Q2 2015 Earnings Call

Company Participants

- German Egloff
- Martin Strobel
- Martin Wenk

Other Participants

- Daniel Bischof
- Jonny Urwin
- Michael I. Huttner
- Peter D. Eliot
- Ralph Hebgen
- René Locher
- Stefan Schürmann

MANAGEMENT DISCUSSION SECTION

Operator

Ladies and gentlemen, good morning or good afternoon depending where you're attending from. Welcome to the Bâloise Group Half Year Results 2015 Analysts Conference Call. I'm Celina, the Chorus Call operator. I would like to remind you that all participants will be in listen-only mode and the conference is being recorded. After the presentation, there will be a Q&A session. The conference must not be recorded for publication or broadcast.

At this time, it's my pleasure to hand over to Mr. Martin Strobel, Group CEO. Please go ahead, sir.

Martin Strobel {BIO 5296838 <GO>}

Thank you very much. Ladies and gentlemen, welcome to our analyst conference. German Egloff and I will be presenting our half year results to you. As you all know, we changed our communication methods. You might have seen the transcripts of our speeches this morning on the Internet, as well as the videos of the presentations. So this means we'll focus only on the highlights and the short introduction at this call and then we are ready to answer your questions. Both of us, so German Egloff and myself, together with Martin Wenk, our Head of Asset Management will be happy to answer your questions at the end of the short presentation.

I would now like to turn to slide number 5 with the highlights of the results. Ladies and gentlemen, Bâloise has posted a strong set of results for the first six months of 2015 with a profit of around CHF 250 million. These results have been driven by strong operational profitability which has enabled us to overcome the significant difficulties posed by low interest rates and the strong Swiss franc.

The non-life sector once again proved to be a pillar of Bâloise's success. Our combined ratio reached 92.3%, an outstanding figure for the European market. We've been able to achieve this high level of operational profitability thanks to the uncompromising implementation of our operational excellence and target customer management strategies that we have now been pursuing for more than 10 years. We've also been able to significantly reduce costs, as a result of numerous efficiency measures. This high margin of our non-life business ensures reliable substantial cash flows.

Our results in life business have been robust despite significant headwinds from a strengthening Swiss franc and the significant fall in interest rates in Switzerland. Developments in the interest rate and currency markets naturally had an impact on our gains or losses on investments. Despite the challenging market environment, our tried and tested team at Bâloise Asset Management was able to generate a good level of gains on investments.

Growth in our target segments has even been stronger than before. The volume of business rose by 3.9%, measured in local currency and with ongoing business. We are strongly capitalized. Our solvency ratio now stands at an impressive 333%. Our operational strength and robust capitalization are also reflected in the confirmed rating of A with stable outlook from Standard & Poor's. With these figures and results, we are on track to deliver our financial targets for 2015.

That was a brief overview of the half-year results 2015 for Bâloise. And now, we are happy and ready to answer your questions.

Q&A

Operator

We will now begin the question-and-answer session. The first question comes from Mr. Daniel Bischof from Baader Helvea. Please go ahead.

Q - Daniel Bischof {BIO 17407166 <GO>}

Yes. Good morning. A couple of points. First on top line, the Swiss non-life business, which was again declining due to the re-underwriting measures on the accident and health side. I think this process is now going on for probably some 18 months. Could you tell us what sort of underlying growth rates you achieved and when we should expect this re-underwriting process to come to an end?

The second one is on the expense side in non-life where you overall reported group progress yet in Germany the gross expense ratio actually increased from the previous year's level, although you think that the ongoing cost reduction initiatives are well on track. Could you explain this and also maybe provide your thoughts where the expense ratio might roughly be in 6 to 12 months' time?

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Mr. Bischof. I'm going to answer both questions from my point of view. So, top line non-life Switzerland, you're absolutely right. We see an increase of premium in the car business, in the property business, in the liability business. All of these type of the business have excellent, really excellent combined ratios. In all of these cases, we grow above market growth. If we take the (05:55) figures – the figures of the Swiss Insurance Association, we're above. And so, we're gaining market share in attractive lines of business which makes us actually quite happy.

On the other side, yes, we have two high combined ratios in the Group Accident and the Group Health business. And as you rightly said, we are in the process of re-underwriting the business for almost now two years. I expect this to level out, let's say, mid next year. The one reason is we see an improvement of the combined ratios in the Group Health business due to our re-underwriting.

At the same time, we are very happy that especially the health insurance in Switzerland, they face, let's say, some pressure be it from the market or be it from the regulator to have a closer look on the profitability in the insurance part of the business they do. So, what we see here is a hardening in the market especially in the Group Health business and this obviously helps the non-life – the combined ratios in this business.

