S&P Global
Ratings

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Baloise Group

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Baloise Group

SACP* Assessments					SACP*			Support			Ratings
Anchor	a	+	Modifiers	0	=	a	+	0	=		Financial Strength Rating: A/Positive/--
Business Risk: Strong			ERM and Management	1		Liquidity	0	Group Support	0		
Financial Risk: Very Strong			Holistic Analysis	-1		Sovereign Risk	0	Gov't Support	0		Holding Company Rating: BBB+/Positive/--

*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, Germany, and Luxembourg.
- Sizable market share in almost all markets it operates, with Germany being the exception.
- Limited earnings diversification compared to multinational peers with higher financial strength, although improving.

Financial Risk Profile: Very Strong

- Extremely strong capital adequacy, based on our risk-based capital model, supported by strong retained earnings and the issuance of hybrid capital in 2017. We expect capitalization to remain at least very strong even if inorganic growth occurs in 2018-2019.
- Strong technical results from Switzerland and Belgium, with a five-year average combined ratios of about 84% and 97% respectively, and Germany's half-year 2017 performance improving to 99.5%, compared with a five-year average of about 104%, following business-restructuring measures supporting bottom–line earnings.

Other Factors

- In our view, Baloise's strong risk-management capabilities reduce downside risk to the ratings. In contrast, we still recognize a lack of earnings diversity, and still-significant, although declining, sensitivity to low interest rates, stemming from Swiss and German operations, which in our view differentiates Baloise from higher-rated multinational competitors.
- Various management actions have helped contain exposure to a further weakened interest rate environment.

Outlook: Positive

S&P Global Ratings positive outlook on Baloise Group indicates that we could raise the ratings on the group's core, highly strategic, and holding entities during the next 12-24 months if the group manages to consolidate its capitalization at the 'AAA' level. It also reflects our expectation that Baloise will maintain its strong franchise in Switzerland and further strengthens its operating earnings diversification through its main international markets.

We could also consider an upgrade if the company manages to demonstrate a sustainable improvement in earnings diversity, particularly from earnings recovery in Germany and a further lowering of exposure to interest rate sensitivities.

Downside scenario

We could revise the outlook to stable over the next 12-24 months if capitalization is not consolidated at the extremely strong level, based on our risk-based capital model, and if the improvements in earnings diversification and interest volatility are not sustainable.

Base-Case Scenario

Macroeconomic Assumptions

- Moderate economic growth and inflation, as well as continuously low unemployment rates in Baloise's core markets over 2017-2019.
- Historically low long-term interest rates, with a 10-year Swiss government bond yields gradually increasing to 0.0% in 2017 from negative 0.3% in 2016, followed by a further recovery to 0.3% in 2018 and 0.7% in 2019, based on our economic estimates.

Company-Specific Assumptions

- Flat premium development in 2017 and 2018, following a premium decline in the German life business after the divestment of the run-off book of Basler Leben AG and an overall selective life underwriting strategy, partly compensated by sound growth in the German and Belgium property and casualty (P/C) operations.
- Extremely strong capital adequacy in 2017 backed by strong retained earnings and the issuance of hybrid capital in 2017. Capitalization to remain at least very strong in 2018-2019 incorporating the potential impact of inorganic growth on capital.
- Annual net income of more than Swiss franc (CHF) 500 million (about €460 million) based on strong technical earnings especially in the Swiss and Belgium P/C operations.
- New business margins as measured against annual premium equivalents (APE) of more than 15%, following a conservative underwriting strategy and slightly higher interest rates on bonds.
- Net combined (claims and cost) ratios of about 93%-96% and a return on equity of 8%-12% in 2017-2019, following cautious underwriting guidelines focused on profitability.
- Slightly declining investment returns as a consequence of the currently very low interest rates.

