Baloise Group

MARKET CONSISTENT EMBEDDED VALUE REPORT

2014

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1. INTRODUCTION

1.1. Basis of Preparation

Since 2001 the Baloise Group has published Embedded Value ("EV") results for its Life Insurance businesses as supplementary information to its statutory and IFRS accounts. EV represents shareholders' economic value of the in-force business from the IFRS Life Insurance segment at the valuation date, excluding future new business. It measures the shareholder value that an insurance portfolio is expected to create over its lifetime, taking a long term view of profitability. This differs from other accounting standards such as IFRS which currently focus on revenues and expenses occurring during a single past reporting period.

Since 2009 the Baloise Group has published the EV results in line with the European Insurance CFO Forum 'Market Consistent Embedded Value Principles'[1] ("MCEV Principles").

This document provides details of the results, methodology and assumptions used to calculate the 2014 MCEV for the Baloise Group in accordance with the disclosure requirements of the MCEV Principles.

The methodology and assumptions used to determine the 2014 embedded value results for the Baloise Group, as well as the new business value and the analysis of movement between 2013 and 2014, have been subject to external review by the Actuarial & Insurance Solutions practice of Deloitte. Their opinion is included in the section 'External Reviewer's Statement'.

The Baloise Group has completed in 2014 the sale of its subsidiaries in Austria, Croatia and Serbia as part of its strategy of focusing on core markets. Furthermore, to strengthen its position in the Luxembourg market, it acquired in 2014 the Luxembourg business of the Belgian insurance company P&V Assurances. These transactions are reflected in the analysis of movement of the MCEV between 2013 and 2014. As a consequence of these transactions and in order to obtain reporting segments of a more equal size than in previous years, Baloise has revised the segmentation of its MCEV results by region. The embedded value results are newly reported separately for Switzerland and the segment "International". The latter includes the life entities in Germany, Belgium, Luxembourg and Liechtenstein as well as consolidation effects.

1.2. Covered Business

Baloise Group's MCEV results cover all its material life insurance operations and entities, consistent with the business covered in its IFRS Life Insurance segment as consolidated into the Group's IFRS accounts.

A Market Consistent Embedded Value is calculated for all the life entities of the Baloise Group except for the life business in Liechtenstein, which has been included in Baloise's MCEV at their IFRS equity value for materiality reasons.[2] The statutory book values of companies held within the other life companies of the Baloise Group are removed as a consolidation effect.

All calculations are net of external reinsurance; results for individual operations are gross of internal reinsurance within the Life segment. All results reflect the interest of Baloise shareholders in the business.

Although no future new business is included in the valuation, the results are produced on the assumption that all operations remain open to new business and continue to operate in a similar manner and scale relative to the current position, i.e. on a "going concern" basis.

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[2] At year-end 2013, the life businesses in Austria, Croatia and Serbia had also been included at their IFRS equity value.

1.3. Definitions

According to the MCEV Principles, the MCEV represents the present value of shareholders' interests in the earnings distributable from assets allocated to the covered business after allowance for the aggregate risks in the covered business, where the allowance for risk is calibrated to match the market price where reliably observable.

The MCEV consists of the following components[3]:

- → Shareholders' Net Assets ("SNA") – the market value of assets attributed to covered business, which are not backing the liabilities from the covered business.
- → Value of In-Force ("VIF"), made up of the following components:
  - Present Value of Future Profits – the present value of future post-tax shareholder profits from the assets backing the liabilities associated with the in-force covered business. Baloise calculates this value on a 'certainty equivalent' basis and refers to it as the Certainty Equivalent Value of Business in-Force ("CEVBF")
  - Time Value of Financial Options and Guarantees ("TVFOG") – an allowance for the potential impact on future shareholder cash flows of all financial options and guarantees in the in-force covered business, valued in line with similar cash flows (from a timing and risk perspective) that are traded in capital markets[4];
  - Frictional Costs of Capital ("FCC") reflecting the taxation and investment management costs on shareholder assets locked into the business. Baloise's approach is to apply this cost to the whole SNA, whereas the MCEV Principles only require it to be applied to Required Capital;
  - Cost of Non-Hedgeable Risks ("CNHR") - an allowance for the potential impact on shareholder cash flows of risks, both financial and non-financial, not allowed for in the CEVBF or the TVFOG.

Baloise also refers to the CEVBF net of TVFOG as the Net Present Value of Future Profits ("NPVFP").

New business is the sale of new Life Insurance segment contracts during the reporting year, including cash flows arising from the projected renewal of those new contracts. Its definition and the derivation of the Market Consistent Value of New Business ("MCVNB") are discussed below under Methodology.

Two measures of the volume of new business are used to derive the margin on new business. The measures of volume are APE (Annual Premium Equivalent)[5] and PVNBP (Present Value of New Business Premiums)[6].

[3] Further details of Baloise's approach to defining and calculating these items are given in the Methodology section below.
[4] Further details on the methods employed and the Economic Scenario Generator used are given in the Methodology section below.
[5] APE is the annual amount of new regular premiums plus 10% of new single premiums written.
[6] PVNBP is calculated as the present value from new business, discounting using the reference yield curve, of its initial and expected future premiums using assumptions and projection periods that are consistent with those used to calculate the MCVNB.

2. MCEV AND MCVNB RESULTS

2.1. Baloise MCEV

The Baloise MCEV was CHF 3'610m at 31.12.2014 with a total return of -4.1%, split into a positive operating return on MCEV of 13.6% and a negative economic return on MCEV of -17.7% in 2014.

Strong operating performance generated earnings of CHF 518m, of which CHF 280m come from Switzerland and CHF 239m from the segment International. All entities contributed to the operating earnings by positive operating returns on the in-force business and profitable new business which increased Baloise's MCEV by CHF 59m in 2014. The operating earnings were more than offset by the negative economic return in 2014. It was driven by the significant reductions in the CHF and EUR yield curves, partly compensated by a favourable investment performance during the year.

Table 1 – Baloise MCEV

CHF Mio.	31.12.2013	31.12.2014	Change	RoEV[7]
Switzerland	2'844	2'777	-67	-0.9%
International	965	833	-132	-7.7%
Total	**3'809**	**3'610**	**-198**	**-4.1%**

The Baloise Embedded Value is the sum of the individual entity Embedded Values subject to consolidation adjustments. The values of the life entities in Germany, Belgium, Luxembourg and Liechtenstein as well as the consolidation adjustments are included in the segment International. The consolidation adjustments result from the removal of the statutory book values of those life companies held within other Life entities included in the MCEV and from the effect on CNHR of diversification of risk between companies. Baloise's MCEV can be further broken down into the following components as shown in Table 2:

Table 2 – Breakdown of Baloise MCEV

	31.12.2013			31.12.2014		
CHF Mio.	Switzerland	International	**Total**	Switzerland	International	**Total**
CEVBF	2'330	640	**2'969**	2'275	316	**2'591**
TVFOG	-203	-149	**-351**	-449	-75	**-525**
CNHR	-196	-111	**-307**	-175	-41	**-217**
FCC	-59	-93	**-152**	-48	-69	**-117**
VIF	**1'872**	**287**	**2'159**	**1'602**	**131**	**1'733**
SNA	971	678	**1'649**	1'175	702	**1'877**
MCEV	**2'844**	**965**	**3'809**	**2'777**	**833**	**3'610**

The components of the Value of In-Force (VIF) and the definition of the Shareholders' Net Assets (SNA) follow the MCEV Principles and are described in the Methodology section below.

The impact of the adverse economic environment is reflected either in a significant increase of TVFOG, which is the case for Switzerland, or a large decrease of CEVBF, which is the case for International, depending on the moneyness of policyholder and shareholder options. CNHR decreased for Switzerland and International as a result of a revision of the CHNR methodology, which is described in the Methodology section below.

[7] The returns on opening MCEV of each entity are calculated in local currency and are net of capital movements, intercompany effects, and the impact of acquired/divested business, except that the RoEV for Switzerland includes the gains of Baloise Switzerland from the sale of Baloise Austria.

