USD 448 million of Zurich Financial Services EUB Holdings Limited notes and loans payable and USD 700 million issued by ZCM Holdings and then lent to our banking operation as described above, while the USD 200 million adjustment contains USD 100 million of non-recourse debt and USD 100 million drawn under the above mentioned Leschi credit facility.

22. Shareholders' equity

Table 22.1

Share capital	Share capital in CHF	Number of shares	Par value in CHF
Issued share capital			
As of December 31, 2006	14,474,940	144,749,399	0.10
New shares issued from contingent capital in 2007	79,742	797,421	0.10
As of December 31, 2007	14,554,682	145,546,820	0.10
Capital reduction by canceling shares bought back under the share buy-back program announced in 2007	(343,250)	(3,432,500)	0.10
New shares issued from contingent capital in 2008	830	8,300	0.10
As of December 31, 2008	14,212,262	142,122,620	0.10
Authorized, contingent and issued share capital			
As of December 31, 2007	16,023,123	160,231,227	0.10
As of December 31, 2008	15,679,873	156,798,727	0.10

a) Issued share capital

As of December 31, 2008, Zurich Financial Services had 142,122,620 issued and fully paid registered shares of CHF 0.10 par value, amounting to total issued share capital of CHF 14,212,262.00. As of December 31, 2007, the share capital amounted to CHF 14,554,682.00, divided into 145,546,820 fully paid registered shares of CHF 0.10 par value.

At the Annual General Meeting on April 3, 2008 the shareholders approved a share capital reduction of CHF 343,250.00 from CHF 14,554,682.00 to CHF 14,211,432.00 by cancelling 3,432,500 registered shares that were bought back under the buy-back program announced on February 15, 2007. The effective date of the capital reduction was June 27, 2008. During the year 2008, a total of 8,300 shares have been issued to employees out of the contingent capital.

In 2007, the shareholders at the Annual General Meeting on April 3, 2007 approved an increase of the contingent share capital for the issuance of new registered shares to employees of the Group from CHF 75,755.60 by CHF 324,244.40 to a new maximum of CHF 400,000 by issuing up to 4,000,000 registered shares payable in full with a nominal value of CHF 0.10 each. During the year 2007, a total of 797,421 shares were issued to employees.

b) Authorized share capital

Until June 1, 2010, the Board of Zurich Financial Services is authorized to increase the share capital by an amount not exceeding CHF 600,000.00 by issuing up to 6,000,000 fully paid registered shares with a nominal value of CHF 0.10 each. An increase in partial amounts is permitted. The Board determines the date of issue of such new shares, the issue price, type of payment, conditions for exercising pre-emptive rights, and the beginning of the dividend entitlement. The Board may issue such new shares by means of a firm underwriting by a banking institution or syndicate with subsequent offer of those shares to current shareholders. The Board may allow the expiry of pre-emptive rights which have not been exercised, or it may place these rights as well as shares, the pre-emptive rights of which have not been exercised, at market conditions.

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

c) Contingent share capital

Capital market instruments and option rights to shareholders

The share capital of Zurich Financial Services may be increased by an amount not exceeding CHF 548,182.80 by the issuance of up to 5,481,828 fully paid registered shares with a nominal value of CHF 0.10 each (i) by exercising of conversion and/or option rights which are granted in connection with the issuance of bonds or similar debt instruments by Zurich Financial Services or one of its Group companies in national or international capital markets; and/or (ii) by exercising option rights which are granted to current shareholders. When issuing bonds or similar debt instruments connected with conversion and/or option rights, the pre-emptive rights of the shareholders will be excluded. The current owners of conversion and/or option rights shall be entitled to subscribe for the new shares. The conversion and/or option conditions are to be determined by the Board.

The Board of Directors is authorized, when issuing bonds or similar debt instruments connected with conversion and/or option rights, to restrict or withdraw the right of shareholders for advance subscription in cases where such bonds are issued for the financing or re-financing of a takeover of an enterprise, of parts of an enterprise, or of participations. If the right for advance subscription is withdrawn by the Board, the convertible bond or warrant issues are to be offered at market conditions (including standard dilution protection provisions in accordance with market practice) and the new shares are issued at then current convertible bond or warrant issue conditions. The conversion rights may be exercisable during a maximum of 10 years and option rights for a maximum of 7 years from the time of the respective issue. The conversion or option price or its calculation methodology shall be determined in accordance with market conditions, whereby for shares of Zurich Financial Services the quoted share price is to be used as a basis.

Employee participation

On February 14, 2007, the Board of Directors of Zurich Financial Services decided to allow the issuance of up to 4,000,000 shares out of the contingent share capital to employees of the Group. A respective proposal for the increase of the contingent share capital was made by the Board of Directors to the shareholders and was approved at the Annual General Meeting on April 3, 2007. On December 31, 2007, the contingent share capital, to be issued to employees of Zurich Financial Services and Group companies, amounted to CHF 320,257.90 or 3,202,579 fully paid registered shares with a nominal value of CHF 0.10 each. During 2008, 8,300 shares were issued to employees out of the contingent share capital under the program described above. As a result, on December 31, 2008 the remaining contingent share capital, which can be issued to employees of Zurich Financial Services and its subsidiaries, amounts to CHF 319,427.90 or 3,194,279 fully paid registered shares with a nominal value of CHF 0.10 each. The pre-emptive rights of the shareholders, as well as the right for advance subscription, are excluded. The issuance of shares or respective option rights to employees is subject to one or more regulations to be issued by the Board of Directors and take into account performance, functions, levels of responsibility and criteria of profitability. Shares or option rights may be issued to the employees at a price lower than that quoted on the stock exchange.

d) Preferred securities

Table 22.2

Preferred securities	Preferred securities in USD	Number of securities	Par value in USD
As of December 31, 2006	700,000,000	700,000	1,000
Redeemed securities	–	–	1,000
As of December 31, 2007	700,000,000	700,000	1,000
Redeemed securities	(125,000,000)	(125,000)	1,000
As of December 31, 2008 ¹	575,000,000	575,000	1,000

¹The amount excludes issuance costs of USD 14 million and USD 29 million as of December 31, 2008 and 2007, respectively.

In February 2001, the Group placed six series of Trust Capital Securities (Zurich RegCaPS) for a total amount of USD 1,125 million (USD 1,096 million net of issuance costs) with a limited number of qualified institutional and corporate US investors. The securities, which were issued under Rule 144A in the US, are perpetual, non-cumulative and have a par value of USD 1,000 each. They have no voting rights, except in certain specified circumstances and are linked to

Farmers Group, Inc. Class C shares. On March 30, 2006, April 11, 2006 and April 18, 2008, the Group redeemed the Series I, III and IV of the Zurich RegCaPS, respectively. The liquidation amounts totaled USD 550 million in aggregate. Of the remaining series totaling USD 575 million, one has a fixed rate coupon of 6.58 percent and two have floating rate coupons at LIBOR +71 basis points. These coupon rates step up after the first call dates. The Group has the option to call all outstanding securities in 2011.

e) Additional paid-in capital

This reserve is not ordinarily available for distribution.

f) Treasury shares

Table 22.3

Treasury shares

number of shares, as of December 31	2008	2007
Treasury shares	5,219,803	5,839,154

Treasury shares comprise shares repurchased under the share buy-back program and shares acquired in the market held to cover employee share and option plans. The number of treasury shares amounted to 5,219,803 and 5,839,154 as of December 31, 2008 and 2007, respectively.

