FY 2011 Earnings Call

Company Participants

- German Egloff, Group CFO
- Martin Strobel, Group CEO
- Martin Wenk, Chief Investment Officer

Other Participants

- Akhil Mittal, Analyst
- Dhruv Gahlaut, Analyst
- Fabrizio Croce, Analyst
- Michael Klien, Analyst
- Peter Eliot, Analyst
- Ralph Hebgen, Analyst
- Rene Locher, Analyst
- Stefan Schuermann, Analyst
- Thomas Noack, Analyst

Presentation

Operator

Ladies and gentlemen, good morning. Welcome to the Baloise Group annual results 2011 conference call. I'm Selena, 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. (Operator Instructions). The conference must not be recorded for publication or broadcast.

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

Martin Strobel {BIO 5296838 <GO>}

Thank you, very much. Ladies and gentlemen, it is my great pleasure to welcome you to our analyst meeting. German Egloff and I will present our annual results to you. We will both be available for the questions in the question and answer round later on; as will Martin Wenk, our Chief Investment Officer. We intend to concentrate solely on the essential facts of our presentation. This will give us more time for detailed question and answers.

I would now like to go to slide 3. First of all, I would like to present the highlights of the annual results 2011. After that, German Egloff will take you through the key financial figures. Building on that, I will illustrate the course of business from a market and customer perspective. To finish off, I would then like to demonstrate to you where we stand in terms of our strategic program, Baloise 2012. And will end with our financial outlook.

Let us start with the most important points relating to our annual results, which are illustrated on slide 5. In 2011, we achieved a very good operating performance but, as already communicated on November 16, 2011, our profit was impacted heavily by the negative economic developments, especially in the second half of 2011.

The interest rate in Switzerland fell sharply. We strengthened the reserves in our Life business accordingly, which led to a one-time negative effect of CHF89 million. The equity markets developed negatively as well, leading to impairments of CHF119 million net.

We had to write down our Greek bonds; and we wrote off some goodwill related to the acquisition of Osiguranje Zagreb in Croatia due to changed assumptions, reflecting the economic environment. All these effects, combined with a significantly higher load from net cat and large claims, as well as the substantially lower euro, weighed on our result.

In contrast to this market related and largely one-off negative accounting impacts, the Insurance business has developed favorably. We can build on a solid growth. Measured in local currency, our premium volume is up by 4.1%.

Our Baloise 2012 program is fully on track. In 2011, we exceeded our targets with an additional profit contribution of CHF150 million, generated by our program. Its effects can be clearly seen on organic growth; our increased efficiency; our lower cash -- cost ratio; and our good combined ratio performance that coped successfully with a higher load from large claims.

Our balance sheet is strong. At the year-end, Solvency I amounted to a good 203%.

We are further expanding our platform for profitable growth by investing in our core markets. With the successful and fast integration of Avero and Nateus, we now capture a leading market position in Non-Life in Belgium.

The high and sustainable level of operating earning power and our strong capitalization are also evident in our dividend policy. Thus, the proposed dividend remains unchanged at a high of CHF4.50; offering an attractive dividend yield of 7%.

After this brief outline, I would now like to hand you over to German Egloff, who will take you through the main financial points of the annual report.

German Egloff {BIO 4782831 <GO>}

Thank you, very much, Martin. I'm glad to take you through the figures. And good morning from my side as well, by the way.

I'm starting with slide 7, the key figures. 2011 was characterized by extraordinary macroeconomic effects; the virtual free-fall of currency that was stopped by the introduction of a lower limit for the euro by the Swiss National Bank; record low interest rates; the European debt crisis. And the widespread uncertainty associated with it; the negative development of the financial markets; the persistently high uncertainty of investors; and the associated volatility on the market.

In this terrible environment, Baloise put in a solid operating performance, which was, however, somewhat overshadowed by the negative one-off effects of the macroeconomic developments. As already announced on November 16, 2011, the fall in profit was correspondingly sharp.

We, once again, felt the impact of the devaluation of the euro against the Swiss franc. The closing rate only minimally moved, compared to the beginning of the year, due to the intervention of the National Bank. But the average rate, down by 11%, impacted significantly the profits from the foreign unit and the growth figures in Swiss francs.

As expected, the growth in business volume declined as the previous year benefited from the Italian tax amnesty. And the anticipated EU interest rate directive that generated extra volume in Liechtenstein and Luxemburg in the investment-type life insurance business in freedom of services.

I would now like to examine in detail the key aspects of 2011 results. And start with the development of the net profit on slide 8. The chart shows the development of net profit from the previous year through to fiscal year 2011. As already announced in November, there were five main drivers behind the decline in profit. Firstly, impairments on Greek government bonds amounting to CHF78 million, net.

Secondly, impairments on shares amounting to CHF119 million net, of which around 40% attributable to consecutive impairments and 10% triggered by the so-called 12 months' rule.

Thirdly, partial depreciation on goodwill in Croatia amounting to CHF50 million, net.

Fourth, on the Non-Life side, above average large losses of CHF123 million, primarily attributable to nat cat.

And, fifth, the sharp decline in interest rates on the Life side impacted the result with a charge of CHF89 million due to reserve strengthening and the level -- to the level of the current interest rate and DAC write-downs.

The cumulative effect of these factors explains the significant decline in profit as compared with the previous year. The factors concerned are, however, largely one-off and non-recurrent items of an accounting nature with, in part, no impact on cash flows.

In contrast to the negative market development, the positive effects, such as the operating improvements from Baloise 2012's strategy program impact on all segments.

Allow me now to examine the operating business in greater detail. I will start with the Non-Life business on slide 9. We can be satisfied with the performance of the Non-Life insurance business. Premiums were up over 3% in Swiss francs, or 11% in local currency. Included here for the first time were the premiums of Avero. And for the last four months of the year those of Nateus, too.

Due to lower investment income as a result of the financial market related factors already mentioned, EBIT declined significantly.

To understand the operating performance of the Non-Life insurance business better I would like to explain the individual components of the combined ratio, on slide 10, in greater detail.

Despite nat cat losses of more than CHF100 million, the combined ratio only changed marginally as compared with the previous year. This reflects the high underlying quality of our portfolio and the positive impact of Baloise 2012.

Total large claims, at CHF123 million, were significantly higher than in the previous year, attributable, above all, to the hail storms and floods in Switzerland. In the New Year, too, the storm, Andrea, has already generated nat cat losses of around CHF9 million in Germany.

Prior year loss development was at the same level as in 2010.

Seen over the entire portfolio, the underlying loss ratio improved by 1.4 percentage points.

The cost ratio, too, developed pleasingly and fell by 1.5 percentage points -- 0.5, not 1.5, unfortunately.

The development of combined ratio shows, however, the impact of the acquisitions in Belgium. In net terms, the purchase had a negative effect of 0.8 percentage points on the Group's combined ratio. Due to portfolio restructuring in the wake of integration, we anticipate seeing an impact on combined ratio in 2012, too.

On slide 11, we see the gross combined ratios split by country. All units are significantly below 100%, with the exception of Croatia, which was able to improve its underwriting performance considerably.

Switzerland, with a combined ratio of 88.4%, produced a really good result despite extraordinary high large claims losses.

Large claims and reserve strengthening impacted on Germany's combined ratio, which was reported at 98%.

Once again, Luxemburg's combined ratio was outstanding, ending at a first class level of 81.1%.

Austria was able to record its best combined ratio in the history of the unit. This reflects the positive impact of its growth and target customer strategy.

The Group as a whole reported an excellent combined ratio of 92.4%. The exceptionally high costs of major claims and nat cat losses counteracted the positive impact of Baloise 2012, reflected, not least, in the development of the cost ratio.

Allow me now to explain the Life insurance business in greater detail, on slide 12. The operating improvement from Baloise [ph] 2012 were, unfortunately, offset by the negative impact of the financial markets. The decline in interest rates, of more than 100 basis points, resulted in the write-down on DAC and reserve strengthening amounting to CHF89 million.

Impairment on shares and Greek Government bonds burdens the Life business EBIT, additionally.

Business volume fell sharply due to the normalization of the volume of the unit-linked business, which benefited in the former period from the scudo fiscale in Italy and the anticipated EU interest rate directive in the previous year.

Despite the difficult economic environment, gross premiums written in local currency were kept at the previous year's level. Annual premiums in the Swiss Group Life business, for example, enjoyed positive development.

As can be seen on page 13, the market consistent embedded value also failed to avoid being impacted by the developments of the financial markets. The operating return on embedded value declined by 5.8 percentage points to 14.5%.

Cost reductions and operating improvements, again, impacted positively in the year under review. By contrast, lower interest rates, higher spreads. And greater volatility on the financial markets all had a negative effect.