On Group Accident, what we have done in recent years is to fully reserve out the very low interest rate levels we see in this business. And as you well know, some of these liabilities in this business are interest rate-related (07:31) to annuities. So, we reached – according to our information, we have now the best reservation level in the Group Accident business and this often means lower load and lower, let's say, claims ratios in this business going forward. So, overall, I think growth should be (07:54) with next year, that's what we expect, and combined ratios will keep on going to be excellent in this business.

Second question was the division of the expense development in Germany and why don't you see this in the combined ratio cost ratio. Costs are down in Germany, and year-on-year it's about €30 million. We promised €40 million to the year-end and we will reach this €40 million. Half year now, we have about €30 million. Not all of these costs you will see in the cost ratio of the combined ratio (08:38) restructuring costs are not necessarily mirrored in the cost ratios. So it gives our cost position also in Germany we have to look at.

So, we will reach by end of the year do you see the €40 million that we indicated. We will reach 300 FTE by end of this year. We stand now at minus 200 FTEs by midyear. We will have the 300 by end of this year, and then the minus 400 by end of 2017. So, again, here, we are at fully on track with the efficiency measures. And this leads to – the question was, okay, what is the run rate in the expense ratio?

We are aiming for a combined ratio in all businesses and for the Bâloise Group as well in between the 93% to 96%. And both elements have to support this, so be it the cost ratio and the expense ratio. And we stick to this target. I already hear your question, but Martin didn't exceed 112% combined ratio in Germany in the first half. This is far away from 93% to 96%. I have to agree. Actually, I have not been happy or not been satisfied with the combined ratio when I saw it for the first half. The main reason for this is this is much, by far, too high combined ratio.

There are two very large claims that we had in the first half. One is from a natural hazard or a storm. And one is from one single fire claim we had in the first half. This is in the Black Forest. They're a big, big company producing cakes and so on. And they burned down. And if you put these two large claims together they account for 12 points, 12 points of the combined ratio.

We're seeing the business as extraordinary. We do not assume that this is, let's say, the normal load of claims in the German business. And so, we expect this not to happen every year. Then, we will be much closer to our target of, let's say, 93% to 96%. It should not count as an excuse. I'm not happy with the result. Just some growth information.

Q - Daniel Bischof {BIO 17407166 <GO>}

That would still leave some four points to the 96% at the upper end of the guidance, so you do expect the remainder of the delta coming from – or from the improvement coming from the underwriting or mainly from the expense side?

A - Martin Strobel {BIO 5296838 <GO>}

Both of them actually. Yeah. Both of them. I mean, the cost ratio is too high in Germany. The market is standing at, I would say now between 28%, 27%. We should get below the 30% over time. Yeah.

Q - Daniel Bischof {BIO 17407166 <GO>}

Nice one. Thank you.

Operator

The next question comes from Mr. Peter Eliot from Berenberg. Please go ahead.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Thank you. I have two questions, please. The first one was just on the sort of Life result, and at the full-year results, you guided to the division having an underlying sort of EBIT run rate of CHF 200 million to CHF 250 million. I think when I sort of add-back the one-offs that we have this time around, you're probably towards the lower end of that range at the moment. And I guess interest rates have sort of taken another leg down recently. So I was just wondering if you could sort of update us on your thoughts about the sort of the run rate there and perhaps share your thoughts about the – in light of the current interest rate environment?

And then the second was on the buyback. I note that you said you made very good progress partly because of the share price. And I'm just wondering if perhaps you could share your thoughts on, I guess, how big a deviation it might have been from the natural run rates, which was well ahead of target for being complete in the time period you set yourself and obviously there's been some volatility in markets recently. So I'm just wondering if you could add any comments about the outlook there? Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Mr. Eliot. I'm going to answer the first question from a general point of view. And if there are details open, I'll hand you over to German Egloff, our CFO. And buyback, I will hand you over then to Martin Wenk who knows everything about our strategy, how fast we buyback these shares.

And coming to Life, you're absolutely right. And our guidance was for – talking about the full-year results, CHF 200 million and CHF 250 million – between CHF 200 million and CHF 250 million. And we stick now to the guidance of CHF 200 million. Swiss franc isn't the reason why it slipped to the lower end. It's exactly what you said. It's translation effects. It's hedging costs that increased and so on. And so that is a change, but there's still a good – very good quality actually of the Life earnings. We stand at the lower EBIT in the half year, and German can give you some insights on that.

But before he goes into detail, I would elaborate (14:09) what are our thoughts on the Life business. Actually, we stick to exactly the strategy that we also discussed in March this year. Meaning, from the product side, we continue to change the new product mix towards, let's say modern or let's say capital-light product that can be pure risk product, that can be capital-light guarantees and so on and so on.