On February 13, 2008 the Board of Zurich Financial Services authorized a share buy-back program for the repurchase of up to CHF 2.2 billion worth of shares over the course of 2008. As of December 31, 2008 3,750,500 fully paid shares, with a nominal value of CHF 0.10, were bought back at an average price of CHF 293 per share, at a total cost of CHF 1.1 billion.

On February 14, 2007 the Board of Zurich Financial Services authorized a share buy-back program. 3,432,500 fully paid shares, with a nominal value CHF 0.10, have been bought back at an average price of CHF 364 per share, at a total cost of CHF 1.2 billion. The shareholders at the Annual General Meeting of April 3, 2008 approved a share capital reduction by CHF 343,250.00 from CHF 14,554,682.00 to CHF 14,211,432.00 by cancelling these 3,432,500 registered shares. The effective date of the capital reduction was June 27, 2008.

g) Earnings per share

Table 22.4				
Earnings per share for the years ended December 31				
	Net income attributable to common shareholders (in USD millions)	Weighted average number of shares	Per share (USD)	Per share (CHF) ¹
2008				
Basic earnings per share	3,007	137,943,218	21.80	23.53
Effect of potentially dilutive shares related to share-based compensation plans		1,049,425	(0.16)	(0.18)
Diluted earnings per share	3,007	138,992,643	21.63	23.35
2007				
Basic earnings per share	5,668	142,685,268	39.73	47.63
Effect of potentially dilutive shares related to share-based compensation plans		1,572,388	(0.43)	(0.52)
Diluted earnings per share	5,668	144,257,656	39.29	47.11

¹ The translation from USD to CHF is shown for information purposes only and has been calculated at the Group's average exchange rates for the years ended December 31, 2008 and 2007, respectively.

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

23. Employee benefits

The Group had 57,609 and 58,220 employees (full-time equivalents) as of December 31, 2008 and 2007, respectively. Personnel and other related costs incurred for the year ended December 31, 2008 and 2007, were USD 5,262 million and USD 4,922 million, including wages and salaries of USD 4,344 million and USD 4,181 million, respectively.

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

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

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

a) Defined benefit plans

Defined benefit pension plans

Employees of the Group's operating companies are covered under various pension plans, the largest of which are in the UK, US, Germany and Switzerland. Certain companies provide defined benefit plans, some of which provide benefits related to employee's service periods and final pensionable earnings and others provide cash balance plans, where the participants receive the benefit of annual contributions made by both employer and employee accumulated with credits reflecting for example the investment return achieved on the assets. Eligibility for participation in the various plans is either based on completion of a specified period of continuous service or from the date of commencement of employment.

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

For the defined benefit pension plans, total contributions to funded pension plans and benefit payments by the Group are currently estimated at USD 451 million for 2009 compared with USD 470 million estimated in the previous year for 2008. The actual amount may differ.

Other defined post-employment benefits

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

The tables below show the funded status of the Group's plans; this being the pension plans' assets at fair value less the pension plans' liabilities based on the present value of the obligations. Plans that are wholly unfunded are shown separately from plans that are wholly or partly funded.

Table 23.1

Status of funded defined benefit plans

in USD millions, as of December 31

	Defined benefit pension plans			Other defined post-employment benefits		
	2008	2007	2006	2008	2007	2006
Present value of funded obligations	(12,680)	(13,653)	(12,190)	(93)	(66)	(70)
Fair value of plan assets	10,879	13,285	11,071	–	5	10
Funded status	(1,801)	(368)	(1,119)	(92)	(61)	(60)
Unrecognized past service cost	(1)	–	2	–	–	–
Cumulative impact of asset ceiling	(7)	(62)	–	–	–	–
Liability – funded obligations	(1,808)	(430)	(1,117)	(92)	(61)	(60)

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

Table 23.2

Status of unfunded defined benefit plans

in USD millions, as of December 31

	Defined benefit pension plans			Other defined post-employment benefits		
	2008	2007	2006	2008	2007	2006
Present value of unfunded obligations	(210)	(207)	(985)	(183)	(208)	(196)
Unrecognized past service cost	–	–	–	(1)	(2)	(1)
Liability – unfunded obligations	(209)	(207)	(985)	(184)	(210)	(197)

Table 23.3

Expense recognized in income	in USD millions, as of December 31	Defined benefit pension plans		Other defined post-employment benefits	
		2008	2007	2008	2007
		Current service cost	(300)	(305)	(5)
Interest cost	(715)	(659)	(15)	(14)	
Expected return on plan assets	727	704	–	–	
Past service cost	(14)	(8)	–	–	
Gains on curtailment or settlement	2	–	–	–	
Net pension expense		(300)	(269)	(19)	(19)

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

Table 23.4

Fair value of assets held in funded defined benefit pension plans	in USD millions, as of December 31	Defined benefit pension plans		Other defined post-employment benefits	
		2008	2007	2008	2007
		Mortgage loans	409	383	–
Cash and cash equivalents	111	126	–	–	
Short-term investments	16	6	–	4	
Equity securities	2,847	4,530	–	–	
Debt securities	6,742	7,404	–	1	
Real estate	671	793	–	–	
Other investments	83	43	–	–	
Total		10,879	13,285	–	5

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

Table 23.5

Movement in funded and unfunded defined benefit pension plan obligation	in USD millions	Defined benefit pension plans		Other defined post-employment benefits	
		2008	2007	2008	2007
		Benefit obligation as of January 1	(13,860)	(13,175)	(274)
Current service cost	(300)	(305)	(5)	(6)	
Past service cost including plan amendments	(15)	(5)	–	2	
Interest cost	(715)	(659)	(15)	(14)	
Actuarial gain/(loss) included in other comprehensive income	(320)	433	3	3	
Employee contributions	(42)	(35)	(4)	(3)	
Effect of curtailments or settlements	2	–	–	–	
Benefits paid	512	462	16	17	
Effects of business combinations and other transfers	(42)	(156)	(15)	2	
Foreign currency translation effects	1,894	(419)	13	(8)	
Benefit obligation as of December 31		(12,886)	(13,860)	(280)	(274)

Movement in fair value of plan assets – funded plans

Table 23.6
in USD millions

	Defined benefit pension plans		Other defined post-employment benefits	
	2008	2007	2008	2007
Fair value of plan assets as of January 1	13,286	11,071	5	10
Expected return on plan assets	727	704	–	–
Actuarial gain/(loss) included in other comprehensive income	(1,485)	188	–	–
Employer contributions	533	1,265	7	10
Employee contributions	42	36	4	3
Benefits paid	(512)	(462)	(16)	(17)
Effects of business combinations and other transfers	52	90	–	–
Foreign currency translation effects	(1,763)	394	–	–
Fair value of plan assets as of December 31	10,879	13,286	–	5

The actual returns on defined benefit pension plan assets for the years ended December 31, 2008 and 2007 were losses of USD 758 million and gains of USD 892 million, respectively.