The value of new business decreased, on the one hand, due to lower volumes, notably from Luxemburg and Liechtenstein; and, on the other hand, as a result of the deterioration in the market environment. The new business margin fell by 1.6 percentage points. Operating improvements were unable to fully offset the negative development of the macroeconomic factors.

I would now like to move on to the investment side, on page 14. As already mentioned, the difficult market environment and high market volatility on a number of occasions, the conflicting priorities to be taken into account in the form of fluctuating markets, unsettling political statements. And the satisfying of regulatory requirements, represent a very great challenge to our asset management activities. This not least if one considers that we are actually obliged to act primarily on our customers' behalf.

A sharp decline in the euro was stopped, provisionally at least, by the intervention of the Swiss National Bank. But the handling of the much discussed joint currency is still a major issue for us.

The uncertainty on the market has driven interest rates down to a record low. We have countered this negative development by increasing the duration slightly on the Life side by the purchase of options.

Further, we used our GIIPS exposure in the course of 2011. We, meanwhile, sold our entire portfolio of Greek and Portuguese Government bonds at the end of February and beginning of March 2012.

As a result of the development of the financial markets, we had impairments on our equity portfolio. Due to the difficult market environment. And notably the high level of volatility, our hedging program was unable to offset these losses in full.

I move onto slide 10 -- no, 15, sorry. As you can see on page 15, record [ph] the equity quota including equity related investments, such as private equity and hedge funds in the course of the year, by a further percentage point due to market developments.

Examination of asset allocation shows that Baloise can still rely on its broadly diversified high quality investment portfolio. This is demonstrated, for example, by the quality of the bond portfolio. 93% of the bonds have a rating of A or better. The share of AAA bonds is 57%.

Our broad diversification enables us to keep our recurring income at a constant level, despite the challenging nature of the environment, as page 16 shows.

Once again, real estate and mortgages, with their persistently high revenues, have had a positive stabilizing effect on recurring income. This is also reflected in the Life Insurance business by the constant margins over the guarantee of 80 basis points, as you can see from slide 44 in the appendix.

The high return on revenues counteracted the impairment on shares and fixed income investments, resulting from the negative market development. Moreover, a negative currency effect of around CHF100 million can be seen on fixed income investments.

Currently, hedges are included on the item other. The balance of currency losses and hedges is negative due to hedging costs. Investment income has declined due to lower realizations and higher impairments.

Slide 17 shows the development in equity. Equity has remained virtually stable, as compared with the previous year, at around CHF4 billion. This equates to a book value per share of 82.3% -- CHF82.3.

The positive impact of lower interest rates was offset by the opposite movement in credit spreads.

The majority of our high quality bond assets, like Swiss Government bonds, are classified as HTM and, hence, the unrealized gains are not reflected in shareholders' equity. At year end 2011, this would have had a positive impact of CHF600 million. You can see that in the financial report on page 165.

The negative development of the equity market is reflected in the reduction of net profit. Furthermore, the dividend payment for 2010 fiscal year and the funds used for concluding the share buyback program impacted dampening.

The available package will generate a strong capitalization and a solvency ratio of 203%.

Due to the low level of earnings and the continued solid nature of capital resources the return on equity was low at 1.6%.

Allow me now to move onto slide 18, with the planned dividend distribution to shareholders. As you can see from the chart, Baloise once again demonstrated the reliable nature of its dividend. Baloise confirms its shareholder-friendly stance against this year and proposes to the annual general meeting a dividend at the continued high level of CHF4.50, resulting in an attractive dividend yield of 7%.

Moreover, April 2011 marked the conclusion of our share buyback program that has been running since 2008.

Thank you for your attention. And I'll hand back to Martin Strobel.

Martin Strobel {BIO 5296838 <GO>}

Thank you, very much, German. I would now like to elaborate on our business from a market and customer perspective. To start, let's look at growth, which is illustrated on slide 20. In 2011, the overall business volume decreased by 9.9% measured in local currency. This decrease is due to the decline in our unit-linked business, stemming from our operations in Liechtenstein and Luxembourg.

In 2010, we profited from the Italian scudo fiscale. And then expected an introduction of the new EU savings directive. Both effects ended in 2010. So we expect to decline our unit-linked business for 2011. We consider this volume level now as a solid base for future growth.

Our life premium volume remains stable, whereas our non-life premiums grew by almost 11% in 2011. The substantial expansion of our Non-Life business is good news since this business is the solid earning pillar in these demanding times.

In Switzerland, our home market, premium volume remains stable. In Non-Life, we grew slightly above market. In our Life business, we had a strong focus on profitable new business, applying to a selective underwriting policy.

In Germany, the business volume remained stable, not a given in the light of our unwinding and integration efforts.

In Belgium, we grew strongly, by more than 50%. This jump in premium income is not least due to the acquisition of Avero and Nateus. With the fast and successful integration, we now hold a top five position in non-life and a top 11 position in life in the attractive Belgian market.

Having taken a look at growth, I would now like to provide you with some explanatory notes on the income side, which is illustrated on slide 21.

A glance at our EBIT shows the impact of the negative economic environment that we have been confronted with. The low interest environment and the decline of equity markets affected all business units. The write-down of our Greek bonds affected mostly the Swiss and Belgian business. The unusual high load of large net nat cat claims mirrors itself in the EBIT of Switzerland, Germany. And Belgium.

In Germany, in addition to these economic effects, we see the unwinding and integration costs reflected in the EBIT. Please have also in mind that the 2010 EBIT included some positive one-off effects stemming from the unwinding.

The write-down of the goodwill can be clearly seen in the EBIT of Croatia, which is displayed in the other units segment in the table at the left.

From the divisional perspective, it is clear that our Life business was strongly affected by the interest rate development, the equity markets. And the weak euro.

Our Non-Life business, although also being affected by the economic environment and the high level of large claims, remains the main earning pillar of Baloise.

Our Banking division was able to improve earning power, not a given in such eventful times. Here, our focus on efficiency pays off nicely.

The segment Other comprises Group activities, such as, for instance, holding functions and the corporate IT. Here, the decline can be explained by a positive one-off effect in 2010 resulting from the unwinding in Germany.

And now to our Swiss operations, illustrated on slide 22. In the Non-Life business, our Swiss operations achieved a very good combined ratio of 88.4%, despite an increased claims burden due to major claims. Our Baloise 2012 measures are paying off.

Besides the high number of large claims, EBIT in Non-Life was negatively affected by lower investment income, mainly caused by impairments.

Growth in Non-Life stood at 1.4%.

In Life business, gross premiums declined by 2.4%. We applied an underwriting policy that focuses on the profitability of the new business. Due to this strategy, we grew strongly in annual premiums of the Life business with 6.1%.

We also grew strongly in our investment-type business by a remarkable 44%. The main driver for this growth was the success of our innovative pension product, Renta Safe Time and Baloise Safe Invest.

Our disciplined focus on profitability can also be clearly noted in the new business margin, which improved to 17.3%.

Our Baloise Bank SoBa also grew substantially. As a bank with regional roots, we benefited from our trust based positioning. Our integrated path of this [ph] business model focused -- the focused financial service provider continues to prove successful.

Besides this impressive growth, Baloise Bank SoBa was able to further increase its efficiency. We implemented a new IT platform that supports more efficient processes. The positive effects can be seen in the cost-to-income ratio, which decreased substantially.

Due to this profitable growth and improved efficiency, Baloise Bank SoBa increased its profit to CHF22 million. You can find more information on Baloise Bank SoBa on the Internet, or in the appendix to this presentation.

On slide 23, I would like to give you a brief summary of our international operations. We already talked about the effect that the low interest environment, the translation effect. And the depreciation of assets had on the income of our international operations.

I would now like to provide some insight on the operational side of the business. In Germany, the major unwinding measures have been successfully completed. The connection of Deutscher Ring with Basler Deutschland has started and is fully on track. Our business volume is stable in a declining market, demonstrating that our integrated operation gains traction.

Our market position in Belgium was significantly strengthened by the acquisition of Avero and Nateus. But also, organically our Belgian entity grew above market in Life and Non-Life. Organically, we grew by 19.9% in Life. And 7.6% in Non-Life; this is not least due to our strong positioning in the Belgian broker market.

In Luxemburg, our local operations progressed substantially. We were able to increase both our life and non-life market share. At the same time, Luxemburg realized a great operational performance of a combined ratio of 81.1%; the best combined ratio performance within the entire Baloise Group in this closing.

In Austria, we are continuing to expand our insurance sales force and, thus, outperform the market significantly in terms of growth of 7.7% in Non-Life. And 3% in Life. Here, again, very good news from the operational earnings side; in 2011, Austria realized its best combined ratio performance ever with 95%.