And we see very good progress in – if you look for the proportion of new business that we classify as being modern, this has again increased. Now, for the first time, we see also a substantial part of the new business in Group Life in Switzerland coming from our semi-autonomous foundations and the risk process – or the risk premium business. So we see a good progress here that we are able to return around the new business in the right direction.

Also, let's say, from a technical point of view, we are very happy with the risk results of the Life business. So nothing worth mentioning in terms of – we still have a very high quality of the risk part of the business. In some markets, we have among the best in the margin of the risk process. Costs are going down in Life. You will also see this at the profit and loss statement. And we are very happy with this since cost process or costs are also – or lower costs are a value driver in the Life business.

And the first element comes in from the assets here, underlying earnings, recurring income, and so on, fitting with the guarantees, it's still intact. So we have a positive margin here if you compare recurring income with the guarantees. The only thing, let's say, for the half year, if you noted, we have a very, let's say, volatile mechanism when it comes to profit and loss with the U.S. GAAP mechanism in the core. The good news is, yes, we have seen very low interest rates in Switzerland, but we're now fully reserved out for this level, but this leads to certain swings. And Peter, I hand you over to German.

A - German Egloff {BIO 4782831 <GO>}

Well, a lot of us said, I guess, the most important thing is maybe that operationally in the business much less have happened than you would expect at a glance if you look at the results of the segments. So therefore, just to remind you that we have a couple of positive one-offs last year that we were communicating as well. I realized gains in Belgium, which were somehow extraordinary. Then, we have the quite substantial gains on interest rate derivatives in Switzerland. We have compound annuities, so policyholder dividends on annuities, and this is one-off of course.

And that actually led us to the guidance of CHF 200 million and CHF 250 million. And you're right, that was of course given the economic platform that we had at that time. And now, this translation effect that we see again is sort of - well, I don't know whether interest rates can fall in further down than they are. On the other hand, I've said that for a couple of years now that build around (17:59-18:00). So therefore, I'm careful with that. But currently, we see still not a different trend in interest rates. And last year, the picture was a bit different. So I would as well say that's, probably for the run rate, it's closer to CHF 200 million and CHF 250 million.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay.

A - Martin Strobel {BIO 5296838 <GO>}

Martin, the share buyback and the speed of having to do this.

A - Martin Wenk {BIO 4193573 <GO>}

Yes. Okay. The question regarding the share buyback has, in my opinion, two levels. One is our strategic goal or our overall goal is to be always ahead of the time schedule, so to be a little bit in front of the linear approach and to finish that before the end of the two years. And technically, it is so that we have imposed - you know that there are two lines. We basically - we buy on the second line. We have to put there a bid order. And if it's executed or not, it's decided basically by the spread between the two lines. And since we don't want to pay too much for those shares, we have imposed ourselves kind of a downtick rule. So we only buy if there is a downtick. And on our home page, you'll find all the details that we had bought 275,000 shares, which is more than a quarter in four months at roughly CHF 117 million. And we will continue that way to get them early but cheap.

Q - Peter D. Eliot {BIO 7556214 <GO>}

Okay. Thanks a lot.

Operator

The next question is from Mr. Michael Huttner from JPMorgan. Your line is open.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you so much. On Solvency, I wonder if you can say a couple of things, maybe just use the S&P report, which seems to hesitate whether you're very, very, very strong or simply very strong. And I still don't understand why in a county as orderly as Switzerland, something which has been in place since 2011 is still not done. But anyway, maybe I'm a bit slow. I don't understand that.

The other point is a broader one, also from the S&P report. They make comments which I really didn't – I kind of struggle with. It's on the outlook section. And they say that they would – in the thing where they say they might upgrade you, they say an upgrade could occur if we expected Baloise's ERM, so that's enterprise risk management (21:05) and management practices to enhance the group's financial strength. That seems such an odd comment. It almost implies that at the moment you're lacking in this area. I just wondered whether you could explain how you see that. Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you Mr. Huttner. I think both questions are perfect for German.

A - German Egloff {BIO 4782831 <GO>}

Yes. On Solvency, I indeed would actually refer to the Standard & Poor's report that's probably the best information you can get about this. And why it is going from 2011 until now and the system is still not tied, I mean, I can just repeat what I said in the last couple of years and that is, indeed, the problem. And I fear that's what (22:04) problem you will see about the same thing in Solvency II as well in the future.

So, internal models, the process that regulators thought how they would approve internal models is, by far, too slow. The market is changing too fast. And that, of course, a kind of a problem if you want to be market-consistent on the one side and, on the other side, you take three years to approve the model. But then, all the new experiences that you have, they have to be built in in the models immediately.

And we will see what will happen but it's just that the whole system is too nervous and I guess we will make sort of the same experience with Solvency II as well. This transition period of 16 years, that might soften the effect. So, there you get sort of quietness into the system but, in fact, that is a problem. And...

