S&P Global Ratings

RatingsDirect®

Baloise Group

Primary Credit Analyst:
Jean Paul Huby Klein, Frankfurt (49) 69-33-999-198; jeanpaul.hubyklein@spglobal.com

Secondary Contact:
Birgit Roeper-Gruener, Frankfurt (49) 69-33-999-172; birgit.roeper@spglobal.com

Table Of Contents

Baloise Group

SACP* Assessments				SACP*		Support		Ratings
Anchor	a	Modifiers	0	a		0		Financial Strength Rating
Business Risk		ERM and Management	1	Liquidity	0	Group Support	0	A/Stable/--
Strong								
Financial Risk		Holistic Analysis	-1	Sovereign Risk	0	Gov't Support	0	
Very Strong								

*Stand-alone credit profile.
See Ratings Detail for a complete list of rated entities and ratings covered by this report.

Rationale

Business Risk Profile: Strong

- Multiline insurance group focusing on its target markets in Switzerland, Belgium, Luxembourg, and Germany.
- Lower business and earnings diversification compared to multinational peers with higher financial strength.
- Low insurance industry and country risk, due to a strong foothold in Switzerland with sizable business also in Belgium and Germany.
- Strong market presence in its target markets, but less prominent in Germany.

Financial Risk Profile: Very Strong

- Extremely strong capital adequacy in 2015, based on our risk-based capital model, and is expected to return to very strong levels in 2016-2018 on active capital management.
- Strong overall technical results in 2015, with lower investment income compared to last year due to one-off effects in 2014 from the disposal of Baloise Austria and Nationale Suisse stake.
- Low earnings contribution from Germany mainly resulting from weak technical performance in the non-life business and the adverse impact of low interest rates.
- Intermediate risk position, reflecting overall conservative investment strategy, but high exposure to employee benefits obligation risk.

Other Factors

- We view the importance of Baloise's strong risk-management capabilities as high for our ratings. While this assessment reduces downside risk to the ratings, our 'A' ratings incorporate a holistic analysis of the group's stable credit fundamentals. Particularly a lack of sustained earnings diversity and more limited market positions than multinational peers' with higher ratings, and still significant, although declining, sensitivity to low interest rates stemming from Swiss and German operations currently hinder upside potential to the ratings. Various management actions have helped contain exposure to a further weakened interest rate environment.

Outlook: Stable

S&P Global Ratings' outlook on Basler Versicherung AG, the core entity of the Switzerland-based multiline insurance group Baloise is stable. It reflects our view that Baloise will maintain its strong franchise in Switzerland and maintain its positions in its main international markets. We anticipate that the group will increase its credit risk in the fixed income portfolio somewhat, but that overall asset allocation will remain conservative. We also believe that expansion will be relatively limited in 2016-2018, and that the company will keep its capital adequacy at least at very strong levels.

Downside scenario

We could lower the ratings if:

- Financial market conditions were to deteriorate, substantially increasing Baloise's exposure to interest rate risk and constraining its investment returns, significantly reducing investment margins on Baloise's book of business over a longer period; or
- Baloise were unable to sustain at least a strong level of capital adequacy.

Upside scenario

We could raise the ratings on Baloise if we saw a sustained improvement in earnings diversity, particularly from earnings recovery in Germany and a further lowering in exposure to interest rate sensitivities, along with maintenance of a solid capital base.

Base-Case Scenario

Macroeconomic Assumptions

- Moderate economic growth and shallow inflation, as well as continuously low unemployment rates in Baloise's core markets over 2016-2018.
- Historically low long-term interest rates, with a 10-year Swiss government bond yields to decline to negative 0.2% in 2016 from negative 0.1% in 2015, and gradually recover to 0.6% by 2018, based on our economic estimates.