Our growth measures in Croatia show an effect. Our business volume grew by 2.5% in an overall declining market. At the same time, the cost base decreased significantly. And the quality of the portfolio increased further, which led to an improved technical performance.

The variable annuity business of Baloise Life Liechtenstein achieved strong growth. Besides the Swiss market, we now sell this product into Germany and Italy. To further accelerate the business and to improve the efficiency in a low interest environment we reinforced the cooperation between Liechtenstein and Luxemburg.

I would now like to take you through the current status of our strategy. Let's start slide 25. 2009 we launched our program, Baloise 2012, to improve profitability and growth of Baloise. In actual and quantifiable terms, the objective of this program is aimed at increasing Baloise sustainable earning power by CHF200 million per annum by 2012. We are fully on track to reach this ambitious objective.

The Baloise 2012 program comprises around 100 initiatives. They are all focused on one of the following topics; optimize, grow. And develop new growth areas. At the center, one might also say at the heart, of these three topics is our positioning strategy, Baloise Safety World. On the lower-left of this slide you will find a breakdown of the CHF200 million effect of Baloise 2012 by these three categories.

Where do we stand in terms of implementation? Many optimization initiatives are now already completed, or almost completed. Thus, our new operating model in Switzerland, the product name is GEPARD, was successfully implemented. The efficiency increase program in Belgium has been almost fully implemented.

In Germany, we completed the major unwinding measures successfully. In 2011, we were investing in the integration efforts to reap the synergy benefits from integrated growth platform from 2012 onwards.

Growth initiatives, detailed here, are the customer retention activities in Belgium and Switzerland, as well as the expansion of the insurance sales force in Austria, are making good progress. Therefore, our good growth figures can also be attributed to the success of these initiatives.

Development of new growth segment is also making good progress. Baloise Safety World is implemented in all our markets. Our modern life products gained traction.

Following this overview, I would now like to take a more detailed look at three initiatives, on slide 26. The first example is taken from Belgium. Here, we established a dedicated team, called the IQC team, IQC standing for internal quality control, that exclusively focuses on the improvement of portfolio quality. For instance, they identify the so-called D [ph] customers and D brokers that have an exceptionally high claims load. They contact the broker and/or the customer to solve this unpleasant situation.

IQC also address fraud detection and prevention. In the broker market, it is sometimes necessary to have a heart to heart talk with a broker who leans maybe a little too much to the client's side. Also, making a low claims ratio part of the broker remuneration has had positive impact on the quality of claims.

Our next example comes from Austria. It is great to see how operation has developed over time. In 2001, Austria had a premium income of EUR58 million.

As growth USP, our Austrian team identified a cultural topic; to be the preferred and most trusted partner for entrepreneurial sales agencies. At the same time, they implemented all the operational excellence, OpEx, knowledge of Baloise Group, in the Austrian business. The effect is impressive. In the years from '09 to '11, our Austrian business realized an average growth rate of around 8%, leading to a premium volume of EUR120 million in 2011.

At the same time, the profitability of the business improved with a combined ratio of 95% in 2011. This success story will continue. We already have more agencies in the pipeline that want to join Baloise Austria and its unique partnership-oriented culture.

The final example is taken from Basel, Switzerland. Here, the Safety World, our unique positioning to make our customers safer, has an impact on growth and profitability.

You might remember, our wholesale product in Switzerland now comes with a safety package, offering unique safety service to our target customers. One example; after burglary at your house or apartment, we not only cover the claim but offer psychological assistance for you and your family to help coping with the side effects of this unpleasant event.

The effect of this innovation is impressive. 40% of the customers that buy or renew the household product, buy this additional safety package. The customers are embracing these new safety services and like our added-value approach.

And we generate value for Baloise. The increased cross-selling ratio at our target customers helps to further deepen this relationship. At the same time, the products sold within the safety package offer attractive margins for Baloise.

Given these successes, we are now rolling out the safety packages to other lines of business. In February, Baloise starts offering a comparable safety package in the motor business. Other lines of business will follow.

To help with these examples, we are able to provide some insight into what we do to make Baloise better; or, in other words, the Baloise 2012 is very vibrant and a realistic program, as the examples fully demonstrate.

Given the heavy headwind from capital markets and significant drop in interest rate levels since inception of this program in 2009, we remain focused on the successful execution of Baloise 2012, with one goal; to further improve the operational earning power of this Company. On slide 27, I would like to give you an update on the progress we made to realize the ambitious CHF200 million profit improvement by 2012.

In 2011, we improved our results by CHF150 million. It is a bit higher than we have anticipated for the year 2011. This additional CHF150 million mainly resulted from the impact of optimization initiatives.

In 2011, measures to increase efficiency had a major impact in Switzerland and Belgium, which you can see, for instance, in the overall improved cost ratio.

We did not fully focus on cost. But also improved our claims handling processes throughout Baloise Group to further reduce claims leakage, which is also demonstrated by the lower underlying loss ratio.

Key contributors to our operational earning power were the systematic re-underwriting initiatives throughout the Group, which is, for example, demonstrated by the outstanding low claims ratio of our Croatian unit.

These positive effects from optimization initiatives have been complemented by investment in growth. We expanded our sales capacity in our existing markets, for instance, in Austria and Croatia, where we grew stronger than the market; and, in the case of Croatia, even grew in a generally shrinking market environment.

Given these successes. And given that most Baloise 2012 measures are already completed or are very close to completion, we are very confident to reach our target of CHF200 million in 2012. We are fully on track to taking the last step of this demanding program successfully.

To conclude, I would like to take you through our outlook to the future, on slide 28. Going forward, we expect the financial markets to remain volatile and challenging. In this demanding environment, our full focus is on the operational strength of Baloise; one of our core strengths already. Accordingly, we strive for reaching the following ambitions; a combined ratio well below 100%; a new business margin of the Life business of 10% or higher.

These ambitions will translate in a strong generation of cash flow that will enable us to continue paying an attractive dividend to our shareholders also in the future.

Based on this focus on the operational earning power, the progress in our improvement program, Baloise 2012. And given our solid capitalization, we will propose to the upcoming general assembly an unchanged high dividend of CHF4.50.

We have come to an end of the presentation of our results. And I would like to summarize the most important key topics. Firstly, we achieved a good operational result, despite the challenging market conditions.

Secondly, we have high operational earning power and aim to enhance it further with the aid of Baloise 2012.

Thirdly, based on our sustainable operating earning power and our strong capitalization, we can propose high dividends.

Finally, we turn to a topic that concerns insurance industry and its customers; the Swiss Solvency test and Solvency II regime in the EU. You will find details on slide 29.

Essentially, the SST and Solvency II are two ideal instruments for risk management. That said, urgent action is required as the Swiss financial center is being systematically disadvantaged by regulations from within its own borders.

I will briefly explain how Swiss relations distort competition and hinder Swiss companies. Firstly, in Switzerland, the SST has been law for over a year, while the EU is still disputing as to when and how Solvency II should be introduced. The latest estimates expect this to happen in 2016.

Secondly, while we do not generally have any objections to the bars being set a little higher here in Switzerland, the so-called Swiss finish [ph], then in EU we cannot accept that the capital requirement for the exact same life insurance has to be 60% to 70% higher in Switzerland than in the EU. Politicians and decision makers must, therefore, ensure that this Swiss regulatory regime is equivalent to the Solvency II guidelines because, ultimately, we cannot expect customers to have to pay the additional costs for two risk management instruments prescribed by the state.

We should also point out that Solvency II still has still severe structural issues because it should now be clear across the whole of Europe that government bonds cannot be risk free, per se. In this respect, reality does not match theory. However, our competitors, for instance, in Belgium, are increasing guarantees, while we, quite rightly, have to decrease them owing to the risk surcharge on state bonds.

As I've just mentioned, SST and Solvency II are merely models in the theoretical world. And models simply do not reflect the original, or indeed, reality. We, therefore, urgently need to develop both regimes as part of an ongoing process.

The life business industry is a long-term business; we are committed to our customers for 10 or 20 years. Today, SST and Solvency II are far too volatile to guide this business in the long run.

We also believe that property valuations in Switzerland are flawed. Insurance companies have, quite rightly, invested their customers' pension funds in property because Swiss property is a blessing at times of high volatility and major debt and currency crisis. After all, it provides reliable returns and keeps its value for decades.

Excessive regulation is damaging our customers. We are, therefore, asking FINMA and political authorities for the following equivalents of the two systems, SST and Solvency II; long-term development of the regulatory system and ratification of the structural issues mentioned above.

Thank you for being so attentive. I would now be pleased to answer your questions, together with German Egloff and Martin Wenk. Thank you for your attention.