Q - Michael I. Huttner {BIO 21417183 <GO>}

And just on the solvency, I did wonder in the S&P report, it comes to us 2014 with 2015 and 2017. What happened between those two dates? It says extremely strong 2014, very strong 2015-2017. What happened?

A - German Egloff {BIO 4782831 <GO>}

Well, the thing was probably that last year, the equity almost exploded. And that might have been – I might come back to that.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Okay. No problem. Okay.

A - German Egloff {BIO 4782831 <GO>}

But the other thing about the ERM, that's actually a point of discussion (24:01) In fact, we are very strong on ERM. The thing is just that up to now, Standard & Poor's claims that ERM is not so important for us and that actually makes the difference. And I, in fact, asked them the question, well, if we were in a riskier business, then it became important and it would create an upgrade whether that's true and they sort of answered it positive which, of course, in the effect is absurd.

So, therefore – but I think ERM becomes more important than – and the other thing might have been that – well, that's just my guess. We had an upgrade last year and they sort of didn't want to upgrade us two years in a row.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Okay. Okay. Understand. Thank you.

A - German Egloff {BIO 4782831 <GO>}

Thank you.

Operator

The next question is from Mr. Jonny Urwin from UBS. Please go ahead.

Q - Jonny Urwin {BIO 17445508 <GO>}

Hi. Good morning. Jonny Urwin here, UBS. Just a couple of questions on the life business if I may. The new business margin has obviously fallen by quite a lot particularly in Switzerland. I'm just wondering if you can give us an idea sort of quantum of investment moves and business mix as well.

And just are you sticking to the 10% guidance, and if so, how do you propose getting there? I supposed pricing actions would be required, your peers are clearly doing that and it's working out quite well. And lastly, I just wanted to know if we can get any color at all into the IRRs and payback periods on the Group Life business, and perhaps on the wider book if you can. Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Sorry. I didn't get your last question. What was the last question?

Q - Jonny Urwin {BIO 17445508 <GO>}

So, any color into IRR and the payback of the Group Life business would be great just so we can get a more economic view.

A - Operator

(26:05)

A - Martin Strobel {BIO 5296838 <GO>}

Internal rate of return. Okay. I see. Okay. Thank you very much for your questions. I'm going to answer the life questions, and then I hand you over to German Egloff, our CFO, for the IRR question.

A - German Egloff {BIO 4782831 <GO>}

(26:21)

A - Martin Strobel {BIO 5296838 <GO>}

Okay. New business margin, yes, it fell. We stand about 7% new business margin at half year. And the main reason for this having gone down is, as you rightly said, the Swiss business, and here we are confronted with a very low interest environment. And what we're doing right now is exactly what we had been – first, first we continue with the process to move the business towards that part of the product area that has better new business margins. And on the other side, especially in the core Group Life business, the next update of the clarification will include a price uptick. So, those are exactly the measures we are going to take.

And for emphasis, I would like to add that's it's hard to compare the new business data from different insurance companies. If you look at some of our competitors in this market, and look at their new business margins in Switzerland, you will find figures that are so high that you should ask them, okay, why don't you sell the non-life business and go for pure life. And so, they seem to be different as, say, business models are. I think that more important part is different assumptions beginning behind different new business market calculations. So, this make it a bit difficult I think to compare the figures.

But nevertheless, yes, we are still aiming for the – this is our target. It remains our target, the 10% new business margin. And we're taking action now to further improve the new business margin especially in Switzerland.

So, the internal rate of return of the life business, German?

A - German Egloff {BIO 4782831 <GO>}

Well, we don't disclose that. And I have actually – well, you have an indication at the end of the year when we are disclosing a full MCV. Currently, just one indication, I mean, probably what you're interested in is whether our cost of capital are covered or not. And what I can tell you is that even though you're – Martin just spoke about the new business margin in Switzerland and – I mean, it's positive.

So, that means capital costs are certainly covered. And probably it's even better than the new business margin looks because the assumption – what the cost of capital are, are given the market environment. So, related to, for example, Swiss government bonds that are negative on a 10 years basis probably the assumption for the cost of capital are rather aggressive currently. So, aggressive means probably too high.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thank you. Just one quick comment perhaps. It would be really helpful to get the source of profits based on a half-yearly basis as well, if possible?

A - German Egloff {BIO 4782831 <GO>}

That's quite a tricky one because especially the Group Life business in Switzerland, there we have a legal quote. And the legal quote is actually done by the end of the year. And that's based on the local debt. So, it could well be that certain things can be done to optimize the profit for the shareholders as well only at the end of the year. So, too much disclosure on half-year could actually be against the interest of the shareholders.

Q - Jonny Urwin {BIO 17445508 <GO>}

Okay. Thanks.

A - German Egloff {BIO 4782831 <GO>}

But that was an internal one. That's not to publish.