2.2. Volume and Value of New Business

The Baloise new business value was CHF 59m in 2014, 30.4% higher than a year earlier, driven by higher volumes as well as improved profitability of the new business. The main contributions to the increase in APE of 16.9% come from higher sales in Switzerland, Belgium and Luxembourg. The new business margins on APE rose to a margin of 15.0% in 2014. The increase of the margin compared to previous year, despite the adverse economic environment, mostly reflects operational improvements. They include among others disciplined pricing, and ongoing changes in the business mix towards modern products. The impact of the adverse economic environment was much less severe on the new business than on the in-force business mainly due to the fact that the interest rates at point of sale of the new business were not as low as they were at the end of 2014.

Table 3a shows the new business volumes, value and margins using APE (Annual Premium Equivalent) and PVNBP (Present Value of New Business Premiums) as measures for the volume of new business.

Table 3a – Baloise New Business - Premium Volumes, Values and Margins

	2013			2014		
CHF Mio.	Switzerland	International	**Total**	Switzerland	International	**Total**
MCVNB	17	28	**45**	27	32	**59**
APE	155	178	**333**	183	207	**390**
NB Margin on APE	11.1%	15.6%	**13.5%**	14.6%	15.4%	**15.0%**
PVNBP	2'105	1'783	**3'889**	2'703	2'154	**4'857**
NB Margin on PVNBP	0.8%	1.6%	**1.2%**	1.0%	1.5%	**1.2%**

In Switzerland the new business value increased substantially by CHF 10m, driven by higher volumes and improved margins. The volume of new business rose significantly from CHF 155m APE to CHF 183m APE in 2014 due to the successful sale of modern products in Individual Life as well as increased volumes in Group Life. The new business margin increased by 3.5%-pts benefiting from improvements in the business mix and operational measures. Since the interest rates at point of sale remained largely unchanged in comparison to last year the economic effects were much less pronounced on the new business than on the in-force business.

The new business volumes, values and margins of the segment International can be further broken down by business unit as shown in Table 3b.[8]

Table 3b – Breakdown of Baloise International New Business Volumes, Values and Margins

	2013				2014			
CHF Mio.	Germany	Belgium	Luxemb.	**Intern.**	Germany	Belgium	Luxemb.	**Intern.**
MCVNB	10	5	13	**28**	9	7	16	**32**
APE	42	30	106	**178**	35	54	118	**207**
NB Margin on APE	23.3%	16.2%	12.3%	**15.6%**	25.0%	13.8%	13.3%	**15.4%**
PVNBP	397	328	1'058	**1'783**	327	641	1'186	**2'154**
NB Margin on PVNBP	2.5%	1.5%	1.2%	**1.6%**	2.7%	1.2%	1.3%	**1.5%**

In Germany a decrease in APE by 15.2% in local currency was mainly compensated by a higher new business margin which increased to 25.0% such that the new business value remained almost stable compared to 2013. The new business margin benefited from the effect of cross-subsidization between in-force and new business and from improvements in the business mix.

In Belgium, the new business value increased driven by significantly higher volumes. APE almost doubled compared to previous year due to higher sales in all lines of business, most notably investment products. The

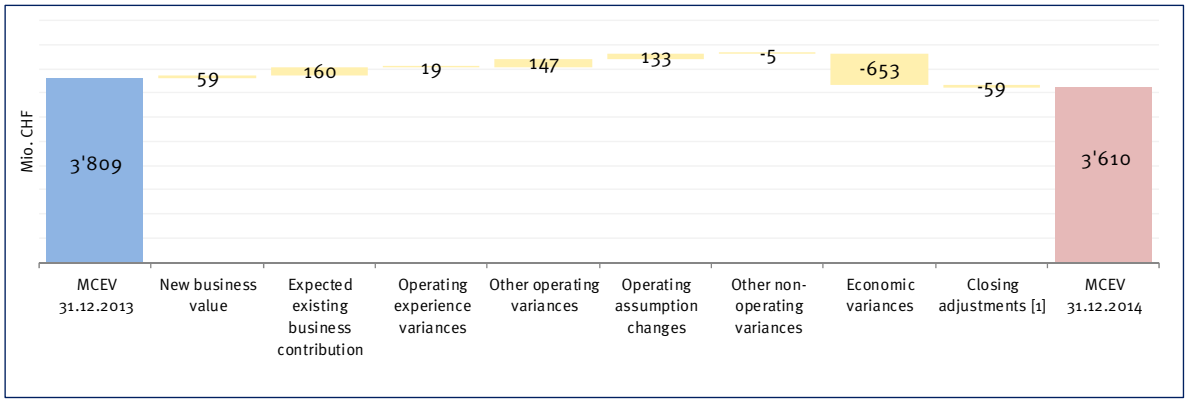
[8] New business of Baloise Life Liechtenstein is not included in Baloise MCEV reporting for materiality reasons.

new business margin decreased to 13.8% due to the lower interest rates despite positive effects from lower expenses and re-pricing measures.

Luxemburg reported higher volumes and improved margins. APE increased by 12.6% in local currency mainly due to growth in the unit linked business. The new business margin improved to 13.3% due to operational improvements which more than compensated an adverse impact of the economic environment.

2.3. Analysis of Change in MCEV

Elements in the movement in Baloise's MCEV over the year are shown below:



[1] Includes the impact of acquired/divested business, capital movements, intercompany and currency translation effects

Table 4 – Baloise MCEV Movement and Earnings Analysis

	Switzerland	International			Total
CHF Mio.	MCEV	MCEV	SNA	VIF	MCEV
Opening values	**2'844**	**965**	**1'649**	**2'159**	**3'809**
New business value	27	32	-38	97	59
Expected contribution at reference rate	18	26	7	37	44
Expected contribution in excess of reference rate	91	26	15	102	116
Expected transfers to SNA	0	0	128	-128	0
Operating experience variances	29	-10	-23	42	19
Other operating variances	41	107	-69	217	147
Operating assumption changes	74	59	0	133	133
Operating earnings	**280**	**239**	**19**	**499**	**518**
Other non-operating variances	-20	15	5	-10	-5
Economic variances	-341	-312	262	-915	-653
Total earnings	**-81**	**-58**	**286**	**-426**	**-140**
Closing adjustments	15	-74	-58	0	-59
Closing values	**2'777**	**833**	**1'877**	**1'733**	**3'610**

The total return on the opening MCEV amounts to -4.1% and splits into an operating return on MCEV of 13.6% and an economic return on MCEV of -17.7% in 2014.[9]

[9] The total return is calculated as the sum of total earnings and currency translation effects (-16m CHF in 2014) divided by the opening MCEV.

The value of new business of CHF 59m consists of the shareholders' share of initial expenses which decreases the SNA and the shareholders' share of the future profits from new business which increases the VIF.

The value shown is that of new business still in force at the year-end, using year-end projection assumptions and adjusted to point of sale to reflect discounting and changes in unrealised gains.

The expected existing business contributions include:

i. expected earnings on the opening SNA and VIF at the opening reference yields including the impact of release from risk in TVFOG and CNHR (CHF +44m), and
ii. management's expectation of additional earnings (CHF +116m) primarily in respect of risky assets expected to earn long term returns in excess of reference yields.[10]

As the in-force business runs off during the year transfers to SNA shows the expected release of profit from the in-force portfolio into shareholder equity. This release of profits has no net impact on the MCEV.

Operating experience variances (CHF +19m) include the impact of experience versus expectations in the insurance contract portfolios in non-economic areas such as mortality, expenses, and persistency. The most significant effects in 2014 come from Switzerland and reflect better than expected persistency experience.

Other operating variances include the impact on MCEV of adjustments of the bonus rates and of changes in the bonus rules except for those which are directly driven by the change in economic conditions and are therefore captured in the economic variances. The position also contains the variance due to modelling changes, the impact of management decisions such as the changes in the asset allocation, as well as adjustments to comply with a point of sale valuation of the new business written during the year.

In 2014, the other operating variances amount to CHF +147m. They include various operating items linked to the current low interest rate environment. Positive contributions result from cuts in bonus rates in the Swiss Individual business and in Germany as well as from model enhancements and revised management rules in Switzerland and Germany. In Switzerland these effects are partially offset by the impacts of management's decision to strengthen reserves.