Key Metrics

	2018f	2017f	2016	2015	2014
Gross premiums written (mil. CHF)	About 6,500-6,700	About 6,600-6,800	6,712	6,833	7,176
Net income (mil. CHF)	>500	>500	534	511	712
Return on shareholders equity (%)	8-12	8-12	9.5	9.1	13.3
P/C net combined ratio (%)	93-95	93-95	93.2	93.1	94.0
Net investment yield (%)	>2,0	>2,1	2.2	2.3	2.6
S&P Global Ratings' capital adequacy	At least very strong	Extremely strong	Extremely strong	Extremely strong	Extremely strong
Fixed-charge coverage (x)	~20	~20	19.7	19.7	24.5
Financial leverage (%)	~20	~20	17.6	21.4	20.1

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

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). About 53% of premiums are generated in the life business, while 47% stem from the P/C business. The group owns a sound franchise in its domestic market, which accounted for about 63% of total gross premiums written (GPW) in 2016. In addition, the group operates in Germany and Belgium, which generated 18% and 16%, respectively, of total GPW. The remaining 3% stem 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 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 in 2017. 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 local branch. Other business segments include asset management and banking. The latter operated through 100%-owned subsidiary Baloise Bank SoBa.

Business Risk Profile: Strong

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

In our opinion, Baloise faces low country and industry risk, which reflects a blended assessment of the markets in which it operates. The group is mainly exposed to the Swiss life and P/C business, but aims to increase its nondomestic footprint in its target markets, especially in Belgium. Within its dominant domestic market, Baloise benefits from a wealthy and diversified economy that has strong and predictable institutions. Demand remains robust on the back of a strong labor market, with an expected low unemployment rate of 3.3% for 2017 and 2018. However, the Swiss life insurance market is facing the challenge of very low interest rates that have squeezed margins in the life insurance portfolio, although it still benefits from some flexibility in both new business and back-book guaranteed rates.

Baloise also operates in Belgium and Germany, which we also see as strong and robust economies. Here, the group is also impacted by low interest rates hurting earnings, especially in the German life business. 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 over 2017-2019, given that we do not anticipate a major shift in Baloise's exposures.

Table 1

Industry And Country Risk -- Baloise Group

Insurance sector	IICRA	Business mix (%)
Switzerland Life	Low risk	43
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	14
Other	Low risk	3
Weighted IICRA	Low Risk	100

IICRA--Insurance Industry Country Risk Assessment. P/C--Property and casualty.

Competitive position: Strong footprint in most of its defined markets, but sluggish premium development due to restructuring measures

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. The group regards Germany also as a core market, but the competitive strength is less prominent.

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 P/C 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 P/C markets.

In 2016, Baloise's total GPW decreased by 1.8% to CHF6.7 billion. The premium reduction is mainly a consequence of a more selective product offering in the Swiss and German life business. Business volumes by end-September 2017 remained nearly stable with a premium decline of 1.5% in the life business based on the disposal of Basler Leben AG, largely offset by a P/C premium increase of 1.9% supported by strong growth in Belgium. We expect premium development to remain nearly stable in 2017-2018 following a strict underwriting strategy.

The group has sound product and premium diversity, offering life and P/C insurance products in its target markets. Within its life business, 69% of its premiums were written in the Swiss group life business in 2016, which accounts for more than two-thirds of its Swiss life technical reserves and almost one-half of its overall life reserves. The P/C 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 yet been fully translated into sustained earnings diversification compared to multinational peers with higher ratings. About 80% of the group's earnings before taxes are derived from the Swiss operations. We believe that Baloise will reap more benefits from its diversification into Germany once the group manages to turn around profitability sustainably.

Table 2

Competitive Position -- Baloise Group					
	--Year ended Dec. 31--				
(Mil. CHF)	**2016**	**2015**	**2014**	**2013**	**2012**
Gross premiums written	6,712	6,833	7,176	7,229	6,742
Change in gross premiums written (%)	(1.8)	(4.8)	(0.7)	7.2	(0.9)
Net premiums written	6,543	6,683	7,010	7,068	6,571
Change in net premiums Written (%)	(2.1)	(4.7)	(0.8)	7.6	(0.8)
Total invested assets	74,847	73,241	75,534	71,204	69,454
Growth in total invested assets (%)	2.2	(3.0)	6.1	2.5	7.3
Reinsurance utilization (%)	2.5	2.2	2.3	2.2	2.5
Business segment (% of GPW)					
Life	53.2	55.4	53.2	52.4	50.8
P/C	46.8	44.6	46.8	47.6	49.2
Health	0.0	0.0	0.0	0.0	0.0
Other	0.0	0.0	0.0	0.0	0.0

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

Financial Risk Profile: Very Strong

Capital and earnings: Improved capital through strong retained earnings and the issuance of hybrid capital

In our view, Baloise's group capitalization materially improved over the last years based on strong retained earnings and the issuance of CHF500 million of hybrid capital in 2017. We see capital adequacy as extremely strong in 2016 based on our risk-based capital model. We believe that the robust capital increase might support the group to consolidate its capitalization within the extremely strong level despite potential volatility from interest rates, a moderate asset portfolio shift toward more credit and market risk, an active capital management, or a potential inorganic growth.