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

Movement in liability for funded and unfunded plans

Table 23.7
in USD millions

	Defined benefit pension plans		Other defined post-employment benefits	
	2008	2007	2008	2007
Liability as of January 1	(637)	(2,102)	(271)	(257)
Current year expense	(300)	(269)	(19)	(19)
Contributions paid	533	1,264	7	10
Change in liability due to asset ceiling	51	(56)	–	–
Actuarial gain/(loss) passed through other comprehensive income	(1,805)	697	3	3
Effects of business combinations and other transfers	(6)	(58)	(9)	21
Foreign currency translation effects	148	(113)	11	(29)
Liability as of December 31	(2,017)	(637)	(277)	(271)

The movements in actuarial gains and losses due to differences between actual and expected experience on the Group's plan assets and defined benefit obligations, together with the impact of changes in actuarial assumptions to reflect economic conditions at the year end are summarized below:

Actuarial gain/(loss)

Table 23.8
in USD millions

	2008	2007	2006
Actuarial gain/(loss) as of January 1	(1,308)	(1,870)	(2,420)
Experience adjustments on plan liabilities	(147)	(118)	(375)
Experience adjustments on plan assets	(1,485)	188	447
Changes due to discount rate assumptions	223	975	–
Changes due to other actuarial assumptions	(392)	(345)	528
Asset ceiling recognition	51	(64)	–
Foreign currency translation effects	152	(75)	(50)
Total actuarial gain/(loss) as of December 31	(2,907)	(1,308)	(1,870)

The actuarial gain/(loss) net of policyholder participation and taxes amounts to a loss of USD 1,933 million and USD 818 million as of December 31, 2008 and 2007, respectively.

The principal financial assumptions used to calculate the Group's major defined benefit pension and defined post-employment benefit obligations and the Group's pension expenses are as follows:

Assumptions used in determining the actuarial liabilities for major defined benefit pension plans	2008				2007			
	Switzerland	UK	US	Germany	Switzerland	UK	US	Germany
Discount rate	2.9%	5.9%	6.1%	5.7%	3.7%	5.5%	6.2%	5.5%
Inflation rate	1.6%	3.0%	2.1%	1.8%	1.5%	2.5%	2.2%	1.6%
Expected long-term rate of return on assets	4.1%	5.9%	6.8%	5.0%	4.1%	5.4%	7.3%	5.0%
Expected future salary increases	2.2%	4.3%	4.4%	3.1%	2.1%	3.7%	4.6%	3.0%
Expected future pension increases	1.1%	3.2%	0.3%	1.8%	1.0%	2.5%	0.3%	1.6%
Current average life expectancy for a 65 year old male	22.5	25.0	19.3	18.0	22.5	22.0	19.7	18.0

The expected long-term rate of return on assets is derived separately for each of the Group's funded benefit plans. Each major asset class is assigned an expected long-term rate of return, net of investment expenses, appropriate for the environment in which that plan is invested. The overall expected long-term rate of return on assets for a plan is calculated as the weighted average of the expected return for each asset class, weighted by the plan's target allocation to each asset class.

The mortality assumptions in each country have been based on the most up to date mortality tables in accordance with the general use in that market. Where appropriate these tables make allowance for projected future improvements in life expectancy.

Assumptions used in determining the actuarial liabilities for other defined post-employment benefit plans	2008	2007
	US	US
Discount rate	6.0%	6.2%
Expected long-term rate of return on assets	0.0% ¹	3.1%
Expected increase in long-term health cost	7.2%	8.5%

¹ Assets expected to be reduced to zero in January 2009.

The actuarial assumptions of healthcare cost trend rates have an impact on the amounts recognized. A one percentage point change in the health care cost trend rate would have the effects on amounts recognized in 2008 as set out in table 23.11:

Table 23.11

	1% increase	1% decrease
Effect on total service cost and interest cost	– ¹	– ¹
Effect on benefit obligation	5	(1)

¹ Below USD 1 million.

b) Defined contribution pension plans

Certain of the Group's operating companies sponsor defined contribution pension plans. Eligibility for participation in such plans is either based on completion of a specified period of continuous service or the date of commencement of employment. The plans provide for voluntary contributions by employees and contributions by the employer which typically range from 3 percent to 15 percent of annual pensionable salary, depending on a number of factors. The Group's contributions under these plans amounted to USD 52 million and USD 51 million in 2008 and 2007, respectively.

24. Share-based compensation and cash incentive plans

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

a) Cash incentive plans

Various businesses throughout the Group operate short-term incentive programs for executives, management and, in some cases, for employees of that business unit. Awards are made in cash, based on the accomplishment of both organizational and individual performance objectives. The expenses recognized for these cash incentive plans amounted to USD 285 million and USD 365 million for the years ended December 31, 2008 and 2007, respectively.

b) Share-based compensation plans for employees and executives

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

Table 24.1

	in USD millions, as of December 31	
	2008	2007
Total option-based expenses	35	49
Total share-based expenses	139	121
Total expenses	174	170

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

Employee share plans

Share Incentive Plan for employees in the UK

The Group established an Inland Revenue approved Share Incentive Plan and launched the partnership shares element of this plan in 2003. This plan enables participating employees to make monthly purchases of Zurich Financial Services shares at the prevailing market price out of their gross earnings. There were 420 and 439 participants in the partnership element of the plan as of December 31, 2008 and 2007, respectively. The Group also operates the profit-sharing element of the Share Incentive Plan (reward shares) which was launched in 2004 with annual share allocations being made in May each year subject to business performance. The awards are based on the performance of the participating employee's business unit for the year, subject to a maximum award of 5 percent of participant's base salary (before any flexible benefit adjustments) or GBP 3,000. The total number of participating employees in the reward share element of the plans as of December 31, 2008 and 2007 was 6,269 and 6,952 respectively.

Share Incentive Plans for employees in Switzerland

The Share Incentive Plan introduced for employees in Switzerland continued to operate in 2008. Under this plan, employees have the option to acquire sales-restricted shares at a 30 percent discount to the market value. The maximum permitted investment in shares is CHF 3,500 per employee. During 2008, 6,282 employees participated in the Employee Incentive Plan compared with 6,369 in 2007. For the year ended December 31, 2008, 1,909 employees received shares under the 2007 employee performance share plan. For the year ended December 31, 2007, 1,929 employees received shares under the 2006 employee performance share plan.

Share-based compensation plans for executives

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

Senior Executive long-term incentive plans

Each year, Senior Executives are granted performance shares and performance options, which vest on an annual basis over the subsequent three year period. The actual level of vesting, which can be between 0 percent and 175 percent, with an additional discretion to increase vesting to a maximum of 200 percent, of the original number of shares and/or options granted, depends on the performance of the Group during the previous calendar year. For 2007 and future grants we are looking back to a three year performance period. The current performance metrics are the Group's return on equity (ROE) and the position of its total annual relative shareholder return measured against an international peer group of insurance companies. One-half of the shares that actually vest are sales-restricted for a further period of three years. The options have a seven year term from the date of grant. Grants under the plan are made annually each April. The actual number of performance shares and performance options granted is determined such that the economic value is a defined percentage of annual salary in the year of allocation. There were a total of 170 and 159 participants in this plan as of December 31, 2008 and 2007, respectively.