Company-Specific Assumptions

- Moderate business decline of about 4% in 2016 from selective underwriting in Switzerland and business consolidation in Germany, but to recover by 2%-3% in 2017-2018 mainly through its operations in Belgium and in Luxembourg.
- At least very strong capital adequacy, as measured by our risk-based capital model over 2016-2018.
- Annual net income of more than Swiss franc (CHF) 500 million (about €460 million).
- New business margins as measured against annual premium equivalents (APE) of more than 10%.
- Net combined (claims and cost) ratios of about 93%-96% and return on equity of 8%-12% in 2016-2018.
- Slightly declining investment returns as a consequence of the currently very low interest rates.
- Financial leverage of less than 30%, fixed-charge coverage of more than 10x.

Key Metrics

	2017f	2016f	2015	2014	2013
Gross premiums written (mil. CHF)	About 6,700-6,900	About 6,500-6,700	6,833	7,176	7,229
Net income (mil. CHF)	>500	>500	511	712	455
Return on shareholders equity (%)	8.0-12.0	8.0-12.0	9.0	13.3	9.5
P/C net combined ratio (%)	93.0-96.0	93.0-96.0	93.1	94.0	96.5
Net investment yield (%)	>2.0	>2.1	2.3	2.6	2.7
S&P capital adequacy	Very Strong	Very Strong	Extremely Strong	Extremely Strong	Very Strong
Fixed-charge coverage (x)	>10.0	>10.0	19.7	24.5	15.1
Financial leverage (%)	<30.0	<30.0	21.4	20.1	19.5

CHF--Swiss franc. f--Forecast. P/C--Property and casualty.

Company Description

A top-5 insurance provider in Switzerland

Baloise Group is a multiline insurer that focuses on private businesses and small and midsize enterprises (SMEs). It owns a sound franchise in its domestic market, which accounted for about 64% of total gross premiums written (GPW) in 2015. In addition, the group operates in Germany and Belgium, which generated 18% and 15%, respectively, of total GPW. The remaining 3% stems from Luxembourg where the group mainly underwrites investment type products, which are not disclosed as premiums in the International Financial Reporting Standards (IFRS) accounts. The group's parent company, Baloise Holding AG, is listed on the Swiss stock exchange with a widely distributed 100% free float.

The company now concentrates on its defined core markets: Switzerland, Germany, Belgium, and Luxembourg. As a consequence, Baloise divested its operations in Serbia and Croatia in 2013, as well as the Austrian operations in 2014. In September 2015, Baloise announced that German traditional life business was no longer considered to be a core business, and it sold its run-off portfolio of Basler Leben AG to Frankfurter Leben-Gruppe. The divestment represented one-fifth of its traditional life book in Germany. Baloise focuses now on biometric and less capital intense unit-linked products in the German market through its branch. Other business segments include asset management and banking. The latter operated through 100%-owned subsidiary Baloise Bank SoBa.

In 2015, Baloise's total GPW decreased by 4.8% to CHF6.8 billion compared with CHF7.2 billion in 2014. The premium reduction is a consequence of negative foreign exchange movements, the restructuring of the German operations, and the disposal of non-strategic operations in Austria, Croatia and Serbia. About 55% of premiums are generated in the life business, while 45% stem from the non-life business.

Business Risk Profile: Strong

We assess Baloise's business risk profile as strong. The group benefits from its operations in healthy and stable economies, with a sound footprint in Switzerland and Belgium. We believe that Baloise will reap more benefits from its diversification into Germany once the group manages to turn around profitability.

Insurance industry and country risk: Focus on Switzerland and expanding in core markets

In our opinion, Baloise faces low country and industry risk. The group's domestic Swiss life and property and casualty insurance markets, which carry a low and a very low risk, respectively, account for 64% of group business volumes. The Swiss economy is wealthy, mature, and saturated, and it has proven to be resilient over the past years. This has resulted in very stable but moderate premium growth in recent years. Product risks in life are predominantly the result of reduced investment margins, although they still benefit from some flexibility in both new business and back book-guaranteed rates.

Baloise also operates in the Belgium and German non-life and life insurance sectors, which we think face low and intermediate industry and country risk, respectively. The business in Luxembourg has a negligible impact on our view of the group's country risk. We do not expect to change our assessment of the group's industry and country risk during 2016-2018, given that we do not anticipate a major shift in Baloise's exposures or in the respective industry and country risk assessments.