Baloise's earnings have improved, based on half-year 2017 figures. The group's net income was up 33.8% to Swiss franc CHF299 million (about €261 million), compared with the first six months of 2016. This enhancement was mainly driven by a strong combined ratio of 89.7%, which is 2.8 percentage points better than the year before. The main contributor of this improvement was a strong profit increase in the German operations, where the combined ratio improved by 16.8 percentage points to 99.5%. In life, the group maintained an interest rate margin of 115 basis points, despite declining investment yields. Additionally, the steady reduction of Baloise's average back-book guarantees to

1.6% on June 30, 2017, from 1.9% in 2015, is narrowing the group's sensitivity to interest rate movements. Baloise disclosed a strong improvement in its new business margin (based on the annual premium equivalent) to 24.8% compared to 7.3% in the first six months of 2016. The strong improvement is driven by a combination of higher margins due to repricing of some life contracts, an improved business mix with new products that are less capital intense, and refinements in the model calculation since 2016 related to the Swiss business.

We expect continued strong earnings to support our extremely strong view of capital adequacy. Under our base case, we assume that Baloise will report net income of more than CHF500 million (about $512 million or €460 million) per year in 2017-2019, with an almost unchanged dividend payout ratio of about 50%. We further expect a life new business margin of about 20% (based on annual premium equivalent), a strong P/C combined ratio of 93%-95%, and a return on equity of 8%-12%.

Table 3

Earnings -- Baloise Group					
	--Year ended Dec. 31--				
(Mil. CHF)	**2016**	**2015**	**2014**	**2013**	**2012**
Total revenues	8,183	8,431	8,944	9,007	8,511
EBIT adjusted	381	340	154	448	394
Net income	534	511	712	455	485
Return on Shareholders' Equity (reported) (%)	9.5	9.1	13.3	9.5	11.4
P/C: Net expense ratio (%)	31.4	30.8	31.9	32.0	32.9
P/C: Net loss ratio (%)	60.8	62.1	61.7	62.7	61.1
P/C: Net combined ratio (%)	93.2	93.1	94.0	96.5	94.7
Life: Return on embedded value (%)	14.7	8.3	(4.1)	35.1	26.4
Life: Embedded value	4,409	3,876	3,610	3,809	2,753
Life: Value of new business	69	36	59	45	23
Operating earnings by segment*					
Life	226	277	481	261	177
P/C	396	396	423	366	410

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

Table 4

Capital -- Baloise Group					
	--Year ended Dec. 31--				
(Mil. CHF)	**2016**	**2015**	**2014**	**2013**	**2012**
Common equity	5,774	5,454	5,831	4,906	4,641
Change in common equity (%)	5.9	(6.5)	18.8	5.7	19.2
Total capital (reported)	7,244	7,161	7,533	6,604	6,659
Change in total capital (reported) (%)	1.2	(4.9)	14.1	(0.8)	20.9

CHF--Swiss franc.

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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 challenging interest rate environment. The divestment of the German run-off portfolio, which carried policies with high guarantees, together with a further strengthening of its life reserves, and the optimization of the business mix toward capital efficient products helped to reduce the average guaranteed rate of return to 1.6% compared with 1.9% in 2015.

The group's asset allocation is concentrated on fixed-income investments, with 57.3% of total invested assets based on half-year 2017 reported figures. Baloise has reduced its equity exposure to 6.4% compared with 8.0% in 2015, but at the same time increased its investment property assets to 12.4% from 11.4% and policy and other loans to 11.6% from 10.8% taking advantage of some illiquidity premiums in the current very low interest rate environment. We regard the credit-risk exposure of Baloise's bond portfolio to be favorable, owing to a substantial proportion of mainly Swiss, Belgium, and German government and covered bonds, with a composition of about 72% 'AA' or higher rated bonds in the portfolio. 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 2017-2019, 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 1.6% in 2016.