Furthermore, the other operating variances contain items which impacted all entities. Those include the revision of the CNHR methodology, which had positive impacts in particular in Switzerland and Belgium, and the change to an economic scenario generator allowing for a wider range of financial risks, which had negative impacts in all entities. More details on the CHNR methodology and the economic scenario generator are given in the Methodology section below. Together, the various effects sum up to other operating variances of CHF +41m in Switzerland and CHF +107m in International.

Assumptions for experience in areas such as lapses, mortality and expenses are reviewed on a regular basis. The impact (CHF +133m for 2014) of any changes in expectations is captured in Operating Assumption Changes. The largest effects in 2014 come with CHF +74m from Switzerland and mainly reflect experience-driven updates of mortality, morbidity and expense assumptions. A further positive contribution of CHF +59m results from International mainly due to updated cost assumptions in Germany and Belgium.

Other non-operating variances (CHF -5m) include any other non-economic deviations from expectation that are not captured by the items above, e.g. the impact of tax and regulatory changes. In Switzerland, the impact is negative (CHF -20m) due to updates in conversion rate assumptions and the persistently high guaranteed interest rate in Group Life business. The positive effect in International mainly comes from Germany and results from the new Life Insurance Reform Act (Lebensversicherungsreformgesetz) in Germany.

Economic variances (CHF -653m) include the impact of both economic experience during the year and assumption changes at the year-end with respect to economic assumptions such as reference yields, volatilities,

[10] The risk premiums over the reference yields used for this calculation are shown in the Economic Assumptions section below.

inflation rates, returns on investments, and taxes. The economic variances have been negative in all entities and are comprised of CHF -341m from Switzerland and CHF -312m from International. They are mainly driven by the significant decrease of interest rates during the year, which was partially compensated by the strong investment performance of equities, properties and interest rate derivatives and the positive impact from the tightening of credit spreads during the year.

Closing adjustments include the impact of acquired/divested business, capital movements, intercompany and currency translation effects. The Baloise Group acquired in 2014 the Luxembourg business of the Belgian insurance company P&V Assurances and divested its subsidiaries in Austria, Croatia and Serbia as part of its strategy of focusing on core markets. Those parts of these transactions which affected Baloise Group's life insurance segment are included in the closing adjustments as impact of acquired/divested business. The item Capital movements include dividends due from the Life segment to Baloise Group during 2014 and capital contributions to the Life segment business. Intercompany effects reflect profit transfers from the Life Segment into other segments. Currency translation effects finally result from the consolidation in Swiss Francs.

In Switzerland the closing adjustments amount to CHF 15m in 2014 and include the financial gains generated by the divestment of the life business of Baloise Austria, the dividend payment of CHF +20m and the impact of intercompany effects. The closing adjustments of International (CHF -74m in 2014) consist of the remaining impacts of acquired/divested business in particular the decrease in SNA due to the sale of Croatia and Serbia[11], the dividend payment of Germany (CHF +8m), a capital increase in Luxembourg (CHF -4m), the impact of intercompany effects and finally currency translation effects of CHF -16m due to the slight depreciation of the EUR compared to the CHF.

2.4. Sensitivities

Sensitivities are an important part of the MCEV analysis in order to judge those areas in which shareholder value can change with experience. The following tables show changes in Baloise's MCEV and MCVNB resulting from changes in various economic and operating assumptions. These sensitivities follow the descriptions in the MCEV Principles (see the Methodology section for details).

Table 5a – Baloise Economic Sensitivities

CHF Mio.	Δ MCEV	Δ MCEV in %	Δ MCVNB	Δ MCVNB in %
Base Value	3'610	-	59	-
+100 bps to reference yields	628	17%	23	38%
-100 bps to reference yields	-904	-25%	-33	-56%
10% decrease in equity / property values	-451	-12%	-8	-14%
25% increase in equity / property implied volatilities	-79	-2%	-4	-6%
25% increase in swaption implied volatilities	-129	-4%	-4	-7%
without liquidity premium	-97	-3%	-2	-3%

The MCEV is particularly sensitive to movements in fixed interest yields since a significant part of the in-force business is traditional business in which shareholder profits are driven by a margin on future interest yields. The effect is asymmetric due to the impact of guarantees and options tending to impact more in low interest rate scenarios. The sensitivity mainly stems from Switzerland and Germany as a large share of these businesses is traditional business with interest rate guarantees close to or just above the level of interest rates at year-end 2014. The interest rate sensitivities increased compared to 2013 mainly because the worsening of the financial conditions allow less flexibility to share investment fluctuations with policyholders.

The economic sensitivities of the MCVNB broadly follow those of the MCEV.

[11] The revenue from these transactions was paid into the Non-Life segment and is hence not reported in MCEV.

Table 5b – Baloise Operating Sensitivities				
CHF Mio.	Δ MCEV	Δ MCEV in %	Δ MCVNB	Δ MCVNB in %
Base Value	3'610	-	59	-
10% decrease in lapse rates	52	1%	7	12%
10% decrease in maintenance expenses	132	4%	6	11%
10% decrease in initial expenses	n.a.	n.a.	6	10%
5% improvement in mortality assumptions – insurance	20	1%	2	3%
5% improvement in morbidity assumptions	46	1%	2	3%
5% improvement in mortality assumptions – annuity	-64	-2%	-1	-1%
1%-pt decrease for CNHR	73	2%	4	6%

Lower lapse rates keep the business on Baloise's books for longer, increasing the average period over which shareholder profits are earned. In some markets this positive impact is offset by lower projected profits on surrenders. Overall the impact on Baloise's 2014 MCEV is slightly positive (+1%). As expected, lower projected expenses increase the MCEV. Mortality improvements affect different types of products in different ways. Lower mortality rates increase profits on products with mortality risk and reduce profits on annuity-type products with longevity risk. Improvements in morbidity increase the MCEV. Baloise also provides the sensitivity of the MCEV to a different rate of capital charge for the CNHR (3% instead of 4%) so that analysts can make their own estimates of this cost.

The operational sensitivities of the MCVNB broadly follow those of the MCEV.

No sensitivity to the level of Required Capital has been provided as Baloise calculates the FCC on the whole SNA. Hence a different level of Required Capital has a neutral impact on the overall MCEV, simply affecting the way the SNA would be split between Required Capital and Free Surplus.

2.5. Reconciling MCEV Shareholders' Net Assets to IFRS Equity

The local statutory balance sheets, rather than IFRS balance sheets, are the starting point for the MCEV projections. It is possible, however, to reconcile the net assets used in determining the MCEV for Baloise's Life business with those published under IFRS, by considering the adjustments necessary to reach statutory net assets:

Table 6 – Reconciliation of SNA to IFRS shareholders' Life equity	
CHF Mio.	Total
IFRS Shareholders' Equity as at 31.12.2014	4'071
Removal of DAC & intangible assets	-104
Unrealised capital gains included in VIF instead of SNA under MCEV	-2'011
Difference in IFRS reserves compared to statutory reserves	-648
Other adjustments	569
Shareholders' Net Assets as at 31.12.2014	1'877

The major elements of the reconciliation are as follows:

- → Elimination of all Deferred Acquisition Costs (DAC) and intangible assets from the IFRS balance sheet;
- → Deduction from IFRS net assets of unrealised gains that are projected in the MCEV as part of the VIF but form part of the IFRS net assets;
- → Further reconciliation steps between the Statutory and IFRS balance sheets, predominantly reflecting different reserving bases.

3. METHODOLOGY

The MCEV is a measure of the consolidated value of shareholder investments in the covered business, determined as the value arising from the run-off of business in force at the year-end using assumptions consistent with a going concern basis. To determine the assumptions for valuing in-force business it is assumed that the company continues to write new business at levels consistent with recent years, although no value of future new business is included in the MCEV.

Projections are made of future cash flows net of external reinsurance and net of taxes over 40 years, with a split between shareholders and policyholders of the residual balance sheet at the end of the projections.