A - Martin Strobel {BIO 5296838 <GO>}

Okay. So, let's keep all the talking today. No, this is an open – this is a conference. We're waiting for the next question.

Operator

the next question comes from Mr. Stefan Schürmann from Bank Vontobel. Please go ahead.

Q - Stefan Schürmann

Yes. Good morning. I have two questions. First one on the reserving fees. I understand you increased reserves in the Swiss Group Life business. Can you maybe give us some indication if we should expect more in the second half of the year and how much average guarantee has been reduced in life overall?

The second one on basically investment yield, recurring yield came down quite a bit. How much was related to FX and where does the new one yield stand?

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Stefan Schürmann. I will hand you over for the first question to German Egloff and then the second one to Martin Wenk. German, please.

A - German Egloff {BIO 4782831 <GO>}

Yes, we did reserve strengthening in the first half. The question is actually whether we'll do it in the second half as well or not is what interest rates are doing in the second half. So that (31:39) driver to do that.

On a technical interest rate basis, no, we're not disclosing how much that is actually. But currently, we are on a comfortable level. But of course, as I said, depending on what the interest rates are like in the future, that's not only the close future, but I mean, if they stay where they are for the next 15 years, there will be further reserve strengthening that part of the year. And of course, the other thing especially in crude price is what the – what will be decided for the minimal interest rate for next year. The discussion about that is currently starting to emerge.

Q - Stefan Schürmann

Okay. Yeah.

A - Martin Strobel {BIO 5296838 <GO>}

And now to Martin Wenk talking about the recurring income.

A - Martin Wenk {BIO 4193573 <GO>}

Yes. The recurring income actually came back by CHF 97 million. That's correct. And it has a threefold source through that. About half of it is actually translation of foreign exchange. So simply, the euro-denominated coupons that we get are worth less. So that's about CHF 45 million and the rest is lower reinvestment yield on our new money and the maturities we have.

Q - Stefan Schürmann

Okay. That's helpful.

A - Martin Wenk {BIO 4193573 <GO>}

And the reinvestment yield of the new investments came also down. It's about CHF 1.4 million in life and about CHF 1.6 million in non-life. But that's only for the new money, not the overall yield.

Q - Stefan Schürmann

Okay. Thank you.

Operator

The next question comes from Mr. Michael Huttner from JPMorgan. Please go ahead.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Hello. Good day. Thank you so much. I have three questions if I may. One is number one and it's just to understand the duration gap where you are now. If I remember last year, you touched it quite a lot to I think 0.6 years or 0.8 years, just a little update there.

The second is – surprised really. So, you're the third company I follow which is (34:18) this year still have – or fourth (34:21) reported. No company, not a single one, have mentioned the China crisis as an issue in their outlook, in the results, in investments, nothing. So, I just wondered if it is just sort of strong in Solvency and management that it doesn't matter or is it too short, I don't know?

And then the last question is now that you've decided to leave, Mr. Strobel, how do you see the group developing? So, the answer I'm really looking for is how much do you think the targets which you kind of obviously have can be improved. I can see the combined ratio, it can be improved. I can't see the (35:06) being improved much. And I just wondered if you have a feel for where the ROE target could end up. Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Okay. Thank you very much. Very interesting questions. I will hand you over for the duration to German Egloff. Then China crisis, since we are not operating in Asia, it's more an asset management question, I guess, from our point of view. So, I would hand you over to Martin Wenk. And then the targets, I had to pull out my crystal ball and give you – share some thoughts with you. German, duration gap.

A - German Egloff {BIO 4782831 <GO>}

Well, to be sure that I don't give you a wrong number relating to the one you mentioned, I won't do so. But just generally, Mark, I guess that Martin is probably aware of my answers. I guess that the duration gap probably had increased due to the low interest rates in long-term fixed income papers. We have to switch to corporate bonds, certain switch to senior secured loans, and I guess those have rather a shorter duration than the ones that we've realized. But that's just a guess. And therefore, I would expect that duration gap has increased to a certain extent. But, Martin...

A - Martin Wenk {BIO 4193573 <GO>}

Well, what you said is absolutely correct. We did all those actions. But on the other hand we also have taken some counter measures, and we have increased the duration of the bond portfolio in life from 8.2 to 8.8. So, the duration gap from that time, I would say, is rather stable, didn't react too much. We have more asset classes that are short-term duration but they have increased the bonds. So, in that level (37:09) at the end of today.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you.

A - Martin Wenk {BIO 4193573 <GO>}

The China question is, I would say, also again it's twofold. One, I can say we are not affected by this development in China directly in our assets. We do not have any assets in China and I can say we do not have investments in the emerging market, Asia area. We have no shares and no high-yield bonds in that area. So, we have not a direct impact.