Questions And Answers

Operator

We will now begin the question and answer session. (Operator Instructions). Michael Klien, Nomura.

Q - Michael Klien {BIO 4262408 <GO>}

I had a few questions; first of all, on your Baloise 2012 program. If I look at the achievements in 2011, i.e., the CHF150 million of net effect. So the delta is about CHF70 versus 2010, would you be able to split this out in terms of benefits to the Life business versus the Non-Life business. And also give a little bit more details of where exactly these benefits were coming through?

And if you look forward into the CHF200 million target for 2012 for the remaining CHF50 million, could you also highlight the split Life, versus Non-Life.

A - Martin Strobel {BIO 5296838 <GO>}

First, you asked for the delta between '10 and '11; I think it's about CHF60 million. CHF92 million to CHF150 million, how's the split Life/Non-Life, I think it's more to the Non-Life side, the effects. This is due to these legal quote effects you find in the Life business.

And now, going to detail where do we see the effects of Baloise 2012, there are several ones. First, you see organic growth in most countries being substantial, being above market. And this is due to the growth measures.

Then you see the efficiency improving. You see the overall cost ratio, for instance, in the Non-Life business is coming down. And I'm really quite happy with that since we have to have in mind that we are still in the investment mode. In Germany, we have invested heavily in the last year in the unwinding and reintegration. We invested last year in the integration of Avero. And also, we have the substantial investments to see the cost ratio come down. So you see that the underlying efficiency is improving substantially.

You see a very good combined ratio performance. Actually, looking around in the marketplace, our competitors, we think that the 95.5% net we realized is excellent. It's really among the best in the industry.

So we were able to cope successfully with a higher load from large claims. And it had a 4% -- 4 percentage point effect on the combined ratio. We also coped successfully with the additional load stemming from the integration of Avero and Nateus on the combined ratio. And, although we had all these effects, it's standing at 95.5%.

Cash frequency is going down, for instance, also in the Swiss motor book. So actually we are very happy with this combined ratio performance. And here we see a lot of effects of Baloise 2012.

Walking now to the Life business, if you have a closer look on our embedded value you see that the operating return on embedded value stands at, I think, about 14.6%. And this is an effect of Baloise 2012.

What do we do in the Life Business? We lower costs. And this affects positively the embedded value. We improved the product mix towards more unit-linked business. We've improved a lot our biometric results by a selective underwriting policy. And all these effects you see in the operating return on embedded value, which is, to our understanding, also, in a benchmarking comparison, at a very decent level.

So the second part of the question was now going for the last step, the last CHF50 million that are missing to fulfill the overall target. I think, more or less, the split will remain the same regarding Non-Life/Life. So it will be more seen on the Non-Life part than in the Life part.

You will see further cost improvements. You will see further improvements in the combined ratio performance. And we apply, we did so in the past and we will so in this year, apply pricing measures that have a positive effect on pricing. And on growth. And at the same time on the margin. So the pattern you have seen in the past, with Baloise 2012, you will also see in the future going forward.

Q - Michael Klien {BIO 4262408 <GO>}

And just to follow up in terms of, as you highlighted, the effect of efficiency program on the combined ratio. And, particularly, if you look at the underlying loss ratio that improved by 1.4 percentage points. And I think you mentioned that the acquisition of the Belgian operations had a negative effect of about 0.8 percentage points.

So would it be fair to say that the underlying improvement would have been closer to 2.2 percentage points in 2011 versus 2010 in terms of the underlying loss ratio? And how much would you say is this due to the efficiency programs, although there may be other effects as well like, for example, lower frequency in claims, or something similar?

A - Martin Strobel {BIO 5296838 <GO>}

First of all, Mr. Klien, I think you're broadly right. There was a negative effect due to Nateus and Avero. The reason for this is that the combined ratios of these two portfolios we bought are higher than the standard of Baloise. We knew that when we bought the companies.

And one part of the business case in acquiring Avero and Nateus is now bring these two companies on the level of Baloise. And we are in the middle of the process of re-underwriting price adjustments, all the OpEx capabilities, these that we have on board with Baloise.

Now, the improvement effect, is it due to Baloise 2012, or frequency, I would say it's Baloise 2012 since Baloise 2012 effects also positively the frequency. The more we grow in target customer segments, A and B customers, the more selective we become to selecting our target customers, the better we become, or the lower frequency becomes.

We have had a look, you might remember, the statistics that we, for instance, in the liability motor book in Switzerland, there we have the market data from the Swiss Insurance Association. Here, in 2011, again, we increased the difference between market frequency and our frequency substantially. So we have become better.

The distance in the market has become better. Again, of all the frequencies lower again, this is due to a better mix, a better quality of our customers. This is a Baloise 2012 effect. So it's hard for me to distinguish between, let's say, overall frequency development and Baloise 2012 since I have the impression a lot of frequency development, which is positive, is due to the program.

Q - Michael Klien {BIO 4262408 <GO>}

And one final question, if I may, on the Non-Life side. If you look at the German operations, the combined ratio there worsened by 1.1 percentage point. You highlighted the nat cat effect, you also highlighted large claims, could you, maybe, split out how each of them affected the combined ratio? And I guess, underlying, we might see actually a combined ratio improvement, would that be the correct conclusion?

A - Martin Strobel {BIO 5296838 <GO>}

First of all, we saw in Germany, especially in the Fourth Quarter, an increase in claims. Important, from my point of view, is that our combined ratio performance seems to be substantially better than the market and most of our competitors. And here I'm quite happy since we see, in comparison, that we are really applying all these Baloise 2012 and OpEx measures successfully.

Nevertheless, we are right now in the process of really analyzing what has happened to the market since this actually -- from I was saying [ph] too high level of the combined ratio, in Germany, it could also be seen in the market. We have seen that the market leader in Germany had a combined ratio above 100%, many others had above 100%, due to market development. So are right now digging into details in the portfolio to find out, okay, what have been the roots. And we'll act accordingly since we are not happy with the combined ratio performance of the German business.

We'll work on the claim side. And also on the cost side. Up until now, we do not see that many synergies in Germany. They will start to pop up this year. A substantial part will also pop up in 2013. And following years. So, going forward, the claims ratio should improve on this actually too high level as we work on the cost side and the claims side.

Q - Michael Klien {BIO 4262408 <GO>}

Okay, thank you.

Operator

Peter Eliot, Berenberg Bank.

Q - Peter Eliot {BIO 7556214 <GO>}

Perhaps, I could just start off with just a follow up on Michael's question on the Baloise 2012 program. Because I think if you take off the one-offs from 2010 then we're looking at an underlying improvement of about CHF73 million. And you're expecting a further CHF50 million this year, which is a bit different to the message we've got in the past, to expect a hockey stick-type approach with a lot of benefits to come in the final year.

So I'm just wondering whether you're, perhaps, ahead of target there, or whether there's any more you can do. Or, if not, perhaps what has changed there?

And then if I could just add two questions of my own. The first one is if you could comment on where you see Baloise's competitive position within the Swiss life market from here? And there's three things, in particular, that struck me that perhaps you could comment on.

Just looking at your premium development in Switzerland relative to that of peers, I would have guessed that perhaps you'd made a small decline in market share. And that seemed contrary to your comments just now so I'm very happy to be corrected on that?

Second thing is on the slide 65 you show the pay out on the legal quote. And you're basically paying out 98% there, which seems quite high. So perhaps I'm wondering if you could comment there on the balancing items with respect to the investment return and competitive position?

And then thirdly. And I know this is a Group target. But your target margin of at least 10% for the Group doesn't seem particularly ambitious when you look at the fact that you beat it last year when interest rates were very low, that you've got additional expense savings to come through, etc.. And I'm just wondering whether there's more going on there? Sorry, for the few parts.

But perhaps if I could then come to my third question, which is on the Swiss Solvency Test. Just for the avoidance of doubt and to confirm, could you clarify that you are on the green there? And I'm wondering if we could perhaps have an update on any progress on getting models approved by FINMA?

And also, I just -- I know you heard your comment on the Life being particularly unfair under the Swiss Solvency Test. But my understanding is that you benefit on the Non-Life side and that it should be, therefore, fairly neutral on a Group level.

Perhaps, you could comment on those? Sorry for all the parts on those.

A - Martin Strobel {BIO 5296838 <GO>}

That's fine. We will answer, or try to answer your questions in a stabilized manner. I'll start at the beginning. And some questions I will hand over to German Egloff, especially the SST questions, Life/Non-Life and how does it work together.

First, on Baloise 2012, you just said, okay, the hockey stick question, I think this relates to the point we aimed for CHF110 million to CHF120 million and now have CHF150 million.

