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## Research Update:

# Baloise Group's Core Operating Entity 'A' Ratings Affirmed; Outlook Stable; Three Group Entities Assigned Ratings

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## Research Update:

# Baloise Group's Core Operating Entity 'A' Ratings Affirmed; Outlook Stable; Three Group Entities Assigned Ratings

## Overview

- Switzerland-based Baloise group continues to demonstrate a strong competitive position benefiting from its robust foothold in Switzerland, Luxembourg, and Belgium. Germany is one of its target markets but the group has a weaker competitive position there.
- The group also continues to benefit from a very strong capital and earnings position and overall financial risk profile.
- We are therefore affirming our 'A' ratings on Switzerland-based Basler Versicherung AG, a core operating entity of Baloise.
- We are also assigning our 'A' ratings to Baloise Belgium N.V.; our 'A-' ratings to Germany-based Basler Sachversicherungs-AG; and our 'BBB+' issuer credit rating to Baloise Holding AG, the group's non-operating holding company.
- The stable outlook reflects our view that Baloise will maintain its strong franchise in Switzerland, defend its positions in its main international markets, and keep its capital adequacy at least at very strong levels.

## Rating Action

On June 29, 2017, S&P Global Ratings affirmed its 'A' long-term insurer financial strength and counterparty credit ratings on Switzerland based multi-line insurer Basler Versicherung AG, a core entity of the Baloise group.

At the same time, we assigned our 'A' financial strength and counterparty credit ratings to Belgium-based Baloise Belgium N.V., and our 'A-' ratings to Germany-based Basler Sachversicherungs-AG.

We also assigned our 'BBB+' issuer credit rating to Switzerland-based Baloise Holding AG.

The outlook on all the ratings is stable, reflecting the overall outlook on the group.

## **Rationale**

The affirmation of Baloise group's core entity, Basler Versicherung AG, predominantly reflects that the group has maintained a strong competitive position resulting from its strong foothold in its defined operating markets--Switzerland, Luxembourg, and Belgium--in which it holds at least top 10 market positions in life and property/casualty (P/C), with sound profitability, especially in the Swiss P/C business. Basler Sachversicherungs-AG has a less prominent position in Germany, which is one of Baloise group's target markets, than the other group entities in their respective markets. The affirmation also reflects our view of the group's very strong capital and earnings and overall financial risk profile.

Switzerland accounts for about 48% of the Baloise group's business volume, with the remainder derived from Belgium, Germany, and Luxembourg. Baloise has built a strong footprint not only in its domestic country but also in Belgium and Luxemburg. The insurer is a relatively small player in Germany with a market share of about 1% in life and P/C, and we believe that it will begin to benefit more from its diversification into Germany once it has completed its business restructuring.

We view Baloise's capital and earnings over 2017-2019 as very strong, supported by a 'AAA' capital adequacy at year-end 2016, as it was in the previous year. However, we expect that capital adequacy may weaken somewhat through active capital management, but remain at least at very strong over the rating horizon. Our expectations take into consideration average annual net income of above Swiss franc (CHF) 500 million, 49% ordinary dividend pay-out ratio, increasing capital requirements in line with business and asset growth, and the announced share buyback program of three million shares over three years.

Baloise's overall group operating performance has been robust, with the group reporting a strong and stable combined ratio of 93% in 2016, driven by very profitable operations in Belgium and particularly Switzerland. Baloise's German operations continue to represent a drag on overall performance, under-performing the German market in 2016. We expect a slow recovery as Baloise strengthened its P/C reserves and announced the successful divestment of the life run-off portfolio of Basler Leben AG. Reserve strengthening and other management actions in Switzerland and, in particular, Germany help to contain exposure to the prolonged low interest rate environment, reducing exposure to interest rates risk and sensitivity.