Executive long-term performance share plans

Each year, selected executives are granted performance shares which vest on an annual basis over the subsequent three year period. The actual level of vesting, which can be between 0 percent and 175 percent, with an additional discretion to increase vesting to a maximum of 200 percent, of the original number of shares granted, depends on the performance of the Group during the previous calendar year. For 2007 and future grants we are looking back to a three year performance period. The current performance metrics are the Group's return on equity (ROE) and the position of its total annual relative shareholder return measured against an international peer group of insurance companies. The actual number of performance shares granted at the beginning of the performance period is determined such that the economic value is a defined percentage of the annual salary in the year of allocation. Actual awards under these plans are made fully in shares of Zurich Financial Services. One-half of the shares that actually vest are sales-restricted for a further period of three years. There were a total of 833 and 746 participants in this plan as of December 31, 2008 and 2007, respectively.

c) Further information on performance share and option plans

Table 24.2

Movements in options granted under the various equity participation plans	Number of shares under option		Weighted average exercise price (in CHF)	
	2008	2007	2008	2007
	As of January 1	2,387,357	2,272,040	273
Options granted	855,214	702,402	314	317
Options forfeited	(61,701)	(75,513)	321	302
Options exercised	(288,287)	(422,451)	182	217
Options expired during period	(132,674)	(89,139)	461	554
As of December 31	2,759,909	2,387,357	284	273
Exercisable options as of December 31	1,912,112	1,468,492	284	273

Certain plan participants elected in 2002 to take their option award in the form of Share Appreciation Rights (SAR). Included in table 24.2 and 24.3 are 61,318 SAR as of both December 31, 2008 and 2007, which will be settled through cash payments rather than through delivery of shares. The fair value of the SAR at grant date is determined using the Black-Scholes option pricing model. The model inputs were the same as used for calculating the value of the share options.

The average share price for Zurich Financial Services shares in 2008 and 2007 was CHF 280.49 and CHF 350.32, respectively.

Table 24.3

Share options exercised during the period	Amount	Average share price in CHF
	Exercise date	
January-April, 2008	149,446	317
May-August, 2008	60,301	293
September-December, 2008	78,540	283

Table 24.4

Range of exercise prices of options outstanding as of December 31, 2008 in CHF	Number of options	Weighted average contractual life in years	Weighted average remaining expected life in years
	100–200	126,561	7.0
201–300	860,355	7.0	2.9
301–400	1,773,451	7.1	4.7

Table 24.5

Options and shares granted during the period	for the years ended December 31		Weighted average fair value at grant date (in CHF)	
	Number		2008	2007
	2008	2007	2008	2007
Shares granted during the period	271,374	270,367	337	356
Options granted during the period ¹	855,214	702,420	67	68

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

The shares and options granted during the year are the target allocations made under the performance option and performance share plans together with any restricted share awards granted during the year. Whether these grants become vested or not will depend on whether the performance achievements are met. In case the performance achievements deviate from the initial assumptions, the expense is being adjusted.

The fair value of options granted is estimated using the Black-Scholes option pricing model, with the assumptions shown in table 24.6.

Table 24.6

Black-Scholes assumptions for fair value of options	2008	2007
Share price, in CHF ¹	337	356
Exercise price, in CHF	337	356
Assumed volatility	29.50%	25.25%
Risk-free interest rate	3.21%	2.87%
Expected dividend rate	4.50%	3.50%
Contracted option life	7 years	7 years

¹ Share price as at date of grant.

The risk-free interest rate was determined by using the seven year CHF swap rate applicable in 2008 and 2007. The implied volatility was determined based on the average of a number of several independent quotes.

25. Contingent liabilities, contractual commitments and financial guarantees

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

Table 25.1

Quantifiable commitments and contingencies	in USD millions, as of December 31	
	2008	2007
Commitments under investment agreements	4,205	4,082
Less funded commitments	(3,423)	(3,300)
Remaining commitments under investment agreements	782	782
Guarantees and letters of credit ¹	915	939
Future rent commitments	1,261	1,613
Undrawn loan commitments (capital markets and banking activities)	646	926
Other commitments and contingent liabilities	47	40

¹ Guarantee features embedded in life insurance products are not included. For such guarantee features refer to note 8 on insurance reserves.

Contractual commitments under investment agreements

The Group has committed to contribute capital to subsidiaries and third parties that engage in making investments in direct private equity and private equity funds. Commitments may be called by the counterparty over the term of the investment (generally 3 – 5 years) and must be funded by the Group on a timely basis.

Contractual commitments under lease agreements

The Group has entered into various operating leases as lessee for office space and certain computer and other equipment. Lease expenses totaled USD 198 million and USD 203 million for the years ended December 31, 2008 and 2007, respectively.

Table 25.2

Future payments under non-cancellable operating leases with terms in excess of one year	in USD millions, as of December 31, 2008	
		Rental payments
	< 1 year	229
	1 to 2 years	208
	2 to 3 years	177
	3 to 4 years	134
	4 to 5 years	112
	> 5 years	401
	Total	1,261

Financial guarantees and letters of credit

The Group knows of no event of default that would require it to satisfy financial guarantees. Irrevocable letters of credit have been issued to secure certain reinsurance contracts.

Indemnity agreements

The Group, through certain of its subsidiaries, has agreed to arrangements that cap Converium's (now Scor Holding (Switzerland) AG) and its successor companies' net exposure for losses arising out of the September 11, 2001 event at USD 289 million. As of December 31, 2008, and 2007 respectively, the Group has recorded in this respect provisions of USD 54 million.

Pledged assets

The majority of assets pledged to secure the Group's liabilities relates to debt securities pledged under short-term sale and repurchase agreements. The total amount of pledged financial assets including the securities under short-term sale and repurchase agreements amounted to USD 3,469 million and USD 5,251 million as of December 31, 2008 and 2007, respectively.

Terms and conditions associated with the financial assets pledged to secure the Group's liabilities are usual and standard in the markets in which the underlying agreements were executed.

Other contingent liabilities

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

The Group has commitments to provide collateral on certain insurance contracts in the event of a credit rating downgrade.

In common with other groups writing life assurance business in the UK, the Group remains exposed to a number of Conduct of Business issues. While provisions are maintained which reflect management's best evolving estimate of the probable costs and expenses of resolving these matters, significant uncertainty regarding the ultimate cost remains. The main area of uncertainty concerns sales advice related complaints. The key assumptions used to derive the complaint

provision are the volume of complaints, both those already recorded and an assumption as to the level of future complaints, the percentage of complaints which will be successful (the uphold rate), the average redress payable per complaint and the expenses of reviewing each case or complaint. The assumptions used to set the provision have been based on actual experience over the past three years weighted towards more recent experience.

In 2003, the Group completed the divestment of various asset management operations. As part of these agreements, the Group has guaranteed certain minimum levels of "assets under management" to the acquirers. The guarantees provide that if the "assets under management" fall below those defined levels under certain conditions, the Group may be required to compensate for these shortfalls.

On December 11, 2001, the Group divested its third party reinsurance business operated under the "Zurich Re" brand name by offering the shares of the newly established Converium to the public. As part of the formation of Converium and the subsequent public offering of its shares, the Group entered into various contracts with Converium and its subsidiaries, including certain Quota Share Retrocession Agreements. These Quota Share Retrocession Agreements, together with subsequent amendments, provide for the reinsurance premium to Converium to be retained by the Group on a funds withheld basis. The Quota Share Retrocession Agreements were amended at the end of February 2008. According to the amendment Converium no longer has the right to call for payments in cash for certain amounts of the funds withheld on pre-determined dates, as it was the case prior to the amendment.

Litigation and regulatory investigations

The Group and its subsidiaries are continuously involved in legal proceedings, claims and litigation arising, for the most part, in the ordinary course of their business operations.