Baloise's MCEV is the sum of the Shareholders' Net Assets (SNA) and the Value of In-Force (VIF) of its Life Insurance Segment business, terms which are described further below.

The Baloise Group provides each reporting entity with detailed methodological guidelines based on the MCEV principles and with basic economic assumptions used in the calculation of its MCEV. MCEV results are signed off against these by the local CEO.

3.1. Covered Business

For the purposes of Baloise Group MCEV reporting, covered business is defined as all the business included in the Life Insurance segment of the published IFRS accounts. This includes a range of traditional and unit linked life insurance risk protection, savings / investment and retirement products distributed to individuals and companies by the life entities of the Baloise Group. Descriptions of terms below apply to legal entities and businesses within the Life Insurance segment.

A Market Consistent Embedded Value is calculated for Basler Leben AG ("Baloise Switzerland"), Basler Lebensversicherungs-Aktiengesellschaft and Basler Leben AG Direktion für Deutschland (together "Baloise Germany"), the life business of Baloise Belgium NV ("Baloise Belgium"), and for Baloise Vie Luxembourg SA ("Baloise Luxembourg"). The life business of Baloise Life Liechtenstein AG ("Baloise Liechtenstein") has been included at its IFRS equity value.[12] The statutory book values of those Companies within other life entities have been removed as a consolidation effect.

The Baloise Group acquired in 2014 the Luxembourg business of the Belgian insurance company P&V Assurances and divested its subsidiaries in Austria, Croatia and Serbia as part of its strategy of focusing on core markets. These transactions are taken into account in the analysis of movement of the MCEV between 2013 and 2014.

[12] At year-end 2013, the life businesses of Basler Versicherungs-Aktiengesellschaft in Österreich ("Baloise Austria"), Basler osiguranje Zagreb d.d. ("Baloise Croatia") and Zivotno osiguranje "Basler" a.g.o. ("Baloise Serbia") had also been included at their IFRS equity value.

3.2. Components of MCEV

Shareholders' Net Assets

The SNA is given by the statutory shareholders' equity[13] plus the amount of undisclosed surplus allocated to the SNA after tax plus the pension scheme deficit / surplus cost after tax[14].

The starting point for determining SNA is shareholders' equity as reported in the local statutory balance sheet. In some territories this balance sheet includes some assets at values other than market value[15] and some technical reserves set up[16] voluntarily, which together can be significant. Where relevant an 'undisclosed surplus' is determined as the sum of such hidden reserves in the assets (unrealised gains) and in the liabilities. To determine the proportion of this surplus included in projections to calculate the NPVFP, appropriate assets are selected with a statutory book value exactly sufficient to back technical reserves (net of any applicable deferred acquisition costs) and funds for future appropriation and bonuses. The unrealised gains on these assets are included in the calculation of NPVFP in accordance with local rules and any relevant past practice, in particular regarding the timing of realisation and proportion of gains expected to be allocated to policyholders as bonus. Any remaining assets, together with their unrealised gains, are included in SNA.

The SNA can be split into Required Capital (RC) and Free Surplus (FS) in line with MCEV Principles 3, 4 and 5. In line with its policy of charging the same rate of FCC to the entire SNA (see 'Frictional Costs of Capital' below), Baloise does not report such a split.

Value of In-Force

The Value of In-Force is defined to be the Net Present Value of Future Profits (NPVFP) minus Frictional Costs of Capital (FCC) minus Cost of Non-Hedgeable Risks (CNHR). The NPVFP is given by the Certainty Equivalent Value of the Business in-Force (CEVBF) minus the Time Value of Financial Options and Guarantees (TVFOG).

These two items are described below. Both involve projections of a balance sheet consisting of local statutory liabilities and assets in line with local legal obligations, company practice due to commercial and competitive constraints and local market practice in the calculation of Embedded Values.

Certainty Equivalent Value of Business in-Force

Financial projections of the statutory balance sheet are carried out allowing for expected behaviour of the in-force business. The Certainty Equivalent Value of Business in-Force ("CEVBF") is the present value of the expected future profits (net of tax) attributable to shareholders. It is based on the assumption that all asset classes earn the forward reference yield, from which general investment management costs[17] are deducted. All projected best-estimate cash flows are discounted using the same reference yield curve. However, the existing bond portfolio is assumed to run off at the running yield, while new money is invested at the reference yield. For business with financial options or guarantees the CEVBF includes the intrinsic value of the options / guarantees.

Time Value of Financial Options and Guarantees

The CEVBF does not allow for asymmetries in the risks that financial outcomes for shareholders could be better or worse than expected in the CEVBF scenario, in particular where products or funds include a guarantee or option of which the policyholder could take advantage in adverse circumstances. Options and guarantees with significant financial risk explicitly valued in the MCEV include:

[13] Includes dividend for the year reported on, which is payable in the following year
[14] See 'Employee Pension Schemes' below for details
[15] E.g. historical cost, lowest ever value
[16] E.g. financial reserves
[17] Excluding specific property management costs

- → Minimum guaranteed interest rates;
- → Bonus options;
- → Maturity guarantees;
- → Guaranteed minimum death benefits (GMDB);
- → Guaranteed annuity options (GAO) / conversion factor for Swiss Group business;
- → Surrender options.

For products with such features a stochastic financial projection[18] is run allowing for the range of possible scenarios for financial markets. The Time Value of Financial Options and Guarantees ("TVFOG") is calculated as the difference between the average over all scenarios of the net present value of future profits to Baloise Group shareholders, and the (usually higher) value from the deterministic (certainty equivalent) projection described above under CEVBF. It therefore captures the cost to shareholders in those scenarios where the options / guarantees come into the money and are exercised.

Such calculations can be particularly important to capture the potential cost to shareholders of providing support to 'participating' funds in order to provide the basic policyholder guarantees in scenarios where the unrealised gains and reserves such as bonus funds are exhausted (shareholder burn-through cost). In such scenarios, where assets are projected in any year to be insufficient, shareholders are assumed to inject sufficient capital to meet basic policyholder guarantees. At the end of the projection shareholders are assumed to meet any shortfall of assets against liabilities, or receive a part of any residual assets as a "liquidation dividend", the amount of which reflects local practice and local requirements.

Where the result is not expected to be materially different from a full stochastic projection, some guarantees and options are valued using closed form solutions. This is the case for Baloise Luxembourg, most of whose business is unit-linked without guarantees.

Frictional Costs of Capital

Frictional costs of capital ("FCC") are costs incurred by shareholders due to investment via the structure of an insurance company compared to investment as individuals, such as tax on profits within the insurance company or the costs of investment management.

Such costs on reserves held to meet expected policyholder benefits are reflected in the calculation of the NPVFP. Baloise's MCEV and MCVNB also allow for the deduction of the following FCC on the total SNA (and not only on the RC), as at the valuation date the whole SNA is held by the Group to support it as a going concern backing both in-force business and the development of future new business:

- → Taxation of the investment income on shareholders' net assets held by the insurance company, at the rate paid locally by each entity;
- → Investment expenses (net of tax relief) incurred in managing the shareholders' net assets.

Cost of Non-Hedgeable Risks

The volatility of the returns on risky assets (such as stock market-listed equities), whose risk is for the most part readily hedgeable in financial markets, is reflected in the determination of the NPVFP. The MCEV also allows for the cost of volatility of non-hedgeable risk factors such as mortality, morbidity, expenses and lapse rates. As

[18] See 'Economic Scenario Generator' below for details

– by definition – there is no clear market for such risks, their valuation is open to interpretation. MCEV Principle 9 proposes a standard method – a 'cost of capital' approach – which Baloise follows.

The initial amount of capital at risk is calculated in a similar manner to the Swiss Solvency Test (SST) analytical model for insurance risk, i.e. based on a number of sensitivities and using the same correlation matrix between sensitivities. However, the assumptions used for the calculations are those from the MCEV rather than those from the SST. For example, reference yields are swap rates and not government bond rates. This initial capital at risk is then projected for future years in line with the evolution of an appropriate proxy measure such as reserves or premiums. A capital charge of 4% is applied to the resulting projected capital at risk. It represents the excess return or risk premium that a shareholder might expect on capital exposed to non-hedgeable risks. These annual charges are discounted using the reference yields and summed up to give the part of the Cost of Non-Hedgeable Risks ("CNHR") for insurance risks.