Table 1

Baloise Group -- Industry And Country Risk

Insurance sector	IICRA	Business mix (%)
Switzerland Life	Low Risk	45
Switzerland P/C	Very Low Risk	19
Germany Life	Intermediate risk	7
Germany P/C	Low Risk	11
Belgium Life	Intermediate Risk	2
Belgium P/C	Intermediate risk	13
Other	Low Risk	3
Weighted IICRA	Low Risk	100

P/C--Property and casualty.

Competitive position: Strong footprint in Switzerland, Belgium, and Luxembourg, but relatively lacking in sustained earnings diversity

Baloise has a strong competitive position, in our view. The group benefits from its solid foothold in its core markets--Switzerland, Belgium, and Luxemburg--where it holds top market positions. Germany is also seen as a core market, but the competitive strength is less prominent.

The group has a sound product and premium diversity, offering life and non-life insurance products in its target markets. Within its life business, about 70% of its premiums have been written in the Swiss group life business, which accounts for more than two-thirds of its Swiss life technical reserves and almost half of its overall life reserves. The non-life business is dominated by motor (33% of GPW), followed by property (32%), accident (12%), general liability (11%), and other lines. Baloise Bank SoBa complements the product range mainly with mortgage products. However, the top-line distribution has not been yet fully translated into sustained earnings diversification compared to multinational peers with higher ratings.

In 2015, about 60% (2014: 72%) of the group's earnings before interests and taxes (EBIT) derived from the Swiss operations and about 87% (2014: 90%) including earnings contribution from Belgium. We believe Baloise will more strongly benefit from its diversification into Germany once the group turns around profitability.

Baloise has fostered its competitive strength through efficient customer and segment selection and a clear focus on value creation. However, we think that the Swiss, Belgium, and German life and non-life insurance sectors suffer from generally limited growth potential and volatile premium development. This, in our view, is amplified by persistently low interest rates, which may reduce potential customers' interest in life insurance savings products, and by saturated non-life markets.

We expect Baloise will maintain its selective growth strategy and strengthen its competitive position by focusing on profitable segments. In 2015, the group decided to sell the run-off portfolio of Basler Leben AG because of the low interest rates. The group is now focusing on biometric and life insurance products that are less interest-rate sensitive. The divestment constituted about one-fifth of Baloise's German technical provisions. Due to the consolidation of the German life and non-life business, and a selective underwriting in the Swiss life business, we anticipate a premium decline of about 4% in 2016. However, we expect a premium recovery of about 2%-3% for 2017-2018 on the back of the Belgium and Luxembourg operations.

Table 2

Baloise Group -- Competitive Position

	--Year ended Dec. 31--				
(Mil. CHF)	**2015**	**2014**	**2013**	**2012**	**2011**
Gross premiums written (GPW)	6,833	7,176	7,229	6,742	6,803
Change in GPW (%)	(4.8)	(0.7)	7.2	(0.9)	(0.8)
Net premiums written	6,683	7,010	7,068	6,571	6,627
Change in net premiums written (%)	(4.7)	(0.8)	7.6	(0.8)	(1.0)
Total assets under management	73,241	75,534	71,204	69,454	64,713
Growth in assets under management (%)	(3.0)	6.1	2.5	7.3	5.6
Reinsurance utilization (%)	2.2	2.3	2.2	2.5	2.6
Business segment (% of GPW)					
Life	55.4	53.2	52.4	50.8	53.8
P/C	44.6	46.8	47.6	49.2	46.2
Health	0	0	0	0	0
Other	0	0	0	0	0

CHF--Swiss franc. P/C--Property and casualty.

Financial Risk Profile: Very Strong

We base our very strong assessment of Baloise's financial risk profile on the group's prospective very strong capital and earnings, intermediate risk position, and its ability to raise additional funds if needed.