What worries us, of course, is if it has any impact on growth generally in the Western Hemisphere in the U.S. and then Europe. That's something we are analyzing and we could implement it into our asset allocation decisions. For the time being, we are analyzing – we haven't not taken any other measures, but, of course, it's something we are monitoring closely. But as I said in the beginning, no direct impact.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Now, coming back to your future – first question regarding the future. So, I'm not giving you – I cannot give you and I will not give you a clear answer. This is up to my successor and he will be happy to answer this question. That's clear.

You asked, is there any further potential within Bâloise Group. Obviously, there is a lot, there is a lot. I mean, if you just – one picture I draw here, not meaning that this is the concrete objective for follow-ups from the new year onwards. But if you compare Bâloise, a second – some of the Nordic insurances, you will find that they have a much better ROE than we have right now. And I mean, they have two big levers. One is we have a big portion of classic life business. We will be moving away from certain new business. I mean, there are different speeds you can take.

And on the other side, we've got very conservative refinancing structure and balance sheet. So, there are levers to improve ROE and there's definitely a little potential for Bâloise to improve further. But these are just thoughts. It's up to my successor and board to come up with the next strategic step, and that will happen in the next year.

Q - Michael I. Huttner {BIO 21417183 <GO>}

Okay. Thank you. Thank you very much.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you.

Operator

The next question is a question from Mr. Ralph Hebgen from KBW. Please go ahead.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Yes. Hi. Ralph Hebgen from KBW. Hi. Just one confirmation and two questions if I may. Just a confirmation, did I hear this right, that you do not disclose at the moment what your average enforced guarantees are? And, well, if that was wrong, then I would be interested to hear what they are at the moment.

Second question would be I would be interested to hear some of your thoughts of how the sort of discussion in Switzerland is progressing with regard to the statutory minimum guarantees. What do you think is the Bundes Life going to announce in September? Of course, you don't know, but you're closer to the development in – and indeed part of the process. So, any thoughts you might share with us would be appreciated.

And the third question is a numbers question. If I look at the P&C segment, it looks to me as if the underwriting result was stable, 1H-on-1H. The investment income has of course come down slightly because of the averaging down in the portfolio return. And so the net positive impact on the EBIT was sort of driven by what is known as net other income. And I would just be interested in having perhaps a breakdown of the composition of this last reporting line?

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Mr. Hebgen. I'm going to answer the first two questions and then what we (41:32-41:35), I'll hand you over to German Egloff. Yes, we do disclose (41:42) average guarantee in the books. If you look at the full year, disclosure we have – if I remember correctly, but you can as well as I can do look this up and the IR can revert to you. I think I have in mind it's 2.2% of the average currently of the entire book at year-end last year. And we disclose this, absolutely, we do so. I mean that's a very important information for your purposes.

And the next question was the minimum guarantee rate in the Swiss Group Life business. I'm very optimistic that it is going to be lowered. Right now, it stands at 1.75%. If you take this 777 formula, so 70% of the seven years bonds with a seven-year average, you end up I think with 0.8% or something.

And there is a very good discussion, let's say, going on in BALN that people feel that the financial environment, be it the currency effect, be it the interest rate effect raise on the pension funds, be it the insurance companies or be it the autonomous or semi-autonomous foundations.

Hence, I think the argument of being stable in the long run is a very important argument I hear in BALN. So my expectation would be that it really goes down, and maybe not to 0.8%, but maybe for instance to 1%. So I think I could imagine this. But I mean, you asked for my opinion, and I gave you my opinion. And it's – I mean, there's now an explosion in share prices and the U.S., if they start to increase the interest rates, the picture might be different. But I would expect that maybe the interest rate comes down, at least a bit down.

A - German Egloff {BIO 4782831 <GO>}

P&C segment, the other elements (43:58) other income and expenses, you have actually two effects there, which were positive. One of them was that the internal reinsurance that we have has its assets in Swiss francs, but the liabilities of course are in euro. So therefore, we made a gain on that. In fact, I was then compensated on the asset side, but you don't see that. And so that's why it looks like a gain.

And the other thing, which is real and probably even more important is that the year before, we had some extraordinary expenses from Germany and Belgium. On the disposition in Belgium, it was the – you remember, we mentioned that with an earn-out that we had from the acquisition of Nateus. And in Germany, there was the social plan costs that were in there and which we don't have meanwhile. And that was exactly the position that Martin mentioned a couple of minutes ago, that absolute costs in Germany are actually going down, even though you don't see it in the cost ratio apart from that day. And of course, premiums have come down even more than the costs, and that's actually creating the increasing cost ratio. But the important thing for you is probably that even if you adjust for these effects, actual costs are going down.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Sorry. Am I still on the line? Can I do a quick follow-up just on the enforced guarantee. I was interested in the average enforced guarantee at the moment, so as at June 30, of course.