In addition, the CNHR also includes an allowance for the estimated potential impact on shareholder cash flows of credit risk (i.e. defaults and rating migrations) where this is not otherwise captured in the CEVBF or TVFOG. This allowance is made by including a cost of capital approach for credit risk, adapted to take into account the shareholder's share in those risks.

Allowance is made within CNHR for diversification of risk between countries and risk factors including credit risk using a matrix of estimates of correlations between the various risks.

3.3. Dynamic Actions, Bonus Policy and Policyholder Behaviour

The actions taken by policyholders and management are likely to vary in different financial scenarios. Baloise has set up Management Decision Rules for each business unit setting out its expected approach to managing, amongst others, targets for asset realizations, the choice of the investment strategy – asset allocations and mix – and setting bonuses or allocation of investment surplus depending on experience and expectations of the financial performance of the business. These Management Decision Rules can have a significant impact on the MCEV, as they define the timing of the cash flows and the distribution of income between the policyholder and the shareholder. The Rules are implemented in cash flow projections for calculating MCEV and New Business Values and have regard to:

- The behaviour of the insurance business in each country;
- The past application of discretion;
- The influence of market practice regarding that discretion;
- Past public communication; and
- Legal requirements.

Bonus Rates

The amount of bonus allocated to policyholders is chiefly dependent on:

- The technical result and financial return of the companies;
- The local regulatory environment, in particular regarding the existence of a 'legal quote';
- The guaranteed interest rate of the products;
- The policyholders' expectation given local market practice; and
- The solvency situation of the company (with respect to unrealised gains, bonus fund or financial reserves).

Dynamic Assumptions in Stochastic Models

For stochastic modelling certain assumptions vary with the scenario being modelled. These include:

- → Bonus rates are linked to the dynamic realisation of gains of the fund and the fund performance, reflecting past and expected future management behaviour in different scenarios. Bonus rates dependent on scenario-dependent projected returns follow the kind of rules described above.
- → Option take-up rate(s), such as annuity take-up rates, are scenario-dependent where financial scenarios are expected to, or have in the past, affected policyholder take-up rates.
- → Dynamic policyholder lapse rates and contract renewal rates are implemented if appropriate and where stochastic projections are performed. Where possible such lapse rules reflect the local observed past behaviour, and expected future behaviour of policyholders.
- → Dynamic asset allocation strategies are incorporated into the stochastic models, where appropriate. They reflect past behaviour, and expected future behaviour of the management.

3.4. New Business

In line with MCEV Principle 10 new business is defined as covered business arising from the sale of new contracts during the reporting year, including cash flows arising from the projected renewal of those new contracts. The distinction between new business and variations on existing business for each product is based on the specific policy conditions, is consistent from year to year, and corresponds to the classification used for Baloise's published new business figures. In each case account is taken of:

- → The contract terms;
- → Whether increments are automatic or whether additional sales effort is required;
- → The manner in which management and the industry treat such cases in managing the business;
- → Whether further initial commission is paid.

Values of new business are calculated using similar approaches to those applied for in-force – dependent on the type of business (participating, non-participating, unit linked) and the type of options / guarantees attached. These allow for TVFOG on new business, FCC and CNHR. Subject to appropriate allocation of assets and unrealised gains (see below) the FCC is calculated in proportion to the solvency margin in respect of new business. The CNHR for new business written during the year is derived either directly, similarly as for in-force, or from the CNHR for the in-force portfolio based on the respective size of the present value of future mathematical reserves for the new business and for the in-force, thus allowing for both the relative size of new business at inception and the relative size of its future development compared to the in-force.

The value calculated is for the business still in force at the end of the year, using year-end projection assumptions adjusted to be consistent with a point of sale valuation.

Consistent with the 'going concern' approach to calculating MCEV, the MCVNB for funds containing participating business is calculated using a marginal approach. This means that the MCVNB (before acquisition expenses) is calculated by performing valuations of the portfolio at the year-end including and excluding new business. The MCVNB is the difference in NPVFP between the two portfolios after acquisition expenses to the company, after allowing for frictional costs and costs of non hedgeable risk related to new business and after adjustments to point of sale. Note that no proportional sharing of the unrealised capital gains between in-force and new business is done, as this would artificially increase the value added by new business.

3.5. Asset and Liability Data

Market values of individual investments are taken where available ("marked-to-market"), or estimated where there is no liquid market ("marked to model"), for example by discounting unquoted loan and mortgage asset proceeds. Credit risk is captured via an increase in the CNHR (as explained above).

For bonds, market and book values are calculated at each point in time in order to project the realisation of gains. The book value is amortised according to local accounting rules.

For equities, the current total book value and market value are input to projection models – future realisations are calculated at an aggregate, rather than a single stock, basis. Local regulatory and accounting frameworks, for example the 'lowest value' principle, are incorporated in the model where appropriate.

For property investments price and income indices are applied in projection models to the current value and income to generate changes in property values and regular income.

Other bond-like securities such as loans (including policy loans) and mortgages are modelled as separate 'buckets' of government bonds in their respective currency. For policy loans in Switzerland, the theoretical duration of the loans has been shortened to take into account expected policy lapses. For all other purposes these assets are modelled as regular government bonds.

Other equity-like securities such as private equity and minority participations in non-group companies, as well as alternative investments (mainly hedge funds) have been modelled either as separate index similar to equity or as linear combinations of existing cash and equity categories, with weights aiming to ensure that the overall volatility of the asset class is in line with market data.

When a substantial part of the assets are held in foreign currencies (in practice, only those assets of Baloise Switzerland denominated in Euros) they are modelled explicitly, including the foreign exchange risk. For other assets denominated in foreign currency but modelled as local currency assets, the modelled volatilities are adjusted to reflect the foreign exchange risk.

Liabilities are calculated in line with local statutory requirements using individual policy data. For projection purposes policies of the same product with similar term, duration and risk profile are grouped to form 'model points'. Checks are made to ensure that modelled values are sufficiently close to those for individual policies.

3.6. Sensitivities

The sensitivities shown in this report follow the descriptions in the MCEV Principles 17.8.

- → +/- 100 bp to reference yields - indicates the impact of a sudden parallel shift in the reference yields,[19] including allowance for consequent movements in fixed interest asset values and other assumptions.
- → 10% decrease in equity/property market values - indicates the impact of a sudden change in the market-values of equity and property assets, without a corresponding change in dividend / rental yields, the situation being equivalent to a fall of 10% of the absolute amount of the future dividends or rental yields.

[19] Up to the last liquid point of the market. Beyond that point the shifted reference yields are extrapolated to reach the ultimate forward rate (see the Economic Assumptions section below). The shifted reference yields are floored at the minimum of zero and the base reference rate curve.

- → 25% increase in equity/property implied volatilities - indicates the impact of a (multiplicative, i.e. volatilities x 1.25) 25% increase in market implied equity/property volatilities on the cost of options and guarantees.
- → 25% increase in swaption implied volatilities - indicates the impact of a (multiplicative) 25% increase in market implied swaption volatilities on the cost of options and guarantees.
- → without liquidity premium - indicates the impact of using reference rates without a liquidity premium.
- → 10% decrease in maintenance expenses – indicates the impact of a reduction in the projected future cost of administering contracts, with no change in inflation assumptions.
- → 10% decrease in initial expenses – indicates the impact of a reduction in the cost of acquiring new business, including initial commissions.
- → 10% decrease in lapse rates – indicates the impact of a (multiplicative) reduction in projected lapse / surrender rates. Depending on the terms for lapses the impact on MCEV and on MCVNB could be positive or negative for different types of contracts or for an individual contract at different times.
- → 5% improvement in mortality rates – indicates the impact of a (multiplicative) reduction in deaths at all ages. The distinction is made between death coverage and annuity contracts where the risk to shareholder cash flows is from higher (death coverage) versus lower (annuities) mortality.
- → 5% improvement in morbidity rates – indicates the impact of a (multiplicative) reduction in disability insurance claims incidence rates at all ages.
- → 1%-pt decrease in capital charge for CNHR – indicates the impact of changing the rate of charge for capital for non-hedgeable risks from 4% to 3%.