In 2006, the Group settled with various US state attorneys general and state insurance regulators in connection with investigations in the US concerning certain business practices involving insurance brokers and insurance companies. In July 2006, the Group also entered into a settlement agreement to resolve consolidated class-action litigation concerning those matters. Final judgment has been entered approving the settlement, but appeals are pending. A number of individual claims not covered by the class action settlement remain pending against the Group.

In addition, in December 2008, Zurich Financial Services entered into a settlement with the U.S. Securities and Exchange Commission (SEC) resolving the SEC's investigation of certain reinsurance transactions engaged in by the Group and its subsidiaries. The SEC was investigating Converium's February 28, 2006 restatement of its financial results for the years 1998 through 2004. In that context, the Staff of the SEC made inquiries of Zurich Financial Services and certain of its subsidiaries related to reinsurance contracts entered into before 2001. Zurich agreed to pay a USD 25 million penalty and USD 1 in disgorgement to settle, without admitting or denying, charges that it had aided and abetted Converium's violations of Section 10(b) of the Exchange Act and Rule 10b-5.

Furthermore, Zurich Financial Services is a defendant in putative class-action securities lawsuits relating to its divestiture of its interest in Converium. On July 25, 2008, Zurich Financial Services and the class-action plaintiffs entered into an amended stipulation of settlement that calls for a payment of USD 28 million to settle the case in two parts on behalf of all persons and entities who purchased Converium securities between January 7, 2002 and September 2, 2004: one settlement in the US court, covering all US persons and entities, and all other persons who purchased Converium securities on US markets, and another settlement in the Amsterdam Court of Appeals, in the Netherlands, covering all non-US persons and entities who purchased Converium securities on the SWX Swiss Exchange (now SIX Swiss Exchange). The proposed US and Dutch settlements are both subject to court approval and are independent of each other. The US court approved the US settlement on December 12, 2008. A notice of appeal was filed on January 9, 2009 from various rulings by the US court. The statement of issues does not challenge or object to the settlement's terms, but rather, focuses on the court's dismissal of the plaintiff's Securities Act claims as untimely and the court's denial of plaintiff's motion to amend the complaint. The proposed Dutch settlement has not yet been presented to the Dutch court.

The Group believes that it is not a party to, nor are any of its subsidiaries the subject of, any unresolved current legal proceedings, claims, litigation and investigations that would have a material adverse effect on the Group's consolidated

financial condition. However, it is possible that the outcome of any proceedings could have a material impact on results of operations in the particular reporting period in which it is resolved.

26. Fair value of financial assets and financial liabilities

The methods and assumptions used by the Group in estimating fair value of the financial assets and liabilities are set out in note 4.

Table 26.1

Fair value (FV) and carrying value of financial assets and financial liabilities

in USD millions, as of December 31

	Total fair value		Total carrying value	
	2008	2007	2008	2007
Cash and cash equivalents	16,397	16,936	16,397	16,936
Available-for-sale:				
Debt securities	105,875	109,278	105,875	109,278
Equity securities	9,307	13,807	9,307	13,807
Total available-for-sale	115,182	123,085	115,182	123,085
Securities at FV through profit or loss:				
Trading:				
Debt securities	159	616	159	616
Equity securities	1,358	2,652	1,358	2,652
Designated at FV:				
Debt securities	16,160	18,338	16,160	18,338
Equity securities	63,731	104,134	63,731	104,134
Total securities at FV through profit or loss	81,408	125,741	81,408	125,741
Derivative assets	1,724	1,055	1,724	1,055
Held-to-maturity debt securities	5,482	5,739	5,244	5,642
Loans and receivables:				
Mortgage loans	13,090	12,800	12,820	12,718
Other loans	13,021	12,545	12,533	12,938
Deposits made under assumed reinsurance contracts	2,391	1,358	2,397	1,359
Mortgage loans given as collateral	1,313	2,266	1,233	2,243
Receivables	13,127	12,716	13,229	12,846
Other financial assets	14	18	14	18
Total loans and receivables	42,956	41,703	42,225	42,122
Other Investments:				
Short-term investments	2,307	2,929	2,307	2,929
Other	61	80	61	80
Total financial assets	265,517	317,268	264,549	317,589
Financial liabilities at FV through profit or loss:				
Trading:				
Obligation to repurchase securities	(3,608)	(5,370)	(3,608)	(5,370)
Designated at FV:				
Liabilities related to unit-linked investment contracts	(30,397)	(48,187)	(30,397)	(48,187)
Derivative liabilities	(1,388)	(276)	(1,388)	(276)
Financial liabilities held at amortized cost:				
Liabilities related to investment contracts	(122)	(117)	(122)	(117)
Liabilities related to investment contracts with DPF	(5,314)	(5,789)	(5,461)	(6,182)
Debt	(11,011)	(9,913)	(10,981)	(9,963)
Deposits received under ceded reinsurance contracts	(1,537)	(1,611)	(1,619)	(1,739)
Collateralized loans	(1,313)	(2,266)	(1,233)	(2,243)
Other financial liabilities	(2,844)	(5,162)	(2,850)	(5,272)
Total financial liabilities	(57,534)	(78,691)	(57,658)	(79,347)

27. Related party transactions

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

The table below sets out related party transactions with investments in associates reflected in the consolidated income statements and consolidated balance sheets.

Table 27.1				
Related party transactions included in the consolidated financial statements	in USD millions			
		2008	2007	
	Consolidated income statements for the years ended December 31			
	Net earned premiums and policy fees	10	9	
	Net investment income	9	16	
	Other income/(expense)	11	(3)	
	Losses and loss adjustment expenses	(8)	(8)	
	Consolidated balance sheets as of December 31			
	Policyholders' collateral and other loans	15	15	
	Receivables	7	6	
Reserves for losses and loss adjustment expenses	(8)	(3)		

Table 27.2 summarizes related party transactions with key personnel reflected in the consolidated financial statements. Key personnel includes Directors of Zurich Financial Services and Zurich Insurance Company and the Members of the Group Executive Committee.

Table 27.2				
Related party transactions – key personnel	in USD millions, for the years ended December 31			
		2008	2007	
	Remuneration of key personnel of the Group			
	Cash compensation, current benefits and fees	39	34	
	Post-employment benefits	4	4	
	Share-based compensation	34	23	
Total remuneration of key personnel	77	61		

Outstanding loans and guarantees granted to Members of the Group Executive Committee amounted to USD 1 million for both the years ended December 31, 2008 and 2007. Outstanding loans and guarantees granted to Members of the Board of Directors amounted to USD 2 million and nil for the years ended December 31, 2008 and 2007, respectively. The terms "Directors" and "Members of the Group Executive Committee" in this context include the individual as well as members of their respective households. The above figures include the fees paid to members of the Board of Directors of Zurich Financial Services and Zurich Insurance Company, which were USD 3.3 million and USD 3.1 million, in 2008 and 2007 respectively.

No provision for non-repayment has been required in 2008 and 2007 for the loans or guarantees made to Members of the Group Executive Committee.

Information required by art. 663b^{bis} and art. 663c paragraph 3 of the Swiss Code of Obligation is disclosed in the Financial Statements of the Holding Company.

The cash compensation, current benefits and fees are short term in nature.