And how come that we exceeded this and made it, say, the hockey stick a bit smaller, bit more, let's say, a linear development of Baloise 2012? It's not easy in such a program, with 100 measures, to really determine exactly when to expect what value from what measure in terms of a hard closing on December 31. So, actually, we have been a little early with some measures that have now realized their potential in '11 and did not so, let's say, in January 2012. So it's more or less a question when exactly, from a time point of view, the value of a measure realizes.

Actually, the program did not change and will deliver its full value, as indicated, the CHF200 million. What I have [ph] mentioned, these CHF200 million include that we won't see in 2012 the full synergies in Germany. But this is integrated in this program so we will see the full synergies in Germany later on.

Now, the competitive positioning in Life. Actually, we are very well positioned. And I'm happy that you asked this question since we manage the business a bit different than our competitors. And it's important, I think, to explain this. First, premium development. On first side, looking at the pure top line, you're right, we grew below market. But I'd like to walk you through the details.

In the Group Life business, we grew above market in annual premiums. And this is exactly what we are aiming for since annual premiums is also the risk content of the business. We grew below market in single premiums in the Group Life business. And why is this so? We have now a much more selective underwriting that focuses on profit to the customers.

And if you have a Group Life customer then profitability is very much determined by the age structure of the insured people that are working for a certain company. And we are heading more for companies that have a better age structure, translating to younger employees, since here the risk content of the Group Life business is higher.

And you don't have that many obligations from the pension part of the business, since the older the employees become the closer you come to the conversion of the savings into an annual pension. And, as you might know, given the interest environment, it's not really a very attractive business to have pension funds, or pension obligations here on the books.

So that's why we focus selectively on certain parts of the SME market, on certain age structures; this leads to quite a high growth in any premium above market. But we don't get as many single premiums, since this is the saving part. And this is high risk with elder employees. So that's the reason for this.

And then another fact, we grow strongly in unit-linked business in Switzerland also in the annuity business. Here, our market share in the new business is almost double as high as the market share we have in the book. The point is that you don't see this new business in the Swiss figures but these products are produced by Liechtenstein and you see the growth in Liechtenstein. But, actually, these products are sold in Switzerland.

For internal controlling purposes, we always integrate this new business from Liechtenstein to the Swiss figures, only the part that is produced in Switzerland. And then we see that we grow by far above market in the individual Life business. And also, the product mix is nice since we have a lot of -- high proportion of this business is unit-linked; not so much the classical business.

So if you take all this information into account, we have, actually. And I'm quite happy, we have a very good market position. We see quite an ongoing interest of customers switching from the autonomous foundation part of the second pillar towards the insurance part of the second pillar. This trend, we expect to continue. We can be quite selective here in writing new business and, actually, have in most parts of the business a market share that's higher than what should one expect.

But, for us, it's important to only write profitable new business. You see this also in new business margin; that improved substantially to above 17% if you compare this to peers. And take into account our assumptions of liquidity premiums accordingly then you see that this is a very nice new business margin we realized in the new business. So this pays off. And that can be seen from that figure.

Now you asked about the payout legal quote, 98%, that is high. This is mainly due to the impairments and write-offs we had in the asset part last year. I don't expect this figure to be so high for the -- going forward for the future; we should be considerably lower going forward as soon as we see normal returns in the investment result. So I would call this an exception due to the impairments we have seen in the result.

Next question of you was the new business margin. 10% is not so high. Actually, we say above 10%, or at least 10%. In the Swiss business, we are at 17%.

Actually, I agree it's not very high. It's surely our ambition to -- at least 10% means also higher. But, actually, we wanted to disclose a target that we really also can meet. And given we have a quite volatile interest rate development, it's hard to say where the new business margin will really be at the end of a certain year because that really depends also on interest rate development.

So, yes, our ambition should be to exceed this target; should be at least 10% or higher. And actually higher.

Swiss Solvency Test, we're dark in the green. So no problems here from the SST from this operation. But I think this is a topic off German Egloff, to provide some details on the SST, on the different models we provide here and how the different in the Non-Life part of SST compared to Solvency II.

A - German Egloff {BIO 4782831 <GO>}

Well, the thing whether versus Solvency II the advantages in Non-Life are offset by the disadvantages in Life, you could argue like that if you are in a stable situation. But the reality is, of course, that we have a lot more assets on the Life side and if you've got volatility in the market it doesn't really help because the volatility you get in the Life business is just enormous. And what really disturbs us at the moment is, let's -- we have the Group Swiss Solvency Test as well. And take as an example Belgium.

In Belgium, we have the situation that on Belgian Government bonds you have quite high spreads. The local market behaves as if they just have an interest rate level of between 4% and close to 5%. And they're even increasing guarantees there, whereas we have to model it on a low risk level and we have to spend additional capital for spread. So, actually, of course we don't have to fulfill SST for Belgium for the Swiss regulator; nevertheless, it affects the Group SST.

And so we come into a situation where we not only have a strong regime compared to European countries. But we have a regime that is in force. And we are competing with competitors who have the Solvency II system, who isn't even invented yet. And that creates a competitive disadvantage. And what we are saying. So that the remarks that Martin made, well, it's not only an economic statement, it's a political statement as well. And we said exactly the same to the journalists about a half-hour ago. And that's probably sort of a waking call for the Swiss politicians, to come to senses there. That's the message behind it.

The models, by the way, there the process is still going on. Nobody has a completely accepted model; and of course the world is moving on so there are new models popping up almost by the week. We are sending the figures, with some model questions, for approvals by the end of April and we'll see then.

Currently, the situation is that normally the regulator says, well, this and this and this part you can use that for next year. But it is not for eternity at the moment. So that's about the situation.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, very much.

Operator

Fabrizio Croce, Kepler.

Q - Fabrizio Croce {BIO 15005585 <GO>}

I start with two follow-ups on the Peter one, if possible. And then I go into four further ones. If you say that in regular premium you actually beat the market. And if I look to the regular premium development I saw some figure around 4% to 8% [ph], could you simply deliver us the figure which Baloise had, in order to bring this a little bit more into perspective?

And the second one is about the SST being in the green. Is this with a duration of zero years on the real estate? Or what duration are you using currently on this metric?

And now about the questions which I have from my side. The first one is in terms of reserve releases. We heard from some competitor the whiplash reserves, which were melted down. And here the question; I assume that you didn't do that and so the question is what kind of amount could we expect to be melted down going forward, from your side? Or will you do it on a case by case base?

The second one is in terms of natural catastrophes. You had a pretty big impact already net so the question is how big was the impact gross? And so did the reinsurance coverage grip [ph] properly?

The third one is about your risk on the equities. What seems to be a pretty large figure is the -- or the CHF109 million which you had to impair on equities. So the question is did you have some large single position which actually collapsed there and, actually, were even out of your risk management frame to certain extent?

And last, sorry for being a little bit long. But it's an interesting case in these days, on page 8, if I look to the improvement of Baloise 2012 I have an improvement of Baloise 2012 of CHF58 million from 2010 to 2011. Could you allocate on this chart where the CHF58 million most likely -- where could I find that CHF58 million improvement, most likely, in which segment?

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Mr. Croce, for your many questions. I will answer two of them. And then I will hand you over to German Egloff and Martin Wenk. You asked for the growth in annual premium Group Life, this was 6.1%.

And the other question you asked regarding Baloise 2012 on page 8, where do we find this CHF58 million, as just pointed out, you find more on the Non-Life side than on the Life side. And this is due to the legal quote effect in the Life business. So that was the information I just provided.

Now I'd like to hand you over to German Egloff about the SST questions, reserve releases, natural catastrophes; and then I'd like to get you over to Martin Wenk, talking about the impairments. German?

A - German Egloff {BIO 4782831 <GO>}

Yes, as you see, no, there is no duration considered for real estate. There is no model around yet. So that's for this.

Then for the whiplash releases, no, it's just ordinary. We had some releases there as well. But it's more like on a case to case basis. We had some releases in, I think, 1.5 years ago. The position is quite big for reserves there, I mean there are still cases around. But we are doing that on a case to case basis so no bulk releases.

If we knew that we had to do it because there is no choice, if your best estimate reserves are different to what you have in your books then you have to release or strengthen the reserves.

And what was the last one? About nat cat gross? Unfortunately, it's almost gross equals net. And the reason for it is that, firstly, our retention level is for the Group, more or less, on a CHF15 million [ph] basis. And we had quite a lot of different events. So we didn't really have a single European event that triggered reinsurance. That was one reason.

And the second reason was that even though, let's say, the hailstorm in the upper Lake Zurich in August was quite a big one. But that was spread over four different lines of business. So for each line of business the limit was still too low. There might be an impact maybe in the coming years out of this elementary pool but, up 'til now, we think that's more or less flat. So it's more or less the CHF123 million are almost fully gross.