The events described are assumed to occur immediately after the valuation date (with the exception of the calculation without liquidity premium, which is an "as if" sensitivity already in force at the valuation date). The economic sensitivities of the new business value hence indicate how the value of the business written in the reporting period changes if the economic market conditions change. They give no indication of the profitability of future new business written in the changed market conditions. The sensitivities allow for consistent changes in future cash flows and experience assumptions directly affected by the changed assumption, for example bonus rates. Each sensitivity is treated independently of the others, though in practice there is likely to be some correlation between them. The sensitivities show the impact of only one from a continuum of possible changes in the parameters tested – note that impacts may not be linear with respect to variation of any given parameter.

Sensitivity projections include the same set of dynamic management and policyholder reaction rules as the main MCEV / MCVNB projection. In more extreme scenarios, or stable long-term scenarios far away from the best estimate, policyholder behaviour might be expected to change and management might be expected to take different (mitigating) actions such as changes to pricing terms – such actions have not been included in these sensitivities. For some types of business the impacts of changing experience are mitigated by the requirement / decision to share profits and losses with policyholders.

3.7. Further Definitions and Assumptions

MCEV theory

The overall approach under MCEV aims to value future statutory profits in line with the way in which financial markets value cash flows with similar timing and uncertainty. In the absence of variations in experience (of investment performance, claims, lapses, expenses…) against that expected, in particular asymmetries in the effect of such variations on shareholder profit, this is achieved by summing SNA and using the 'certainty equivalent' approach (as described above) to determine a VIF. Calculation of the TVFOG as described above makes a market-based allowance for the cost to shareholders of future variation in financial market risks that are generally hedgeable, whilst the calculation and deduction of FCC and CNHR make allowance – albeit in areas for which prices are not generally visible in markets – respectively for the direct cost of holding capital within

the insurance business in excess of that needed to meet reserves, and the price that shareholders require for exposing their capital to risks that are not generally hedgeable.

Beyond the approach described above no allowance is made for other costs sometimes associated with market consistent valuation of a business - 'Agency costs', 'Limited liability put option', or 'Costs of financial distress'. Allowing for the Limited liability put option would be inappropriate under the assumption of the business as a going concern in which shareholders are assumed to contribute capital to meet shortfalls of assets over liabilities. Allowance for costs of financial distress, being largely related to future new business, is inappropriate in the context of a valuation excluding any value of future new business.

Economic Scenario Generator (ESG)

Baloise has changed the ESG compared to previous year. For stochastic modelling Baloise now employs the "XSG" model developed by Deloitte Capital Markets. XSG is an economic model that generates risk-neutral and arbitrage-free simulations of market scenarios for all years of the projection period (currently 40 years for Baloise) and for several economies (in effect EUR and CHF for Baloise). The model allows for simulations with negative interest rates and with twisted yield curves. For stochastic simulations 1,000 to 5,000 simulations are used in the projections (e.g. 5,000 for Switzerland). The economic model is calibrated to observable market data as at the valuation date in such a way that modelled market values of equities, bonds, some specific swaptions and equity options are market consistent. The model calibration is described below in the Economic Assumptions section.

Consolidation Adjustments

MCEV and MCVNB are calculated as described above on an entity-by-entity basis. Each entity models its business gross of Life segment internal group reinsurance so that all corresponding reinsurance contracts consolidate out.

The Baloise Group's MCEV / MCVNB is the sum of these individual entity MCEV / MCVNB, where the MCEV is subject to consolidation adjustments to:

- → Allow for stakes held in covered business by investors outside the Baloise Group;
- → Remove the statutory book values of those companies within other Life entities; and
- → Allow for the effect on CNHR of diversification of risks between countries.

Holding Companies, Service Companies and "Look Through" Principle

In the Baloise Group, all expenses incurred with regard to covered business are passed down to the life insurance entities and these costs are included[20] in the expenses modelled in the NPVFP. The expenses passed to the Life Insurance companies include an allocation of Head Office expenses incurred by the Baloise Holding which are split between life, non-life and asset management segments and pushed down to the respective entities. Thus expenses allowed for in the MCEV are entirely consistent with the IFRS reporting for the Life Insurance segment of the Baloise Group.

MCEV Principles Guidance (G11.13) requires that profits for the covered business are measured on a "look-through" basis. On this basis, where services such as investment management are provided and charged for by another Group entity the cost reflected in the MCEV should be that to the group as a whole (rather than just that to the Life entity). In line with the "look-through" principle, Baloise's MCEV allows for services provided to

[20] Except for those investment expenses allowed for in FCC.

the covered business by all suppliers – whether within the Life segment, within the Baloise Group but outside the Life segment, or external to the Baloise Group – at their cost to the Baloise Group. This approach applies to expenses allowed for in calculation of both the NPVFP and the MCVNB. Profit or loss to the Baloise Group companies outside the Life Segment on services provided to the Life Segment is thereby included in the MCEV and MCVNB.

Employee Pension Schemes

For the Baloise MCEV calculation adjustments are made to the SNA in respect of any employee pension scheme surplus / deficit and ongoing obligations relative to those as calculated under IAS 19 except of those which are already included in the NPVFP at their market consistent value. The SNA is adjusted[21] to allow for:

- The net of tax shareholders' share (as some will effectively be allocated to policyholders) of the proportion allocated in respect of employees working in the Life Insurance Segment (vs. other IFRS segments) of the surplus / deficit in the pension fund as per the IAS 19 Defined Benefit Obligation ("DBO").
- Any excess / shortfall[22] of the IFRS future contribution rate[23] compared to the pension fund contributions allowed for in the statutory expense basis (which forms the basis for expenses in the NPVFP), multiplied by a Net Present Value factor to allow for its continuation over the projected run-off of in-force business, adjusted for any surplus / deficit to allow for its net of tax impact on shareholders in the Life Insurance segment.

Employee Share Options

All employee benefits are accounted for. Wherever there is an obligation this is reflected in a market consistent liability in line with IAS 19 which is included in the liabilities for the MCEV calculations. All actual expenditure is allowed for in the expense used to produce future expense assumptions.

Currency Conversion for Group Presentation

MCEV and MCVNB calculated in local currency are converted to CHF at year-end rates and year-average rates, respectively, as disclosed below in the MCEV Assumptions Section.

Group MCEV

Although MCEV Principles Guidance (G17.3.37-45) describes an approach to disclosure of a measure of the consolidated value of shareholders' interests in both covered business and other business segments combining covered business at MCEV and other business segments at (adjusted) IFRS net asset values, Baloise does not disclose such a 'Group MCEV'.

[21] Increased for a surplus, decreased for a deficit.
[22] Reduction / increase in SNA.
[23] That projected to be sufficient to maintain assets at the level of the IAS19 DBO.

4. MCEV ASSUMPTIONS

4.1. Economic Assumptions

The economic assumptions are updated at each valuation and, taken together, aim to ensure that projected cash flows are valued in line with similar cash flows traded on capital markets.

Reference Yield Curves

The reference yield curves used for the calculation of Baloise MCEV are based on the following swap rates as at the valuation date.

Table 7 - Reference Yield Curves

	CHF	CHF	EUR	EUR
Term	31.12.2013	31.12.2014	31.12.2013	31.12.2014
1 year	0.09%	-0.11%	0.40%	0.16%
3 years	0.30%	-0.10%	0.77%	0.22%
5 years	0.76%	0.06%	1.26%	0.36%
10 years	1.68%	0.52%	2.22%	0.82%
15 years	2.11%	0.81%	2.71%	1.18%
20 years	2.37%	1.08%	2.85%	1.37%
30 years	2.63%	1.60%	3.17%	1.95%

Baloise applied a macroeconomic approach to derive the reference yield curves after the last liquid point (LLP) for CHF and EUR. Beyond this point, the Smith-Wilson extrapolation methodology is used to reach the currency specific ultimate forward rate (UFR), which reflects a long term equilibrium interest rate.[24]

For the MCEV 2014, Baloise has included a liquidity premium (LP) of 18 bp for the Euro Zone. No LP was used in Switzerland. The liquidity premiums are derived by applying the QIS5-formula Maximum[0; 0.5*(credit spread over swap – 40bp)], where the credit spreads over swap are measured with appropriate market indices. As in QIS5, the liquidity premium depends on the nature of the liabilities and is applied to the following lines of business:

- → 100% for annuities in pay out;
- → 75% for participating business;
- → 0% for non-participating risk business, unit linked business and variable annuities.