The ratings on the Baloise group benefit from our view of its strong risk-management capabilities, which we view as having high importance to the rating. On the other hand, the still limited earnings diversity compared with higher rated multinational peers, and still significant, although declining, sensitivity to low interest rates stemming from the Swiss and German operations currently limit the ratings at the current 'A' level.

#### BALOISE BELGIUM N.V.

Our 'A' rating on Baloise Belgium reflect our view of its core status to the overall group. Belgium is one of the four strategic markets for Baloise, contributing 18% of the group premiums and 25% of Baloise's EBIT in 2016. Baloise Belgium benefits from a strong position in the Belgian market and is highly integrated with the group in terms of asset management, risk management, human resources, and reinsurance strategy.

#### BASLER SACHVERSICHERUNGS-AG (BASLER SACH)

Our 'A-' rating on Basler Sach is based on our view of its highly strategic status to the overall group. As such we rate the entity one notch below the group credit profile. Although the German operations are also among the group's key strategic markets, contributing 16% to the overall business volume, the earnings contribution is much lower. In 2016, it reported a net combined ratio of 110%, hindered by reserve strengthening in the industrial business. The contribution from life has also been modest, leading to an overall negative EBIT of CHF60,9 million. Basler Sach is also highly integrated with the group in terms of asset management, risk management, human resources, and reinsurance strategy.

#### BALOISE HOLDING AG

We rate Baloise Holding AG, the non-operating holding company of the group at 'BBB+'. All senior debt has been issued by this entity, being the group's main vehicle for external funding. The holding company's main earning streams are dividend payments from its operating subsidiaries. Based on the structural subordination of earning streams, we are applying our standard two-notch gap between the non-operating holding company and the group's core operating activities.

## Outlook

S&P Global Ratings' outlooks on Baloise's rated entities are stable reflecting our view that over the next two years, 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 2017-2019, and that the company will keep its capital adequacy at least at very strong levels.

## 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. We could also upgrade the group, if we considered that its capital adequacy would remain comfortably over our 'AAA' benchmark based on our risk-based capital model, despite the effect on the planned capital management actions.

We could also raise the ratings on Basler Sachersicherungs-AG, if the company managed to substantially and sustainably enhance its operating performance in line with the German market average and its parent's expectations, significantly contributing to the group's earnings diversification. This would trigger a change in our group status view from highly strategic to core.

### Downside scenario

We could lower the ratings if:

- Financial market conditions deteriorated, 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 strong capital adequacy.

## Ratings Score Snapshot

	To	From
Financial Strength Rating	A/Stable	A/Stable
Anchor	a	a
Business Risk Profile	Strong	Strong
IICRA	Low Risk	Low Risk
Competitive Position	Strong	Strong
Financial Risk Profile	Very Strong	Very Strong
Capital and Earnings	Very Strong	Very Strong
Risk Position	Intermediate	Intermediate
Financial Flexibility	Adequate	Adequate
Modifiers	0	0
ERM and Management	+1	+1
Enterprise Risk Management	Strong	Strong
Management and Governance	Satisfactory	Satisfactory
Holistic Analysis	-1	-1
Liquidity	Exceptional	Exceptional
Support	0	0
Group Support	0	0
Government Support	0	0

IICRA--Insurance Industry And Country Risk Assessment.

## Related Criteria

- 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
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

## Ratings List

### Ratings Affirmed

#### Basler Versicherung AG

Counterparty Credit Rating

Local Currency

A/Stable/--

Financial Strength Rating

Local Currency

A/Stable/--

### New Rating; Outlook

#### Baloise Belgium N.V.

Counterparty Credit Rating

Local Currency

A/Stable/--

Financial Strength Rating

Local Currency

A/Stable/--

#### Baloise Holding AG

Counterparty Credit Rating

Local Currency

BBB+/Stable/--

#### Basler Sachversicherungs AG

Counterparty Credit Rating

Local Currency

A-/Stable/--

Financial Strength Rating

Local Currency

A-/Stable/--

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