Table 5

Risk Position -- Baloise Group

	--Year ended Dec. 31--				
(Mil. CHF)	**2016**	**2015**	**2014**	**2013**	**2012**
Total invested assets	74,847	73,241	75,534	71,204	69,454
Change in invested assets (%)	2.2	3.0	6.1	2.5	7.3
General account invested assets	64,196	63,459	65,692	62,535	61,572
Separate accounts/unit linked assets	10,651	9,782	9,842	8,669	7,882
Net investment income	1,416	1,461	1,635	1,695	1,723
Realized/unrealized gains/(losses)	303	379	775	211	224
Net investment yield (%)	2.2	2.3	2.6	2.7	2.9
Net investment yield including all gains/(losses) (%)	2.7	2.9	3.8	3.1	3.3
Investment portfolio composition (%)					
Cash and short-term investments (%)	6.2	5.9	5.4	5.7	6.5
Bonds (%)	56.9	56.8	59.0	58.7	59.5
Equity investments (%)	7.7	8.2	7.4	6.2	4.7

Table 5

Risk Position -- Baloise Group (cont.)					
	--Year ended Dec. 31--				
(Mil. CHF)	**2016**	**2015**	**2014**	**2013**	**2012**
Real estate (%)	11.6	10.9	10.1	10.3	10.1
Mortgages (%)	17.4	17.9	17.8	18.7	18.8
Investments in affiliates (%)	0.2	0.3	0.3	0.4	0.4

Financial flexibility: Cautious debt and proven access to capital markets

Baloise has adequate financial flexibility, in our view, thanks to sound operating cash flows, a cautious level of debt, proven access to capital markets, and ample liquidity. The group has six senior bonds outstanding with a total face value of CHF1.25 billion and a widely spread maturity profile. In addition, the group issued for the first time two hybrid bonds in 2017 with a total amount of CHF500 million. The company demonstrated its commitment to the capital markets by announcing in December 2016 a share-buyback program over up-to-three million shares. The expected buyback period is over three years, and the completion rate at the end of August 2017 was 8%.

We estimate that the Baloise group's financial leverage (debt plus hybrid capital, divided by the sum of economic capital available, debt, and hybrid capital) will remain relatively conservative in 2017-2019, at about 20%. The fixed-charge coverage ratio (EBITDA divided by senior and subordinated debt interest) is likely to remain comfortable, above 10x.

Table 6

Financial Flexibility					
	--Year ended Dec. 31--				
(x)	**2016**	**2015**	**2014**	**2013**	**2012**
Fixed-charge coverage (x)	19.7	19.7	24.5	15.1	11.9
Financial leverage (%)	17.6	21.4	20.1	19.5	26.1

Other Assessments

Enterprise risk management: Strong with high importance for the rating

We assess Baloise's ERM as strong. Our assessment reflects our positive view on strategic risk management, risk-management culture, and risk controls for the group's major risks. It is unlikely, in our view, that the group will experience losses exceeding its risk tolerance and that it would minimize losses relative to its current risk appetite over the next two years. 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 as high, limiting downside risk to the current rating. 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 P/C operations.

Management and Governance: Smooth transition in management

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.

The group's top management changed over the last two years, first with the CEO transition in April 2016 followed by a change in the CFO and CIO positions in April 2017. We observed a smooth change in management, with a general continuation of Baloise's strategy. However, the new management team faces the challenge of sustainably 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 66% 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

- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General Criteria: Criteria Clarification On Hybrid Capital Step-Ups, Call Options, And Replacement Provisions, Oct.

22, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- Criteria - Financial Institutions - General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Criteria - Financial Institutions - Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Insurance - General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Related Research

- Swiss Insurer Baloise Outlook To Positive On Improved Capital; Basler Leben Rated 'A'; Proposed Notes Rated 'BBB+', Sept. 1, 2017

Ratings Detail (As Of November 30, 2017)	
Holding Company: Baloise Holding AG	
Issuer Credit Rating	
Local Currency	BBB+/Positive/--
Operating Companies Covered By This Report	
Basler Versicherung AG	
Financial Strength Rating	
Local Currency	A/Positive/--
Counterparty Credit Rating	
Local Currency	A/Positive/--
Baloise Belgium N.V.	
Financial Strength Rating	
Local Currency	A/Positive/--
Issuer Credit Rating	
Local Currency	A/Positive/--
Basler Leben AG	
Issuer Credit Rating	
Local Currency	A/Positive/--
Basler Sachversicherungs AG	
Financial Strength Rating	
Local Currency	A-/Positive/--
Issuer Credit Rating	
Local Currency	A-/Positive/--
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 debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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