Capital and earnings: Very strong through active capital management

Baloise's group capitalization remained at what we see as extremely strong levels in 2015 based on our risk-based capital model. Although shareholders' funds declined by about 6% driven by a negative movement in other comprehensive income, a decline in capital requirements through its conservative investment policy, as well as lower business volumes could overcompensate the negative movement. We believe that the result is not sustainable, as some volatility from interest rates, a moderate asset portfolio shift towards more credit and market risk, and active capital management will bring capital adequacy back to Baloise target of very strong capital adequacy over the next two years.

The group's Solvency I ratio, as reported under IFRS, slightly decreased to 341% in 2015 from 354% in 2014, due to the aforementioned shareholders equity decline. Furthermore, we also consider the group's regulatory capital requirements based on Swiss Solvency Test in our analysis. Results based on Baloise's internal model raise no concerns despite the negative impact of ongoing low interest rates.

Baloise's consolidated net income in 2015 was CHF511 million, down by about 28% compared with 2014. The high decline was mainly influenced by about CHF160 million of extraordinary profits in 2014 as a result of the divestment of the Austrian operations and two participations, including the Nationale Suisse stake. Although currently low interest rates further reduced investment returns, the group manages to reduce the average guarantee rate of return in its life book maintaining the margin nearly stable. On the new business, Baloise reported a margin of 9.8% in 2015 after 15.0% in 2014 (both ratios based on annual premium equivalent). The decline mirrors the new business profitability in Switzerland, which offers some guaranteed products, especially in the group business, that are sensitive to the very low level of interest rates.

In non-life, the net combined ratio further declined to 93.1% in 2015 (2014: 94.0%) due to a benign claims environment, stringent costs management and improvements in the portfolio quality, especially in Belgium. Within its domestic market, which dominates the non-life portfolio, the group achieved a strong technical result with a gross combined ratio of 83.2%. However, the performance in the German business worsens by 5.4% disclosing a gross combined ratio of 106.9%. Baloise started with restructuring measures in its German operations further reducing costs and improving its portfolio quality.

Under our base case, we assume that Baloise will report net income of more than CHF500million (about $512 million or €460 million) per year in 2016-2018, with an almost unchanged dividend payout ratio of about 50%. We further expect a life new business margin of more than 10% (based on annual premium equivalent), a strong non-life combined ratio of 93%-96% taking profit from some enhancements in Germany, and a return on equity of 8%-12%.

Table 3

Baloise Group -- Capital

	--Year ended Dec. 31--				
(Mil. CHF)	**2015**	**2014**	**2013**	**2012**	**2011**
Common equity	5,462	5,831	4,906	4,641	3,894
Change in common equity (%)	(6.3)	18.8	5.7	19.2	(5.8)
Total capital (reported)	7,170	7,533	6,604	6,659	5,506
Change in total capital (reported) (%)	(4.8)	14.1	(0.8)	20.9	0.2

CHF--Swiss franc.

Table 4

Baloise Group -- Earnings

	--Year ended Dec. 31--				
(Mil. CHF)	**2015**	**2014**	**2013**	**2012**	**2011**
Total revenues	8,431	8,944	9,007	8,511	8,645
EBIT adjusted	340	154	448	394	490
Net income	511	712	455	485	61
Return on shareholders' equity (reported) (%)	9.0	13.3	9.5	11.4	1.5
P/C: Net expense ratio (%)	30.8	31.9	32.0	32.9	31.1
P/C: Net loss ratio (%)	62.1	61.7	62.7	61.1	64.2
P/C: Net combined ratio (%)	93.1	94.0	96.5	94.7	95.9
Life: Prebonus pretax earnings/total assets (%)	1.9	2.0	2.2	2.4	2.7
Life: Return on embedded value (%)	8.3	(4.1)	35.1	26.4	(17.8)
Life: Embedded value	3,876	3,610	3,809	2,753	2,153
Life: Value of new business	36	59	45	23	35
Operating earnings by segment *					
Life	277	481	261	177	16
P/C	396	423	366	410	127

*Before interest, depreciation, and amortization. CHF-Swiss franc. P/C--Property and casualty.