The liquidity premium is added to the forward rate only until five years before the last liquid point. Beyond that point a five year linear decrease to zero is used. For the extrapolated part of the reference rates no liquidity premium is applied. The following table summarizes the parameters which underlie the construction of the reference yield curves used for CHF and EUR.

Table 8 –Liquidity Premium and Extrapolation

	LP	LP	LLP	UFR
Currency	31.12.2013	31.12.2014	31.12.2014	31.12.2014
CHF	-	-	15 years	3.20%
EUR	22 bp	18 bp	20 years	4.20%

For certainty equivalent and stochastic projections the discount rates used are the swap rates referred to in the table above after allowance for the liquidity premium.

[24] Following EIOPA's November 2014 consultation paper regarding the risk free interest rate term structure. The UFR is reached in year 60 for all currencies.

Equity and Property Volatilities

The equity volatility statistics shown below are based on an analysis of the stochastic simulations produced by the ESG for the two main currencies. The following table shows the annualised volatilities of equity indices used in the EV calculation, calibrated to market-implied volatilities of at-the-money EuroStoxx 50 (EUR) and SMI (CHF) capital return options.[25]

Table 9a - Equity implied volatility

	Switzerland		Euro Zone	
	31.12.2013	31.12.2014	31.12.2013	31.12.2014
1 year term	n.a.	15.7%	n.a.	20.6%
5 year term	n.a.	16.3%	n.a.	20.9%
10 year term	16.9%	18.3%	20.9%	22.4%

Baloise also makes assumptions regarding the volatility of property investments, estimated from relevant historical data. The following table shows the average of the forward at-the-money property implied volatilities over all 40 years of the projection period based on analysis of the stochastic simulations produced by the ESG.[26]

Table 9b - Property implied volatility

	Switzerland		Germany		Belgium	
	31.12.2013	31.12.2014	31.12.2013	31.12.2014	31.12.2013	31.12.2014
Property volatility	9.8%	9.3%	9.4%	9.4%	16.7%	16.9%

Interest Rate Volatilities

Interest volatility can be described by the implied volatility of interest rate swaptions. Swaption implied volatilities vary both by the term of the option and also the term of the underlying swap contract. The following tables show swaption implied volatilities based on the stochastic simulations used for the EV calculation and calibrated to market-implied at-the-money swaption volatilities:

Table 10a - Swaption implied volatilities CHF, 31.12.2013

option term \ swap term	5 year	10 year	15 year
5 year	41.5%	35.6%	31.4%
10 year	31.8%	28.3%	25.7%
15 year	26.8%	24.2%	22.1%

Table 10b - Swaption implied volatilities CHF, 31.12.2014

option term \ swap term	5 year	10 year	15 year
5 year	56.6%	51.3%	43.1%
10 year	52.3%	44.9%	37.5%
15 year	45.8%	39.6%	34.1%

[25] At year end 2013 only 10 year at-the-money capital return options were used for the calibration.
[26] At year end 2013 the historical volatilities of the property indices were shown.

Table 10c - Swaption implied volatilities EUR, 31.12.2013			
option term \ swap term	5 year	10 year	15 year
5 year	30.3%	25.6%	23.7%
10 year	23.5%	22.5%	20.3%
15 year	23.1%	19.9%	17.6%

Table 10d - Swaption implied volatilities EUR, 31.12.2014			
option term \ swap term	5 year	10 year	15 year
5 year	47.3%	42.8%	37.6%
10 year	43.9%	39.3%	33.2%
15 year	40.1%	34.1%	28.8%

Risk—Adjusted Returns

For the expected existing business contribution in excess of reference rates, risk premiums on bonds, equity and real estate are applied. For bonds, the risk premium is estimated based on each entity's bond portfolio taking into account a reduction to allow for the default risk. For equities the risk premium is assumed to be 300 bp. For properties, the risk premium above reference yield is set to 150 bp in Switzerland, to 250 bp in Belgium and to 100 bp in Germany and Luxembourg. These risk premiums contribute to the expected existing business contribution in the analysis of earnings but do not have any impact on Baloise MCEV.

Correlations

Assumptions are also derived regarding the correlations between returns on different asset classes. Correlation targets are based on historical market data. The resulting correlations between 10-year bond returns and equity excess returns are +0.04 (CHF) and +0.23 (EUR) at 31.12.2014.

Inflation

The forward rates used for the projection of price inflation are shown below and are derived as follows:

- For projections in CHF, in the absence of a market for inflation-linked bonds, synthetic inflation-linked bonds were used, calibrated to a target inflation in year 1 of 0.7%, in year 2 of 0.7% and year 3 of 1.2% for the short term and 2.0% (previous year: 2.0%) for long term, which corresponds to the inflation target of the Swiss National Bank.
- For projections in EUR the mean inflation is calibrated to a short term inflation target of 1.2% which is derived from a consumer price index. The long term target is set to 2.0% (previous year: 2.1%) based on inflation-linked bonds and the inflation target of the European Central Bank.

Table 11a – Inflation, 31.12.2013						
Currency	1 year	2 years	5 years	10 years	20 years	40 years
CHF	0.6%	0.9%	1.7%	1.7%	1.7%	2.0%
EUR	1.4%	1.4%	1.5%	1.6%	1.7%	2.1%

Table 11b – Inflation, 31.12.2014						
Currency	1 year	2 years	5 years	10 years	20 years	40 years
CHF	0.7%	0.7%	1.5%	1.6%	1.7%	2.0%
EUR	1.2%	1.2%	1.4%	1.5%	1.6%	2.0%

Expenses are assumed to grow in line with price inflation. For Group contracts where contributions are salary-dependent, salaries are assumed to grow slightly above price inflation.

Foreign Exchange Rates

For businesses operating outside Switzerland, values calculated in local currency are converted to CHF at the following rates – year-end rates for year-end items (e.g. MCEV) and average rates over the year for items representing values spread throughout the year (e.g. MCVNB).

Table 12 - Exchange Rates

CHF per EUR	31.12.2013	31.12.2014
Year-end	1.225	1.203
Year average	1.231	1.215

4.2. Taxation and Legislation

All components of tax, including tax payable on investment returns, are modelled as explicit cash flows, at the rates expected to be incurred by each entity in the Life Insurance Segment. Tax rate assumptions are summarised in the following table:

Table 13 - Corporate Tax rate

Country	2013	2014
Switzerland	20.0%	20.0%
Germany	31.0%	31.7%
Belgium	34.0%	34.0%
Luxembourg	31.5%	31.5%

Values allow for all current local regulation and any known future changes. The tax rate in Germany is a weighted average between the tax rates of the German entities.

4.3. Operating Assumptions

Demographic Assumptions

Assumptions used in projections for variables such as lapse / surrender, paid-up policies, withdrawal, mortality and morbidity rates are based on analyses of Baloise's recent experience with the aim of projecting a best estimate of future experience.

Experience analyses for each of these factors are undertaken on a regular basis and attention paid particularly to the most recent experience as well as longer term trends. Adjustments are made where the experience or trends are not expected to continue in the long term.

Lapse rates are measured and projected by product type and, where possible, by duration in force. Experience analyses are normally weighted by annual premium or reserves for single premium policies rather than by numbers of policies.

Experienced mortality rates are normally investigated by sex, age and product type, weighted by sum assured or annuity rather than by numbers of policies or lives.