Q - Fabrizio Croce {BIO 15005585 <GO>}

Will this change your reinsurance policy, actually?

A - German Egloff {BIO 4782831 <GO>}

No. See, for the Board of Directors, we had -- we made a simulation and said, well, if we would lower the reinsurance retention to CHF3 million. So to really make a difference, that would have been positive this year but year after year, the reinsurance premiums would be CHF90 million higher. So within the last 10 years, it would only -- in two years it would have created a positive return. And in all other years it creates a negative return. So.

And we have the risk-bearing capacity to -- I mean, this is our core business, to have reinsurance in. So, therefore, you can't win year after year with reinsurance. If someone tells you that, he lies to you. So, therefore, the question is just where would you spend your risk capacity or not? And we think actually this level is a proper one. We check it every year. But this is the level we've had for quite a while.

Except for tackle the reinsurance [ph] contract, of course; that's a different story.

A - Martin Strobel {BIO 5296838 <GO>}

Now Martin Wenk, please, on the impairments.

A - Martin Wenk {BIO 4193573 <GO>}

Yes, okay. First of all, I wanted to say that probably don't have a very low exposure into equity if I compare it to the competition. We still have quite a sizeable exposure. And that's because we can afford it and we have the risk management to do that.

There are two effects that you have to bear in mind. First of all, it depends on where the equity exposure is, if it's Non-Life or in Life. And our exposure is mainly in Non-Life. And there the impairments are accounted for full, except for the taxes. So it depends if you compare Non-Life or a Life company for the impairments.

And the second effect is impairments are non-linear. It's important to know if it's an impairment because of the 12-month rule, because it's below cost after 12 months, if it's a follow-up impairment, or what kind of an impairment it is. So you cannot just extrapolate it from the actual positions in equity you have.

Q - Fabrizio Croce {BIO 15005585 <GO>}

But there were no single positions which actually hit you for some CHF30 million/CHF40 million, things like that?

A - Martin Wenk {BIO 4193573 <GO>}

Not in equity, no. The only effect was on the bond side with Greece. But that was it.

Q - Fabrizio Croce {BIO 15005585 <GO>}

Okay. So, thank you very much.

Operator

Stefan Schuermann, Bank Vontobel.

Q - Stefan Schuermann {BIO 3235442 <GO>}

I have two questions. The first one is on the duration management. I saw you increase your ratio on the asset side by half a year, should we expect that this is further increasing in 2012? And maybe can you give some indication where the duration gap now stays in the Life and Non-Life books?

The second question is more detailed. On slide 65 you show some CHF42 million one-off impact in the risk result in Group Life and in the profit sourcing summary, can you just maybe explain what exactly this is. And what the impact here is?

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Mr. Schuermann. I hand you over for the duration management question to Martin Wenk.

A - Martin Wenk {BIO 4193573 <GO>}

Yes. Thank you. Indeed, we have increased the duration by half a year, last year. We tried to do that in a way that we still can keep the upside. So not all of that is done just by increasing the duration of bonds. But also we are using swaptions to do that. So this is one thing.

I don't expect that to go on much more at that level we have right now. But it will depend on the development of the interest rates this year if we will bring it down more than it is at the moment. And at the moment we have a gap of about two years in Life and a very small gap in Non-Life because this is very different there.

Would that answer your question?

Q - Stefan Schuermann {BIO 3235442 <GO>}

Yes, that's good. Thank you, very much.

A - Martin Strobel {BIO 5296838 <GO>}

And now the question on the slide 65, the Group Life processes, German Egloff, please.

A - German Egloff {BIO 4782831 <GO>}

Well, we had a one-off in there; you see it in the footnote. And just bear in mind that, of course, this slide is based on the statutory result.

So we had a positive result in the risk process, which was kind of reinvested directly into the reserves because of the low interest rate. The thing was -- of course, that's probably the question before as well about the legal quote, people sometimes forget that in the first place we have to fulfill the guarantees. So your legal quote could theoretically be above 100%. And that's the reason that this is so high. So if you want to go more into data I would think we take it up afterwards.

Q - Stefan Schuermann {BIO 3235442 <GO>}

No, that helps to understand. Yes, that's fine. Thank you.

Operator

Ralph Hebgen, KBW.

Q - Ralph Hebgen {BIO 6297020 <GO>}

First of all, apologies, I was very late on the call so I'm going to ask a few questions. But if they have already been answered, again, apologies; please just say so and I will refer to the transcript afterward the call.

First of all, this morning I noticed that on Bloomberg there was a note saying that you may wish to revise your ROE target quote in March next year. It would be interesting if you could give us some background on that.

Second question. I noticed that your MCEV sensitivity to falling interest rates has increased materially from last year and is now. And I can't find the slide of course now that I speak, something, off the top of my head, like 57% and last year it was 35%. This sensitivity is even more pronounced on your business value and, again, it would be helpful if you could explain the dynamics there.

And finally, new business margins, strongly negative in international business; would you be able to explain the dynamics. And also give us some insight on the internal rate of returns on the Life business which you are writing? Thank you, very much.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, Mr. Hebgen. I think none of those has been posed before. So we will answer them. I will take care of the first two. And I think also the new business international. The internal rate of return, that I leave to German; he has some time to look at that.

ROE target. As you might have seen, our ROE target, that has been so far 15% over the cycle, is under revision right now. Why is this so? We have to consider that the R and the E are affected by factors that we cannot completely control. You have seen the R, for instance, this year that has operational elements. But as well elements from the financial markets that are substantial. So ROE of 15% also in this low interest environment led us to the conclusion, okay, let's put this under revision.

What we said. And that was not really transmitted correctly to Bloomberg, this morning is, first of all, we stick to the strategy of the Company. So there's no change in strategy now and we refocus on operational improvement, as we have done in the past, to generate a decent cash flow. And this translates into high dividend yields for our shareholders. So this remains absolutely unchanged. And also, the execution of Baloise 2012 remains unchanged. All these strategic elements remain unchanged.

Right now, we are in the process of designing the next strategic steps since Baloise 2012 will end this year. And March next year we want to disclose our objectives in the program and the ideas for the next phase to follow. And this will include also an update on the targets we want to reach in this phase. And what the exact targets will be and what the levels will be, we will disclose then.

So, for the time being, only under revision the ROE target. But the new target set will be disclosed then in March next year.

MCEV sensitivity, this is due to the lower interest environment. We are now with the interest environment closer to the guarantee levels in the book. And you see this on the MCEV. You also see this on the new business margin sensitivities. Here, volatility is higher since you -- one reason for this, there are many. But one reason for this is in the MCEV you've got a fixed SNA.

You don't have SNA elements in the new business margin so you want SST [ph] high since there are no, let's say, dampening elements as the SNA, for instance, is in the MCEV.

The new business margin, international business is negative. It's only negative in Liechtenstein; this is due to cost reasons. We disclosed some weeks ago that we now bundle our forces from Luxembourg and Liechtenstein. And this is not least to the fact that we want to increase efficiency.

We are confronted with lower margins, not -- largely coming from the low interest environment. And here we have quite a close look on our internal cost structures and now integrate, let's say, from a structural point of view, the Liechtenstein into the Luxembourg business. This leads to considerably lower cost load for this business. And this should improve the new business margin substantially.

I hand you over German Egloff, talking about the internal rate of return.

A - German Egloff {BIO 4782831 <GO>}

We don't disclose any. We don't disclose an internal rate of return.

Well, I think the question is whether we are earning our capital costs or not, that's probably what you're interested in. And there an indication is certainly in new business margin. And if the new business margin is positive we are actually earning the money in the new business. And for the whole business, I would answer that positively as well.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay. Just, perhaps, one follow-up question on MCEV sensitivity. I understand the heightened sensitivity is because of lower interest rate environment, in particular, presuming Switzerland; however, the sensitivity also last year is, I think, one of the highest in the life assurance sector in Europe. And my question is are you thinking about taking measures to limit and reduce the sensitivity of your MCEV to movements in interest rates?

A - Martin Strobel {BIO 5296838 <GO>}

Actually, no, since -- first of all, why do we have such a high sensitivity? One of the reasons is our duration gap. Actually, we have historically this duration gap. And we stick to this since we think it would destroy substantial value if we closed the gap right now given the low interest environment. And given recent developments in financial markets I think are hinting at increasing interest rates. To what speed and what extent that's open. But I think we have seen the lowest in the interest rates.

So I think close the gap right now would be not one of the best ideas to have right now in terms of value terms.

Also, swaptions, for instance, we could buy them but they are quite expensive. So why invest in swaptions since we can bear this mismatch due to our capital we have? This is one element in our risk management and we invest some, let's say, risk capital in the mismatch to profit, from a value perspective, in the upside.