28. Farmers Exchanges

Farmers Group, Inc. (FGI) and its subsidiaries provide certain non-claims related management services to the Farmers Exchanges. In addition, the Group has the following relationships with the Farmers Exchanges.

a) Surplus note and certificates of contribution issued by the Farmers Exchanges

As of December 31, 2008 and 2007, FGI and other Group companies held the following surplus note and certificates of contribution issued by the Farmers Exchanges. Originally these were purchased by FGI in order to supplement the policyholders' surplus of the Farmers Exchanges.

Surplus Notes	in USD millions, as of December 31	
	2008	2007
6.15% surplus note, due December 2013	88	88
6.15% certificates of contribution, due December 2013	523	523
6.15% certificates of contribution, due August 2014	296	296
10.30% certificates of contribution, due December 2013	300	–
Various other certificates of contribution	23	23
Total	1,230	930

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

b) Quota share reinsurance treaties with the Farmers Exchanges

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

Effective January 1, 2004, Farmers Re assumes annually USD 200 million and ZIC assumes USD 800 million of gross written premiums under an Auto Physical Damage (APD) Quota Share reinsurance agreement with the Farmers Exchanges. In addition, Farmers Re and ZIC assume a quota share percentage of ultimate net losses sustained by the Farmers Exchanges in their APD lines of business. The agreement, which can be terminated after 30 days notice by any of the parties, also provides for the Farmers Exchanges to receive a ceding commission of 18.0 percent of premiums, with additional experience commissions that depend on loss experience. This experience commission arrangement limits Farmers Re and ZIC's potential underwriting gain on the assumed business to 2.5 percent of premiums assumed.

Effective January 1, 2006, the Farmers Exchanges modified the terms of the APD agreement with Farmers Re and ZIC. The new agreement provides for annual ceded premiums of USD 1 billion of gross written premiums with 20.0 percent assumed by Farmers Re and 80.0 percent assumed by ZIC, a 25.8 percent ceding commission for acquisition expenses, and an 8.2 percent ceding commission for unallocated loss adjustment expense. The agreement also includes provisions for additional experience commissions that will depend on loss experience and recoveries below a specified ratio for each year. This experience commission arrangement limits Farmers Re and ZIC's potential underwriting gain on the assumed business to 2.0 percent of premiums assumed plus 20.0 percent of the underwriting gain resulting from a combined ratio under 98.0 percent. The agreement, which can be cancelled after 90 days notice by any of the parties, has a termination date of December 31, 2008.

Effective December 31, 2004, Farmers Re and ZIC entered into a 12.0 percent All Lines Quota Share reinsurance treaty under which they each assume a percentage of all lines of business written by the Farmers Exchanges, prospectively. Under this treaty, which amended the 10.0 percent All Lines Quota Share reinsurance treaty in effect since December 31, 2002, Farmers Re and ZIC assume a 2.4 percent and 9.6 percent respective quota share of the premiums written

and the ultimate net losses sustained in all lines of business written by the Farmers Exchanges after the APD reinsurance agreement has been applied. Underwriting results assumed are subject to a maximum combined ratio of 112.5 percent and a minimum combined ratio of 93.5 percent. In addition, under this treaty the Farmers Exchanges' catastrophe losses are subject to a maximum of USD 800 million. Farmers Re and ZIC assumed USD 19 million and USD 77 million, respectively, of maximum annual catastrophe losses. This reinsurance agreement, which can be terminated after 60 days notice by any of the parties, also provides for the Farmers Exchanges to receive a provisional ceding commission of 22.0 percent of premiums for acquisition expenses, 8.8 percent of premiums for unallocated loss adjustment expenses and 5.3 percent of premiums for other expenses with additional experience commissions potentially payable depending on loss experience.

Effective December 31, 2005, the 12.0 percent All Lines agreement was amended and the quota share participation ratio was reduced to 6 percent. As a result, Farmers Re and ZIC assume a 1.2 percent and 4.8 percent respective quota share of the premiums written and the ultimate net losses sustained in all lines of business written by the Farmers Exchanges after the APD reinsurance agreement has been applied. In addition, under this treaty the Farmers Exchanges' catastrophe losses are subject to a maximum of USD 800 million. Farmers Re and ZIC may assume USD 10 million and USD 38 million, respectively, of the maximum Farmers Exchanges' catastrophe losses subject to under this treaty.

Effective December 31, 2007, the All Lines agreement was amended and the quota share participation ratio was reduced by 16.7 percent to 5.0 percent. As a result, Farmers Re and ZIC assume a 1.0 percent and 4.0 percent respective quota share of the premiums written and the ultimate net losses sustained in all lines of business written by the Farmers Exchanges after the APD reinsurance agreement has been applied. In addition, under this treaty the Farmers Exchanges' catastrophe losses were changed from USD 800 million to a maximum of USD 1 billion. Farmers Re and ZIC may assume USD 10 million and USD 40 million, respectively, of the maximum Farmers Exchanges' catastrophe losses subject to under this treaty.

Effective September 30, 2008, Farmers Re and ZIC entered into a new 25.0 percent All Lines Quota Share reinsurance treaty under which each assumes a percentage of all lines of business written by the Farmers Exchanges, prospectively. Under this treaty, which amended the 5.0 percent All Lines Quota Share reinsurance treaty in effect since December 31, 2007, Farmers Re and ZIC assume a 5.0 percent and 20.0 percent respective quota share of the premiums written and the ultimate net losses sustained in all lines of business written by the Farmers Exchanges after the APD reinsurance agreement has been applied. In addition, under this treaty, the Farmers Exchanges catastrophe losses are subject to a maximum of USD 1.0 billion. As a result, Farmers Re and ZIC are subject to a maximum annual catastrophe loss of USD 50 and USD 200 million, respectively. This reinsurance agreement, which can be terminated after 90 days notice by any of the parties, also provides for the Farmers Exchanges to receive a provisional ceding commission of 25.0 percent of premiums for acquisition expenses, 8.8 percent of premiums for unallocated loss adjustment expense and 5.3 percent of premiums for other expenses with additional experience commissions that depend on loss experience. Unearned premiums totaling USD 1,079.3 billion were transferred from the Farmers Exchanges to Farmers Re and ZIC effective September 30, 2008 as a result of their increased participation in this treaty. In addition, Farmers Re and ZIC remitted USD 269.8 million of reinsurance commissions to the Farmers Exchanges for acquisition expenses due to the increased participation in the All Lines treaty.

For the year ended December 31, 2008, assumed premiums by Group companies under the All Lines Quota Share reinsurance treaty were USD 2,380.8 million with a combined ratio of 97.7 percent and an underwriting gain of USD 31.1 million. For the year ended December 31, 2007, assumed premiums under the All Lines Quota Share reinsurance treaty were USD 731 million with a combined ratio of 95.1 percent and an underwriting gain of USD 38.0 million.

c) North America Commercial Small Business Solutions (SBS)

On June 13, 2008, the Group completed the sale of the rights to access renewals of its North America Commercial Small Business Solutions (SBS) book of business to Truck Insurance Exchange (TIE), one of the Farmers Exchanges, which the Group manages but does not own. As part of the transaction, the Group has entered into a 100 percent quota share reinsurance agreement for the in-force business as of June 1, 2008. This resulted in the Group paying TIE the balance of unearned premium reserve related to the business ceded to TIE of USD 425 million and TIE compensating the Group for its deferred acquisition cost balance as of the effective date of the transaction by paying a ceding commission of USD 120 million. In addition, the management of the in-force SBS book of business has been

transferred together with certain assets and liabilities to Farmers Group, Inc. This transaction had no impact on the scope of consolidation.