A - German Egloff {BIO 4782831 <GO>}

No. I think we don't have it from half year.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay. Many thanks. Thank you very much.

A - Martin Strobel {BIO 5296838 <GO>}

Yeah.

Operator

The next question comes from Mr. René Locher from MainFirst. Please go ahead.

Q - René Locher

Yes. Good morning, all. Can you hear me?

A - Martin Strobel {BIO 5296838 <GO>}

Yeah, we hear you loud and clearly.

Q - René Locher

Okay. That's fine. So, just going back on the P&C underwriting. So it looks like matching (46:32). If I take a look at Germany, here the combined ratio increased by 8.6 percentage point. If I apply that on premiums of roughly €472 million, that would result in a lower underwriting result of €41 million. And despite the negative or diversion of the combined ratio, you increased the German EBIT from €17 million to €34 million. So perhaps – I just had a discussion before with you prior the forum, but just to see if I got it right? So that's my first question.

Then the second one is on slide 14, for Martin Wenk, I guess. Yes, you have slightly increased your equity and equity-related investment exposures, now 8.3%, roughly at CHF 4.5 billion. And as I understood, you have increased your exposure to senior secured loans in the U.S., which are included in others. So Martin, perhaps you could explain a little bit what risks are you running there and what's the return you can generate?

And then, the last question on slide 28, where I see the business mix, right. Well, I can see you have a very strong sort of this combined ratio. And I was wondering if the Health business, which account for 4.6%, and Accident, which account for 13.3%, is this mainly Swiss business or do you have Health and Accident exposure somewhere outside Switzerland? Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you. Well, you have four for (48:33) the questions. I'm going to answer the first and the third one. And yes, you already – you rightly saw Martin Wenk to give some insights on the risk return profile of the senior secured loans.

EBIT is – so the combined ratio of Germany is high. It's 111%. Actually it's too high. We talked about this with these two large claims, but still EBIT doubled. Then, how come? There are two reasons for this. One is costs are significantly down in Germany. That's a big factor. It's about CHF 30 million. So it's a huge factor. And we have some increase in realized gains in Germany. So this explains the EBIT or the increase of the EBIT.

And now at page 28, the business mix, the Health portion, you see here, this 4.8%. This is only the Group Health business of Switzerland. That's the only, let's say, Health business we have in the group. And then the Accident portion, this is the 13.1%. There are two major sub-components. One is the Accident business in Germany. We have quite substantial platform of(49:57) business in Germany, such as Accident. And the other part being the Group Accident business in Switzerland. (50:07-50:15) Yeah, absolutely. Okay. Now, Martin, risk return.

A - Martin Wenk {BIO 4193573 <GO>}

Yes. As you rightly said in these figures that you have for the equity portion. There are also old investments that are held in the form of util funds (50:34) or institutional funds, so let's say, so you have also investments in there in the real estate funds and in bond funds. Bond funds, it's mainly the senior secured loans you mentioned that we started about 18 months ago. And we have a pretty good experience right now.

The risk involved there is really very low. We hedge 100% of the forex risk. So we end up with a fixed income return of about 3% off of that hedge year-on-year. And this is a result of a very low volatility because behind that you have a lot of different loans.

The particularity of senior secured loans is that there is a market through that in the U.S. So basically it's loans and not listed bonds, but you have a market as for listed bonds. And that makes it very interesting as an investment at that time. So it's really – I really can say it's a fixed income risk you have there more than equity risk.

Q - René Locher

Okay. Thank you. Martin, just a follow-up on Germany, unfortunately. Your leading the company, but if I'm right, you were always guiding for an EBIT above CHF 100 million for Germany in 2016. Is this guidance which is still valid or you have those...?

A - Martin Strobel {BIO 5296838 <GO>}

The guidance is valid. And it has to get there as well. I mean, if you look at, as I said, risk capital that is in Germany, I mean, we have to have certain earnings to meet our standards at Bâloise group.

Actually, as we talked about, I'm not satisfied especially with the Non-Life performance. I mean, just to give you an impression here, the big two losses we talked about, they weigh on the EBIT, let's say, with a double-digit figure. And so, I think assuming for a second that we won't see every year such big claims, such as really big claims, and I think the other earnings power of Germany is already better than it is now demonstrating the EBIT, I see that costs are going down, I see that we have quite a good growth in our target segments to have a better combined ratio in the overall business, and I see that in new Life product to pick up, and I see that FTEs numbers are coming down.

So every measures we have taken to improve the business is going in the right direction, but we have seen a bit large claims in the first half. So Germany is yet to demonstrate its full ability off in the EBIT. That's the ultimate test. But the guidance is all right.