Risk position: Managing interest rate risks

We consider that Baloise has an intermediate risk position, which is in line with most of its peers', reflecting the group's generally risk-conscious investment strategy, high asset quality, and sound investment-risk control practices.

The main challenge Baloise faces is interest rate risk, in our view, owing to pressure on investment margins and capital. We believe that the group faces a still significant, although declining, sensitivity to interest rates stemming from Swiss and German life operations. Various management actions have helped contain exposure to a further weakened interest rate environment. It increased the asset duration in life bonds to 9.3 years from 8.2 years, further reducing the mismatch between assets and liabilities. A strengthening of its life reserves, together with a decline in guaranteed rates for group life business reduced the average guaranteed rate of return to 1.9% compared to 2.2% in 2014. Additionally, the company's divestment of its German run-off portfolio represented one-fifth of its German traditional life book, which carried policies with high guarantees.

The group's asset allocation is concentrated on fixed-income investments, with about 57% of total invested assets based on reported figures. Baloise has further increased its equity position slightly to about 8.2% in 2015 from 7.4% in 2014. We regard the credit-risk exposure of Baloise's bond portfolio to be moderate, owing to a substantial proportion of mainly Swiss and German government and covered bonds and a composition of about 75% 'AA' or higher rated bonds in the portfolio. Real estate and mortgage investments are prominent within Baloise's asset allocation, accounting for nearly 30% of investments predominantly in the Swiss market, which has shown resilience and has achieved a history of stable and reliable returns over several years in these asset classes. In our opinion, Baloise also has a relatively high exposure to employee benefit obligations--a common feature for Swiss insurers.

We view the investment portfolio as posing low concentration risk because the assets are well diversified by issuer, country, and industry. However, we observed a slight concentration toward financial institutions.

For 2016-2018, we expect net investment yield will gradually decline as a result of the low-yield environment, but the group should be able to sufficiently cover the average technical interest rate in the back book, which stood at 1.9% in 2015.

Table 5

Baloise Group -- Risk Position

	--Year ended Dec. 31--				
(Mil. CHF)	**2015**	**2014**	**2013**	**2012**	**2011**
Total invested assets	73,241	75,534	71,204	69,454	64,713
Change in invested assets (%)	3.0	6.1	2.5	7.3	5.6
Total invested assets adjusted	73,241	75,534	71,204	69,454	64,713
General account invested assets	63,459	65,692	62,535	61,572	57,554
Separate accounts/unit linked assets	9,782	9,842	8,669	7,882	7,159
Net investment income	1,461	1,635	1,695	1,723	1,705
Realized/unrealized gains/(losses)	379	775	211	224	(346)
Net investment yield (%)	2.3	2.6	2.7	2.9	3.1
Net investment yield including all gains/(losses) (%)	2.9	3.8	3.1	3.3	2.4
Proportion of liabilities with significant profit sharing characteristics (%)					
Cash and short-term investments	5.9	5.4	5.7	6.5	5.6
Bonds	56.8	59.0	58.7	59.5	58.3
Equity investments	8.2	7.4	6.2	4.7	5.3
Real estate	10.9	10.1	10.3	10.1	10.3
Mortgages	17.9	17.8	18.7	18.8	20.2
Investments in affiliates	0.3	0.3	0.4	0.4	0.3

CHF--Swiss franc.

Financial flexibility: Cautious debt and proven access to capital markets

Baloise has adequate financial flexibility, in our view, thanks to diverse operating cash flows, a cautious level of debt, proven access to capital markets, and ample liquidity. The group has seven senior bonds outstanding with a total face value of CHF1.5 billion and a widely spread maturity profile. Moreover, it issued one convertible bond with a current face value of CHF242.5 million that is due in November 2016. So far, Baloise has not issued any hybrid debt. The company demonstrated its commitment to the capital markets finishing the announced shares repurchasing program of one million shares at an average price of CHF113.83 per share in July 2016. Additional financial needs should be fairly limited, in our view, and likely to be financed from retained profits.