29. Segment information

Table 29.1

in USD millions, for the years ended December 31

Income statements
by business
segment

	General Insurance		Global Life	
	2008	2007	2008	2007
Revenues				
Direct written premiums and policy fees	35,357	34,199	10,684	9,506
Assumed written premiums	1,794	1,451	100	117
Gross written premiums and policy fees	37,151	35,650	10,784	9,623
Less premiums ceded to reinsurers ¹	(5,646)	(5,345)	(739)	(8,002)
Net written premiums and policy fees	31,505	30,305	10,046	1,622
Net change in reserves for unearned premiums	(583)	(574)	(16)	(5)
Net earned premiums and policy fees	30,922	29,731	10,030	1,617
Farmers management fees and other related revenues	–	–	–	–
Net investment result on Group investments	2,452	3,913	3,258	4,741
Net investment income on Group investments	3,712	3,662	4,496	4,226
Net capital gains/(losses) and impairments on Group investments	(1,260)	250	(1,237)	514
Net investment result on unit-linked investments	–	–	(19,039)	6,479
Net gain/(loss) on divestments of businesses	14	13	4	74
Other income	735	644	1,205	1,203
Total revenues	34,123	34,300	(4,542)	14,114
Intersegment transactions	(1,244)	(987)	(76)	(246)
Benefits, losses and expenses				
Losses and loss adjustment expenses, net of reinsurance	22,388	20,916	33	90
Life insurance death and other benefits, net of reinsurance	53	50	9,867	10,385
(Decrease)/increase in future life policyholders' benefits, net of reinsurance	–	–	(689)	(9,781)
Insurance benefits and losses, net of reinsurance ¹	22,441	20,966	9,211	694
Policyholder dividends and participation in profits, net of reinsurance	16	11	(18,943)	7,755
Underwriting and policy acquisition costs, net of reinsurance	5,679	5,358	1,880	1,629
Administrative and other operating expense	3,400	3,226	2,400	1,962
Interest expense on debt	235	310	45	17
Interest credited to policyholders and other interest	195	268	521	585
Total benefits, losses and expenses	31,967	30,138	(4,886)	12,642
Net income/(loss) before income taxes	2,156	4,162	344	1,472
Income tax benefit/(expense) attributable to policyholders				
Income tax expense attributable to shareholders				
Net income attributable to non-controlling interests				
Net income/(loss) attributable to shareholders				
Supplementary segment information				
Additions and capital improvements of property/equipment and intangible assets	1,614	996	3,127	331
Depreciation and impairments of property and equipment	77	85	42	43
Amortization and impairments of intangible assets	133	96	224	143

¹ In 2007, for the Global Life segment, premiums ceded to reinsurers included USD 7.3 billion and ceded insurance benefits and losses included USD 7.0 billion relating to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts have been transferred to the reinsurer. This transaction had no impact on the income statement in 2008.

Farmers Management Services		Other Businesses		Corporate Functions		Eliminations		Total	
2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
		478	381	(6)	6	19	11	46,532	44,103
		3,565	1,969	182	160	(279)	(344)	5,362	3,353
		4,043	2,350	176	166	(260)	(333)	51,894	47,456
		(41)	(32)	(61)	(152)	260	333	(6,226)	(13,197)
		4,001	2,318	115	14			45,667	34,259
		(962)	82		1			(1,560)	(495)
		3,040	2,401	116	15			44,107	33,763
2,458	2,266							2,458	2,266
68	134	507	1,219	544	1,309	(998)	(1,221)	5,832	10,094
84	167	903	1,025	528	731	(998)	(1,221)	8,725	8,591
(16)	(33)	(396)	193	16	578			(2,893)	1,503
		(2,692)	663					(21,731)	7,142
		(1)	33		(2)			16	118
1	62		176	1,044	898	(1,321)	(1,082)	1,665	1,900
2,528	2,462	854	4,491	1,704	2,220	(2,318)	(2,303)	32,349	55,285
(86)	(52)	(154)	(332)	(759)	(686)	2,318	2,303		
		1,724	1,174	1			(25)	24,145	22,155
		517	362	101	18		23	10,538	10,837
		743	110	73	(32)	1	2	128	(9,701)
		2,984	1,646	175	(14)			34,811	23,291
		(2,587)	761					(21,514)	8,526
		717	578	14		(3)	(7)	8,287	7,559
1,331	1,215	(238)	264	1,118	1,061	(1,282)	(1,047)	6,729	6,679
9	9	198	264	1,122	1,317	(1,009)	(1,233)	599	685
		71	111	9	9	(24)	(16)	773	957
1,341	1,224	1,144	3,623	2,438	2,373	(2,318)	(2,303)	29,685	47,698
1,188	1,238	(291)	868	(734)	(153)			2,663	7,587
								1,184	83
								(732)	(1,874)
								(77)	(83)
								3,039	5,714
171	610	13	13	151	134			5,076	2,084
63	54	4	3	33	28			218	214
59	53	3		18	10			437	302

Assets and liabilities
by business segment

Table 29.2

in USD millions, as of December 31

	General Insurance		Global Life	
	2008	2007	2008	2007
Total Group investments	77,328	84,996	94,399	95,740
Cash and cash equivalents	9,279	10,896	5,095	3,713
Equity securities	5,965	7,011	4,816	8,336
Debt securities	53,444	60,005	56,456	54,939
Real estate held for investment	2,922	2,744	4,228	4,408
Mortgage loans	1,794	1,453	8,953	9,203
Other loans	3,340	1,975	13,385	13,296
Investments in associates	26	24	113	134
Other investments	559	887	1,353	1,710
Investments for unit-linked contracts	–	–	65,977	106,355
Total investments	77,328	84,996	160,377	202,094
Reinsurers' share of reserves for insurance contracts ¹	12,749	13,149	1,999	9,555
Deposits made under assumed reinsurance contracts	68	68	–	–
Deferred policy acquisition costs	3,247	3,306	10,752	11,547
Deferred origination costs	–	–	770	1,003
Goodwill	895	706	565	635
Other related intangible assets	–	–	1,252	780
Other assets	17,423	15,652	9,336	8,155
Total assets after consolidation of investments in subsidiaries	111,710	117,876	185,051	233,769
Liabilities for investment contracts	–	–	36,230	54,736
<i>Reserves for losses and loss adjustment expenses, gross</i>	<i>61,396</i>	<i>63,383</i>	<i>9</i>	<i>6</i>
<i>Reserves for unearned premiums, gross</i>	<i>14,874</i>	<i>15,428</i>	<i>210</i>	<i>157</i>
<i>Future life policyholders' benefits, gross</i>	<i>95</i>	<i>97</i>	<i>72,699</i>	<i>77,422</i>
<i>Policyholders' contract deposits and other funds, gross</i>	<i>1,102</i>	<i>1,024</i>	<i>12,611</i>	<i>14,173</i>
<i>Reserves for unit-linked contracts, gross</i>	<i>–</i>	<i>–</i>	<i>35,069</i>	<i>54,337</i>
Reserves for insurance contracts, gross¹	77,468	79,932	120,598	146,096
Debt related to capital markets and banking activities	–	–	–	–
Senior debt	3,031	5,673	694	239
Subordinated debt	2,189	2,311	412	72
Other liabilities	14,680	16,291	15,351	20,758
Total liabilities	97,368	104,207	173,284	221,901
Supplementary segment information				
Reserves for losses and loss adjustment expenses, net	50,530	51,935	8	6
Reserves for unearned premiums, net	12,996	13,721	204	154
Future life policyholders' benefits, net	95	97	70,837	68,019
Policyholders' contract deposits and other funds, net	1,072	1,006	12,481	14,026
Reserves for unit-linked contracts, net	–	–	35,069	54,337
Reserves for insurance contracts, net	64,693	66,759	118,599	136,542

¹ In 2007, for the Global Life segment, reinsurers' share of reserves for insurance contracts included USD 7.1 billion related to the reinsurance of a UK annuity portfolio. Subsequent to the approval from the UK High Court, effective on June 30, 2008, the underlying contracts have been transferred to the reinsurer, resulting in a reduction of both the reinsurers' share of reserves for insurance contracts and gross reserves for insurance contracts.