And to our risk management is not so much based on the MCEV, it's based on the SST Solvency I figures, all this. This is in the green, dark in the green in the SST case. So no need for action to -- from a risk point of view (inaudible). I think that's the explanation for the MCEV.

A - German Egloff {BIO 4782831 <GO>}

I just may add, maybe that looks a bit more dramatic than it is, in fact, if you compare it to our companies. The reason for it is that we have quite a large portfolio in Group Life business in Switzerland. And, of course, if interest rates are going down there. And especially so if they are close to the guarantees, it looks extremely sensitive.

Now the reality is, of course, that in the Group Life business the guarantee is changed every year. And that applies for the whole book. That's not reflected in the management rules if this happens. So the sensitivities are always calculated on a steady state situation so, in fact, it will probably emerge less dramatic in reality than it looks if just look at the sensitivities.

Q - Ralph Hebgen {BIO 6297020 <GO>}

Okay, thank you very much.

Operator

Akhil Mittal, JPMorgan.

Q - Akhil Mittal {BIO 16419388 <GO>}

I have two questions, please. The first one is regarding the combined ratio. I am particularly interested in the -- if you could give some details on the Avero integration in Belgium and what could be the combined ratio of that unit in 2012? And, in general, what is your guidance for the whole Group 2012 combined ratio?

And the second question would be regarding the Solvency I. If you could tell me that what is the Solvency I ratio in February, in the sense that if we do the accounting in February including the Swiss and German government bonds at the market prices. And what is the Solvency I ratio in February? Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Thank you, very much. I will answer the first one, guidance on the combined ratio. And then I will hand over you over to German Egloff, talking about the February status of the Solvency I.

Combined ratio, there's one guidance we give to financial markets; it's well below 100. And this is what we are aiming for now for many years. And we deliver on this target. And, actually, we're quite proud since combined ratio performance, I think, is very good in the last year.

We disclosed that we had a negative effect on the total combined ratio of 0.8 points due to the integration of Avero and Nateus. The reason for this is that the quality of the book we bought is lower than the quality of our book.

And now we're in the process of re-underwriting. This is exactly what we disclose today. We expect effects on the combined ratio for this year on the re-underwriting process we will -- what do we do? We will increase prices, we will exclude part of the risks of whatever we do in the re-underwriting process and this will have effect on the combined ratio.

It's hard to say what the exact effect will be since it really depends on the market development, on how we progress in this re-underwriting. But I don't -- we will see this effect but it will not distort the NDD [ph], The complete picture of combined ratio at Baloise Group. So I think I expect it to be near the effect we have seen in the last year. We will see effects. But not really substantial from a Group perspective.

Now I hand you over to German Egloff.

A - German Egloff {BIO 4782831 <GO>}

Well, for Solvency I, since we don't do monthly closings. And even if we did I wouldn't have the figure yet. So I can't really give you precise information. I can't just give you a guess. I would expect, due to the movements we have seen in the spreads, namely in Belgium, that the Solvency I ratio will probably be a bit higher at the end of February. And even higher now; so after March 15, we had quite a movement in the interest rate environment.

So I can just make a guess; it's probably, I don't know, 210 or something. But I wouldn't know.

Q - Akhil Mittal {BIO 16419388 <GO>}

Okay, thank you. Thank you. So much.

Operator

(Operator Instructions). Rene Locher, MainFirst.

Q - Rene Locher {BIO 1921075 <GO>}

So just a follow-up question on slide 10, the combined ratio, just a few clarifications. First of all, your large loss budget, is that still at CHF45 million?

And then, German mentioned before the retention you have in your reinsurance coverage. Is it now CHF15 million or is it CHF20 million per event?

And also, the prior year development, this 4 percentage points, is that the kind of run rate we can use in the coming years?

And so the second question is on slide 14. I'm not an expert in hedging. But I was just wondering what are you hedging going into 2012/2013? Is it just the equities do you hedge, or the bonds because of the duration asset liability?

The third question is on slide 21; here, again, a clarification. You have mentioned a lot of restructuring costs, unwinding costs, Germany, you mentioned Belgium. So I was just wondering should we expect further restructuring costs in 2012/2013?

And then just a question CIO margin [ph] Bank. I'm just wondering where is investing these days. Is it more bonds, real estate, equities?

And just a last question. I'm very much surprised that it looks as if everybody's going back to normal. We are talking about one-offs in 2011. But I do believe that for insurance companies we have a new norm. We still have a lot of volatility in financial markets, we are in a low bond yield environment. And I was just wondering, Mr. Strobel, if you can just comment a little bit if it's really back to normal. Thank you, very much.

A - Martin Strobel {BIO 5296838 <GO>}

Mr. Locher, thank you very much for your many questions. I'll think we'll answer them in step wise. Maybe, first, I hand you over to German Egloff about the large claims, the budget retention. And prior loss developments; and afterwards, we will answer step wise. German, please.

A - German Egloff {BIO 4782831 <GO>}

Well, the large loss budget, currently, that's still CHF45 million; for events about CHF4 million. On the other hand, that's not rocket science. You can't actually operationally do a budget on a net basis; that doesn't work. The CHF45 million were at the time created with an SST simulation.

Just to give you an indication, because the analysts were actually asking what is the normal expectation there, we probably have to look at this now because the portfolio has grown in Belgium. And in Luxembourg as well. And there will be a better picture to give an indication above CHF3 million; maybe CHF4 million wasn't exactly the same. Let me think about that. Maybe that will be another guidance next year. But currently it's the CHF45 million.

But just, by the way, if you have frequency cases, that doesn't make a difference. And that's, of course, the problem with the reinsurance as well, that frequency cases never go into reinsurance.

Reinsurance layers, we have -- that depends on the program. In certain programs we have, indeed, CHF20 million; in others, we have CHF50 million. In average, I think most programs that would have been triggered if they had this year, there you can assume a CHF50 million retention.

And for the prior year loss development, that's of course a trap question. Actually, the expectation should be nil, otherwise I would assume that we are over reserved, which is not allowed by IFRS.

Last year, I gave you an indication and said, well, just given the experience of the last couple of years we have been at 2 to 3 combined ratio points in that area. But it could be more, it could be less. So currently there is nothing special in it. But I wouldn't, of course, tell you just calculate with the 4%; what figure you assume in your model, that's actually your problem not mine.

A - Martin Strobel {BIO 5296838 <GO>}

Okay, then I hand you over to Martin for the asset management questions on hedging, on how does Martin Wenk invest these days.

A - Martin Wenk {BIO 4193573 <GO>}

Okay, let's start with the hedging. Our main hedging activities will be the foreign exchange exposure again because this is, basically, something that is ongoing, that opens us up to bond markets of different currencies since the Swiss franc market is so narrow and doesn't provide the necessary durations and maturities we are looking for. So this is the main activity that actually will take place.

On the equity side, we have a CPPI approach. So that means that the hedging will only be effective, triggered by some risk considerations. So if we deem it necessary, we do it there and that's really -- it's an ongoing thing. There is no quota or no ratio I could give you for that because that changes a lot.

On the interest rate side, we are not hedging the interest rate risk as interests rate could rise because we have a natural hedge in the balance sheet itself. It's the liabilities and the assets together that make the interest rate risks, which is basically at the end shown in the duration gap. And we manage that. So, nothing to the upside.

To the downside, we are using swaptions as long as they are priced fairly. But, as I said before, at that level of interest rate, we are not doing that in an extended way, let's say, that way.

Then, where do we invest? What I can say that the asset allocation will not change substantially, we will proceed with that.

The asset allocation is an ALM question, to a large extent. And we still have the same situation there so the asset allocation will not change. We will maintain the equity and the exposure in alternatives. And we are in a very good position regarding mortgages because we have the synergies with the bank. We can maintain our positions there when it is difficult to maintain them because the market is very competitive.

And so the full, let's say, focus is on the fixed income side; to improve that, to find new ways to get the right maturities, to find ways to look for every basis point we can get without increasing the risk.

Q - Rene Locher {BIO 1921075 <GO>}

Okay, thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Then I come back to your questions, the last remaining, according to my list, the restructuring costs. First of all, all costs that are associated with the Baloise 2012 program are integrated in the Baloise 2012 figures. So if I say, for instance, in Germany we have this unwinding and integration costs, yes, we do have these costs. But they are integrated so we disclosed the net figures; these are enclosed in the net figures these costs.

On top of these costs there are only the acquisition activities we have. So what we had in the last year is the acquisition of Avero. Avero was part of the Baloise 2012 program. And to integrate Avero we had a two-digit number in Swiss francs of integration cost. And now for this year and following years we will have integration costs of Nateus. We bought Nateus and this, again, will be a low two-digit figure for this year. But that's the only topic, I think, besides Baloise 2012, or, let's say, the only major topic here.