We expect the financial leverage ratio will remain below 30% and fixed-charge coverage greater than 10x in 2016-2018, both of which we consider as supportive to the group's financial flexibility. In our base case, we do not expect the group will raise funds to finance any major acquisition.

Table 6

Baloise Group -- Financial Flexibility					
	--Year ended Dec. 31--				
	2015	**2014**	**2013**	**2012**	**2011**
Fixed-charge coverage (x)	19.7	24.5	15.1	11.9	5.3
Financial leverage (%)	21.4	20.1	19.5	26.1	23.4

Other Assessments

Enterprise risk management (ERM) and management and governance practices reduce downside risk to the ratings, in our view.

Enterprise risk management: High importance for the rating

Our assessment of ERM as strong is based on Baloise's strong strategic risk management, strong risk-management culture, and strong risk controls for the group's major risks. It is unlikely, in our view, that the group will experience losses exceeding its risk tolerance. This assessment reflects our favorable view of the development and use of Baloise's ERM framework for proactive business steering. We also see the importance of the group's strong risk management practice for the 'A' rating as high compared to low in previous years. This is in line with our view of competitors with a similar risk profile consisting of multinational operations, and a mix of traditional interest-rate sensitive life, other life, and non-life operations.

Management and Governance: Consistent path with a new CEO

We consider Baloise's management and governance practices to be satisfactory, based on our generally positive opinion of its strategic positioning, financial management, and organizational effectiveness. Management has shown that it is effectively executing its strategy by strengthening operations in its main markets through acquisitions, divesting noncore operations, and continuously developing its business model, with mainly strong underwriting results. Management transitioned smoothly to the new CEO in April 2016, and we expect a continuation of Baloise's current strategy. However, the new management team faces the challenge of returning the business in its German operations to profitability amid difficult market conditions.

The absence of any visible governance issues underpins our unchanged view of management and governance.

Liquidity: Highly liquid asset portfolio supports exceptional assessment

We regard Baloise's liquidity as exceptional, owing to the strength and variety of liquidity sources with no risks from collateral posting and confidence-sensitive liabilities. There are no refinancing concerns, and we believe the group is capable of managing unexpectedly large claims or an increase in life insurance policy lapses. The group has a strong cash flow generation from premium income and investment returns, with a highly liquid asset portfolio that is about 70% of invested assets.

Accounting Considerations: Transparent Financial Disclosure

Baloise prepares its consolidated financial statements under IFRS. We view the group's financial communication and disclosure as sound and transparent.

Our analysis of the profitability of the life insurance business is based on embedded-value results and IFRS profits.

Our assessment of Baloise's capital adequacy is based on reported IFRS shareholders' equity, which we have adjusted by:

- Crediting 50% of the life insurance value in force but eliminating double counting by adjusting the on-balance-sheet values for the shareholders' portion in deferred policy acquisition cost;
- Including the statutory-free and unallocated portion of the policyholder bonus reserve in life insurance; and
- Deducting goodwill and other intangible assets.

In adjusting risk-capital requirements, we have recognized hedging measures for equity exposures.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Insurers: Rating Methodology, May 7, 2013
- Enterprise Risk Management, May 7, 2013
- Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Basler Versicherung AG Ratings Affirmed At 'A' On Sustained Solid Capital And Earnings Prospects; Outlook Stable, June 30, 2016

Ratings Detail (As Of August 11, 2016)	
Operating Company Covered By This Report	
Basler Versicherung AG	
Financial Strength Rating	
Local Currency	A/Stable/--
Counterparty Credit Rating	
Local Currency	A/Stable/--
Domicile	Switzerland

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings’ credit ratings on the global scale are comparable across countries. S&P Global Ratings’ credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and

Ratings Detail (As Of August 11, 2016) (cont.)

debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

Additional Contact:
Insurance Ratings Europe; InsuranceInteractive_Europe@spglobal.com