Farmers		Other Businesses		Corporate Functions		Eliminations		Total	
Management Services									
2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
2,158	2,311	17,085	18,758	15,193	18,560	(26,593)	(26,764)	179,570	193,600
349	264	3,288	4,862	6,682	8,459	(12,728)	(14,250)	11,965	13,943
-	-	1,185	2,063	2,277	3,006	-	-	14,242	20,416
76	83	7,058	7,396	1,434	1,769	(365)	(430)	118,103	123,762
156	172	175	197	44	42	-	-	7,524	7,563
-	-	2,104	2,095	-	-	(32)	(33)	12,820	12,718
1,517	1,714	2,764	1,999	4,708	4,872	(13,184)	(10,921)	12,531	12,936
-	-	78	76	3	4	-	-	220	238
60	79	432	69	44	410	(283)	(1,130)	2,165	2,024
-	-	12,226	15,738	-	-	-	-	78,203	122,092
2,158	2,311	29,311	34,495	15,193	18,560	(26,593)	(26,764)	257,773	315,693
209	207	5,486	6,392	-	107	(1,849)	(2,440)	18,595	26,970
-	-	2,362	1,323	-	2	(32)	(34)	2,397	1,359
-	-	324	89	-	-	-	(1)	14,323	14,941
-	-	-	-	-	-	-	-	770	1,003
382	385	-	-	5	5	-	-	1,846	1,730
1,025	1,025	-	-	-	-	-	-	2,278	1,805
1,352	1,337	2,006	1,384	2,092	1,793	(2,246)	(2,482)	29,962	25,841
5,125	5,266	39,488	43,684	17,290	20,468	(30,721)	(31,721)	327,944	389,342
-	-	-	-	-	-	(251)	(251)	35,979	54,485
-	-	4,991	6,084	44	114	(1,223)	(1,697)	65,218	67,890
-	-	1,319	381	5	43	(10)	(68)	16,399	15,941
-	-	3,656	2,871	366	415	(598)	(657)	76,218	80,147
-	-	3,334	3,489	-	-	-	-	17,047	18,687
-	-	12,228	15,738	-	-	-	-	47,297	70,075
-	-	25,529	28,562	415	572	(1,831)	(2,423)	222,179	252,740
-	-	3,632	3,385	-	-	(1,106)	(1,722)	2,527	1,663
-	-	1,047	622	19,893	18,397	(21,306)	(22,102)	3,358	2,830
180	180	73	99	5,169	5,588	(2,926)	(2,780)	5,096	5,470
1,612	1,480	3,974	5,004	2,707	1,745	(3,301)	(2,443)	35,024	42,836
1,792	1,660	34,255	37,673	28,184	26,302	(30,721)	(31,721)	304,163	360,023
-	-	2,404	2,733	44	43	-	(7)	52,986	54,712
-	-	1,304	339	5	6	-	-	14,510	14,221
(209)	(207)	3,257	2,559	366	415	-	7	74,345	70,889
-	-	786	662	-	-	18	17	14,357	15,711
-	-	12,228	15,738	-	-	-	-	47,297	70,075
(209)	(207)	19,979	22,031	415	465	18	17	203,495	225,607

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

Table 29.3

in USD millions

	Gross written premiums and policy fees for the years ended December 31		Total revenues for the years ended December 31		Total assets as of December 31	
	2008	2007	2008	2007	2008	2007
	North America	18,486	17,461	17,745	18,589	68,907
Europe	29,810	26,712	13,707	29,942	225,596	275,828
International Businesses	4,243	3,855	2,780	3,919	12,207	14,434
Central Region	1,321	1,295	(57)	4,472	47,889	54,234
Eliminations	(1,967)	(1,867)	(1,827)	(1,636)	(26,654)	(25,754)
Total	51,894	47,456	32,349	55,285	327,944	389,342

Additions and capital improvement of property/equipment and intangible assets by geographical segment

Table 29.4

in USD millions, for the years ended December 31

	Property and equipment		Intangible assets	
	2008	2007	2008	2007
North America	107	136	124	562
Europe	258	128	4,349	1,086
International Businesses	26	16	48	9
Central Region	54	55	110	92
Total	445	336	4,631	1,748

Disclaimer & Cautionary Statement

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

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

Persons requiring advice should consult an independent adviser.

This communication does not constitute an offer or an invitation for the sale or purchase of securities in any jurisdiction.

THIS COMMUNICATION DOES NOT CONTAIN AN OFFER OF SECURITIES FOR SALE IN THE UNITED STATES; SECURITIES MAY NOT BE OFFERED OR SOLD IN THE UNITED STATES ABSENT REGISTRATION OR EXEMPTION FROM REGISTRATION, AND ANY PUBLIC OFFERING OF SECURITIES TO BE MADE IN THE UNITED STATES WILL BE MADE BY MEANS OF A PROSPECTUS THAT MAY BE OBTAINED FROM THE ISSUER AND THAT WILL CONTAIN DETAILED INFORMATION ABOUT THE COMPANY AND MANAGEMENT, AS WELL AS FINANCIAL STATEMENTS.

Report of the Statutory Auditors

To the General Meeting of Zurich Financial Services

As statutory auditors, we have audited the consolidated financial statements of Zurich Financial Services, 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 related notes (pages 131 to 236 and 90 to 123), for the year ended December 31, 2008.

Board of Directors' Responsibility

The Board of Directors is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) and the requirements of Swiss law. This responsibility includes designing, implementing and maintaining an internal control system relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error. The Board of Directors is further responsible for selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Swiss law and Swiss Auditing Standards as well as the International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers the internal control system relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control system. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements for the year ended December 31, 2008 give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the International Financial Reporting Standards (IFRS) and comply with Swiss law.

Report on other legal requirements

We confirm that we meet the legal requirements on licensing according to the Auditor Oversight Act (AOA) and independence (article 728 CO and article 11 AOA) and that there are no circumstances incompatible with our independence.

In accordance with article 728a paragraph 1 item 3 CO and Swiss Auditing Standard 890, we confirm that an internal control system exists which has been designed for the preparation of consolidated financial statements according to the instructions of the Board of Directors.

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

PricewaterhouseCoopers AG

Patrick Shoumlin

Ray Kunz

Audit expert

Audit expert

Auditor in charge

Zurich, February 4, 2009