Q - René Locher

Okay. And just the last one for German on slide 12, so that's about the guidance, this CHF 200 million that's I guess that's on a net basis. But what is interesting when I take a look at this interest rate effects, there is a huge swinging there. And I do understand with the derivative, you had decreased your hedges somewhat. I guess the big swing is also coming from liabilities, DAC, and PVFP, which increased from minus CHF 31 million to minus CHF 99 million. And I guess these are the additional reserving in the Swiss Group Life business. So, assuming that interest rates remain at the current low level and you'll see no need (54:40) to increase reserves in Switzerland, then I do believe there's quite a positive swing here in H2?

A - German Egloff {BIO 4782831 <GO>}

That is a dangerous question.

Q - René Locher

Okay.

A - German Egloff {BIO 4782831 <GO>}

I will not give you a dangerous answer. I mean, everything can happen. In fact, what we have found is the strengthening of the technical reserves was more or less set by realized capital gains, so that's more policies. And you're right, I mean, a certain effect from – on the FX side, they come immediately in the first half. They will not repeat in the second half.

Nevertheless, I mean, interest rates – if interest rates stayed where they are – unfortunately, they never do. They never stay where they are. So therefore, it is a bit dangerous and it gets more and more, not only in Switzerland, but in general, it gets more unpredictable because local regulators are, in this interest environment, applying more rules on the local accounts and where we – whether it's not very friendly there, it's what you have to do in re-reserving local accounts. And that's only a downward potential.

So that means volatility that comes through from the local accounts is always negative. Volatility that can be positive is on the IFRS side. But it makes it difficult to predict because that's really – not only in Switzerland, in Belgium as well. You have already (56:48) in Germany since 2011. So that is sort of moving as well. And that makes it really difficult to say what will actually happen.

But I repeat, operationally, in Life as well, not a lot has changed actually. It's really the market movements that are running around that kind of business, and that makes it a bit difficult. I agree with you, and that's probably what I can tell you. If interest rates are staying where they are, I expect the second – and the exchange rates as well, I expect that the second half could be a bit better than the first half.

Q - René Locher

Okay. That helps. Thank you.

Operator

We have a follow-up question from Mr. Stefan Schürmann. Please go ahead.

Q - Stefan Schürmann

Yes. There are just maybe two follow-up questions for me. The first one on the, basically level of shareholder funds, I mean, we all got it wrong. I mean, have you been surprised that we got it wrong or have you been surprised that it was that low in terms of translated FX impact? And the second question, just coming back on the regulation, is there anything you want maybe to update in terms of regulatory talks in regard to standard models, SST and so on, that with these, is there anything moving there?

A - Martin Strobel {BIO 5296838 <GO>}

Thank you very much. I hand you over to German for both questions.

A - German Egloff {BIO 4782831 <GO>}

For the equity, well, that's really difficult to guess because what has a heavy weight in there is they are historical currencies in our participation. And that goes directly into the balance sheet, and that do have the sensitivities there. That's not that easy. I would say, depending who you're asking, the accountants were not at all surprised. I was of the impact, a bit surprised but not worried. It's just technical thing.

On the regulatory update, there have been – there are actually currently a lot of (59:36) the kind of things will be published in the next couple of months. Some of them are following the equivalent discussion with the European Union. So, a lot is happening. But not actually in those areas where you're interested, unfortunately, as far as we know. I mean, you have heard that the FINMA Chief talking about more standard models. What we know meanwhile or what we have seen meanwhile is that they invented standard models for captives, for branches of foreign reinsurers, and that kind of things. So things that isn't our choice, but for example for the Life business I haven't that there are – at least, a standard model is currently in development.

Q - Stefan Schürmann

Yes. Okay. Yeah. Thanks.

A - German Egloff {BIO 4782831 <GO>}

Because, I mean, we think there is a standard model, even if it's useless.

Q - Stefan Schürmann

The question basically most have – I mean, there's a lot of stuff going on and 80% of the level of happiness has changed or unhappiness has changed like half year going now?

A - German Egloff {BIO 4782831 <GO>}

Well, well, I'm sort of trying to avoid that my happiness is actually dependent of regulators.

Q - Stefan Schürmann

Okay, good. It's very clear.

A - German Egloff {BIO 4782831 <GO>}

It doesn't improve your quality of life.

Q - Stefan Schürmann

Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

There are companies who do. (01:01:12)

Operator

This was the last question. Would you like to conclude the call?

A - Martin Strobel {BIO 5296838 <GO>}

I'll ask around if there's anything else you would like to ask us? If that's not the case, I thank you very much, gentlemen, for your interest in Bâloise and for you attending the call. And I wish you a good day. Thank you very much.

Operator

Ladies and gentlemen, the conference is now over. Thank you for choosing Chorus Call and thank you for participating in the conference. You may now disconnect your lines. Goodbye.