Then the last question was back to normal? Obviously not. Yes, the last four, five, six, seven weeks have been a bit more quiet than the second half of '11. But we are not in normal mode.

I don't -- we expect financial markets to remain volatile so what we do is we focus on operational business since this is what can influence, this is where we can really apply our capabilities. But what financial markets will do, we don't think the situation is normal and will be stable going forward. If it comes so then it's nice. But actually we don't expect it to be so. We have seen a lot of volatility, a lot of black swans nobody expected. And why should this become otherwise in a very short timeframe?

So I think, no, we're not back at normal times.

Q - Rene Locher {BIO 1921075 <GO>}

Okay, thank you very much.

Operator

Thomas Noack, WestLB.

Q - Thomas Noack {BIO 7284728 <GO>}

Actually, most of my questions have already been answered. So just two very short questions left. First, you stated the negative impact from the low yield environment for Life was a consequence of DAC write-downs and reserve strengthening. But just assuming interest rates stay on this level in 2012, for the full year do you expect, let's say, a further negative impact here for the year 2012? Could you please comment on this?

And second question is on the structure of your new business. With respect to your new business, how much actually is normal unit-linked and how much is for other [ph] annuity? And are there actual markets where you completely focus on unit-linked business?

And perhaps last. But not least, what is the reason for the higher new business margin in Switzerland here, with plus 7 percentage points? Thank you, very much.

A - Martin Strobel {BIO 5296838 <GO>}

Yes, I walk you through. If interest rates stay at the level right now in Switzerland, I think the 10-year government bonds are standing at least less today. I don't know where it stands today, it was 0.93, or something around this. So that's higher than the 0.66 we have seen end of year last year so this mean there won't be any negative affect any more on the interest rate vector [ph].

Then you're talking about unit-linked. And we wrote the [ph] annuities. We've wrote CHF112 million new business last year, all the other new business we wrote. And this is at a single premium. So, by APE terms, this is divided by 10 [ph]. So all of the APE CHF10 million, or roughly CHF10 million, just to give you an estimate, was VA; all the other unit-linked business is other type of unit-linked business.

And is there other markets where we have purely unit-linked business? I think most of the markets are since, for the time being, we only sell VA annuity in Switzerland; this CHF112 million is 99% in Switzerland. All the other unit-linked business you see in Switzerland and the other markets is not VA business.

Maybe German Egloff can add [ph]?

A - German Egloff {BIO 4782831 <GO>}

I'm not sure. I think your question was a different one, or wasn't it? Your question was whether we have markets where we don't sell any traditional business any more?

Q - Thomas Noack {BIO 7284728 <GO>}

That was the point, yes; you're absolutely right, yes.

A - German Egloff {BIO 4782831 <GO>}

Sorry. Just to walk you through, overall, the part of unit-linked of new business is about 35% to 40% in last year. And this is exactly what we're aiming for, that one-third to one-half of the new business should be unit-linked; this is our strategy. And we've been following this now for many years.

The quote is much higher in Germany. In Germany, I think about 70% or even 70% plus of new business is unit-linked. And all the other markets are more or less a mixture of classical business and unit-linked business that add up to this, let's say, overall 40%/45% -- or let's say 40% of new business is unit-linked.

Q - Thomas Noack {BIO 7284728 <GO>}

Okay, perfect, thank you.

A - German Egloff {BIO 4782831 <GO>}

The new business margin, that was the other question?

Q - Thomas Noack {BIO 7284728 <GO>}

Yes; the last one, yes.

A - German Egloff {BIO 4782831 <GO>}

Well, the reason is quite a simple one; that Switzerland wrote a lot of annual premium business in Switzerland in Group Life. And this is mainly risk business. And the new business margin risk business is a lot higher than saving products and actually pushed up the -- so the new business margin in Group Life in Switzerland is a really good one.

Q - Thomas Noack {BIO 7284728 <GO>}

Perfect, thank you very much.

Operator

Michael Klien, Nomura.

Q - Michael Klien {BIO 4262408 <GO>}

Thank you for the opportunity to ask one more question. I just wanted to touch on M&A. Obviously, you have been fairly active, latest now in Belgium, does this mean now you're appetite has been met? Or do you still have a hunger for further acquisitions? If that's the case, where would these most likely be focused on?

And also, under what circumstances would you be considering potential asset disposals? Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

Our policy remains unchanged. So our main focus was. And is, on operational business. We don't regard M&A being at the core of our strategy.

In case that in our core markets they remain unchanged, in case that in our core markets we find an attractive bolt-on acquisition, we will look at it. But right now, to be honest, we are quite busy in integrating all these acquired businesses.

I don't expect an M&A transaction in the near future. First of all, let's realize the value that is associated with this transaction. So we really focus now on value creation from these acquisitions. And I don't expect an M&A transaction in the near future. And if there were one in the further future down the road and it would exactly meet the same criteria that we have seen in the past bolt-on, only in core markets, it has to fit the culture, it has to fit the strategy. And it has to be accretive. So that remains unchanged. But I don't see any M&A transaction on the horizon.

Q - Michael Klien {BIO 4262408 <GO>}

And in terms of disposals?

A - Martin Strobel {BIO 5296838 <GO>}

In terms of disposals, when we have the impression that we cannot earn at least capital costs and so generate added value also for the shareholder then we would think about those goals.

But right now, one question of the other analyst was look at Austria, such a small operation and then you will never earn capital cost. They improved right now; you might have seen the combined ratio now at 95%, will even improve their performance. So here in the small operations we will reach earning of capital cost. So I think, for the time being, no major topics in terms of disposals from our side.

Q - Michael Klien {BIO 4262408 <GO>}

Okay, thank you very much, that's very clear.

Operator

Dhruv Gahlaut, HSBC.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Just two questions. Firstly, could you guys comment on the expectation for rate developments in your main P&C markets?

And secondly, on slide 44, there has been a 10 bps reduction in the average guarantee rate in 2011. Could you say what we should expect for 2012 given there's already been a reduction in the guarantee rate on the Group Life business? Thanks.

A - Martin Strobel {BIO 5296838 <GO>}

I'd like to answer both of them. Rate development, that's a mixed picture throughout the markets we operate. Either we see stable prices or slightly increasing prices. But that depends very much on the client situation, market situation, on the segment you're working in.

The good news is that we don't see a decline in prices. So I think going forward we can expect at least stable prices. And also in some areas increasing prices, most notably increase in prices in Belgium. A substantial part of the business is linked to indices. And if the indices go up then the premiums are linked to these indices and then premiums go up as well.

Now the question the investment margin you refer to on page 44. Actually, going forward, for quite many years, although the interest rate came down substantially we managed that the margin remained at a quite decent level with 80 basis points. And I think that's a very good development since this is one indicator if we are able to sustainably manage our LIBOR [ph] book well. And do we earn the guarantees from recurring income. And I think, I look at Martin Wenk, I don't have any reason to believe why this should change substantially.

We have seen, as you quoted, a decrease of the guaranteed rate in the Group Life business this year in Switzerland, a substantial part of our technical reserves. At the same time, I think interest rates are not really going down any more, they are table on a lower level right now. So I think there are reasons to believe it should remain at least stable going forward.

Martin, maybe you can add something here.

A - Martin Wenk {BIO 4193573 <GO>}

No, I would agree with that. You have seen that the direct yield in Europe went down. That was because we have increased also our quality again and we have bought a lot of high quality bonds. And there the yields have been down substantially. But I think this phase is really over.

Our rate outlook would probably be that we stay in a certain bandwidth now where we are because the debt has to be refinanced. But equally, at the same time you have the risk that they will increase after that period. So this is something to watch. But for the margin, for the interest rate margin at the moment, I'm not afraid. On the contrary, we should see some opportunities now to invest again into decent yield.

A - German Egloff {BIO 4782831 <GO>}

Just to add for the guarantee level on the Group Life business, don't overestimate the decrease there because just keep in mind the extra mandatory part, we had the guarantee level also last year on 1.25. So we compensated for the too high guarantee level on the mandatory part and, meanwhile, that levels out so you can't really calculate the whole book coming down with that level. So, therefore, the effect is probably a bit smaller than you think, just from the movement, from the guarantee level.

Q - Dhruv Gahlaut {BIO 16209870 <GO>}

Thank you.

A - Martin Strobel {BIO 5296838 <GO>}

As far as I see, there are no further questions in the queue so, if this is the case, then I'd like to end this phone conference. I thank you very much for your very interesting questions, for your interest in Baloise. And wish you a nice day. Thank you, very much.

Operator

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