Expense Assumptions

Expense assumptions are based on allocations of all expenses incurred by the Baloise Group on Life Insurance segment business ("Look-Through Basis" – see section 'Further Definitions and Assumptions' above) during the reporting year, including allocations of overheads within the Segment and of Baloise Holding expenses allocated to the Segment, plus expected expense inflation. No allowance is made for any future productivity gains. In total expenses of CHF 14m are treated as 'one-off' or non-recurring costs. They were partially already anticipated in the previous year and therefore partly already included in the MCEV 2013. The one-off costs mainly relate to investments in cost efficiency projects.

Expenses are split into the following categories:

- Investment management expenses – allocated in projections as a percentage of invested assets by reducing future investment returns.
- Acquisition costs allocated to new business consisting of:
  - Commissions;
  - Other acquisition costs.

- Maintenance costs allocated via a combination of 'unit costs' and proportional costs to the existing business, consisting of:
  - Policy maintenance costs;
  - Adjusted administration expenses;
  - Investment expenses, where these are not directly deducted from investment returns.

Dynamic Management Actions and Policyholder Behaviour

Management's selection of bonus rates and policyholder lapse rates are key variables for which dynamic assumptions – varying depending on the economic scenario – are applied in stochastic projections. Local application of dynamic bonus rates is consistent with current market and company practices as well as local regulatory requirements. In particular the 90% minimum legal quote for Group business in Switzerland and the "Mindestzuführungsverordnung" in Germany are respected. In the Swiss Individual business, in Belgium and

Luxembourg there is no legal quote. Here bonuses are essentially driven by market competition and modelled through a target credited rate, and by constraints on the bonus fund or on statutory solvency rules.

Where appropriate, dynamic asset allocation strategies are incorporated into the stochastic models reflecting the past behaviour and expected future behaviour of the management.

For local application of dynamic lapse rates the yields available on bonds are generally used as a proxy for policyholder expectations. The lapse parameters depend on the company and on the type of the policy.

5. DIRECTORS' STATEMENT AND EXTERNAL REVIEWER'S STATEMENT

Directors' Statement

The MCEV Accounts have been prepared in accordance with the latest MCEV Principles launched by the European Insurance CFO Forum in June 2008 and amended in October 2009. Any deviation from the MCEV Principles or interpretation is stated in the Methodology section of this report.

We hereby confirm that the data, assumptions, models and methodology used to prepare the MCEV accounts:

- → Are materially accurate;
- → Appropriately reflect the way the Life business is managed, as well as its regulatory constraints and market environment;
- → Cover the essential drivers of the Company's profitability and risks.

External Reviewer's Statement

Baloise Holding, Aeschengraben 21, CH-4002 Basel, Switzerland

Dear Sirs,

Review of Embedded Value for the year ended December 31, 2014 of the Life segment of Baloise

We have reviewed the Market Consistent Embedded Value for the Life segment of Baloise as set out in Baloise's Financial Report for the year end 2014 ("the Disclosure"). The Disclosure comprises the Market Consistent Embedded Value of the Life segment as at 31 December 2014 together with the value of new business generated and the analysis of movement in the Embedded Value during 2014 (together "the Embedded Value results"). The scope of our review covered Baloise's major life insurance companies and considered the methodology adopted together with the assumptions and calculations made by Baloise in its Embedded Value.

The Embedded Value results, the assumptions underlying them and the information contained in the Disclosure are the sole responsibility of the Board of Directors of Baloise. They have been prepared by Baloise on the basis of Baloise's methodology as described in the Disclosure.

Our review was conducted in accordance with generally accepted actuarial practices and processes. It comprised a combination of such reasonableness checks, analytical review and checks of clerical accuracy as we considered necessary to provide reasonable assurance that the Market Consistent Embedded Value results have been compiled free of significant error. However, we have relied without verification upon the completeness and accuracy of data and information supplied by Baloise, including the shareholders' net assets as disclosed in the audited local statutory accounts and the IFRS accounts of the companies in the Life segment.

The calculation of Market Consistent Embedded Value results necessarily makes numerous assumptions with respect to economic conditions, operating conditions, taxes, and other matters, many of which are beyond Baloise's control. Although the assumptions used represent estimates which the Directors believe are together reasonable, actual experience in future may vary from that assumed in the calculation of the Embedded Value results and any such variations may be material. Deviations from assumed experience are normal and are to be expected. Market Consistent Embedded Value does not purport to be a market valuation and should not be interpreted in that manner since it does not encompass all of the many factors that may bear upon a market value, in particular franchise value as well as value from Non-Covered (e.g. Non-Life) business.

In our opinion,

- *The methodology and assumptions used are appropriate and - except as explicitly noted in the Disclosure - are compliant with the Market Consistent Embedded Value Principles set out by the European Insurance CFO Forum in June 2008 (the "MCEV Principles") and amended in October 2009;*
- *The assumptions taken together made by Baloise are reasonable; and*
- *Baloise's Embedded Value and New Business Value have been properly compiled on the basis of the methodology and assumptions chosen by Baloise and are compliant with the MCEV Principles.*

Our opinion is made solely to Baloise's Directors as a body. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than Baloise's Directors as a body for our work in respect of this opinion or for the conclusions that we have reached.

Yours faithfully,

Deloitte Consulting AG

6. LIST OF ABBREVIATIONS

APE	Annual Premium Equivalent
CEO	Chief Executive Officer
CEVBF	Certainty Equivalent Value of Business in Force
CFO	Chief Financial Officer
CNHR	Cost of Non Hedgeable Risks
DAC	Deferred Acquisition Costs
DBO	Defined Benefit Obligation
ESG	Economic Scenario Generator
EV	Embedded Value
FCC	Frictional Cost of Capital
FS	Free Surplus
GAO	Guaranteed Annuity Option
GMDB	Guaranteed Minimum Death Benefit
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
LLP	Last Liquid Point
LP	Liquidity Premium
MCEV	Market Consistent Embedded Value (= SNA + VIF)
MCVNB	Market Consistent Value of New Business
NPVFP	Net Present Value of Future Profits (= CEVBF – TVFOG)
PVNBP	Present Value of New Business Premiums
RC	Required Capital
SMI	Swiss Market Index
SNA	Shareholders Net Assets (= RC + FS)
SST	Swiss Solvency Test
TVFOG	Time Value of Financial Options and Guarantees
UFR	Ultimate Forward Rate
UL	Unit Linked
VIF	Value of In Force (= CEVBF – TVFOG – FCC – CNHR)

Information on the Baloise Group

The Market Consistent Embedded Value Report 2014 is only published in English.

AVAILABILITY AND ORDERING

The Market Consistent Embedded Value Report 2014 will be available on the Internet at www.baloise.com/annualreport from 26 March 2015.

INFORMATION FOR SHAREHOLDERS AND FINANCIAL ANALYSTS

Detailed information and data on Baloise shares, the IR agenda, the latest presentations and how to contact the Investor Relations team can be found on the internet at www.baloise.com/investors. This information is available in German and English.

INFORMATION FOR MEMBERS OF THE MEDIA

You will find the latest media releases, presentations, reports, images and podcasts of various Baloise events as well as media contact details at www.baloise.com/media.

CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS

This publication is intended to provide an overview of Baloise's operating performance. It contains forward-looking statements that include forecasts of future events, plans, goals, business developments and results and are based on Baloise's current expectations and assumptions. These forward-looking statements should be noted with due caution because they inherently contain both known and unknown risks, are subject to uncertainty and may be adversely affected by other factors. Consequently, business performance, results, plans and goals could differ substantially from those presented explicitly or implicitly in these forward-looking statements. Among the influencing factors are (i) changes in the overall state of the economy, especially in key markets; (ii) financial market performance; (iii) competitive factors; (iv) changes in interest rates; (v) exchange rate movements; (vi) changes in the statutory and regulatory framework, including accounting standards; (vii) frequency and magnitude of claims as well as trends in claims history; (viii) mortality and morbidity rates; (ix) renewal and expiry of insurance policies; (x) legal disputes and administrative proceedings; (xi) departure of key employees; and (xii) negative publicity and media reports. Baloise accepts no obligation to update or revise these forward-looking statements or to allow for new information, future events, etc. Past performance is not indicative of future results.