MOODY'S
INVESTORS SERVICE

Credit Opinion: Pohjola Insurance Ltd

Global Credit Research - 26 Jun 2014

Helsinki, Finland

Ratings

Category	Moody's Rating
Rating Outlook	STA
Insurance Financial Strength	A3

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Key Indicators

Pohjola Insurance Ltd[1][2]

	2013	2012	2011	2010	2009
As Reported (Euro Millions)					
Total Assets	3,205	3,054	2,847	2,820	2,674
Shareholders' Equity	392	372	256	233	198
Net Income (Loss) Attributable to Common Shareholders	150	216	23	115	160
Gross Premiums Written	1,149	1,033	949	853	822
Net Premiums Written	1,093	984	895	814	772
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	197.9%	201.1%	251.3%	222.6%	206.3%
Reinsurance Recoverable % Shareholders' Equity	15.4%	15.7%	23.7%	16.0%	17.6%
Goodwill & Intangibles % Shareholders' Equity	10.6%	10.5%	8.5%	6.0%	6.9%
Gross Underwriting Leverage	6.8x	6.4x	7.2x	6.1x	6.4x
Return on Capital (1 yr)	24.2%	36.7%	4.0%	20.4%	35.1%
Sharpe Ratio of ROC (5 yr avg)	181.9%	43.5%	41.2%	NA	NA
Adv (Fav) Loss Dev % Beginning Reserves (1 yr)	1.3%	0.8%	0.2%	-2.6%	-0.9%
Financial Leverage	9.3%	9.3%	9.9%	9.4%	10.0%
Total Leverage	9.3%	9.3%	9.9%	9.4%	10.0%
Earnings Coverage (1 yr)	49.3x	64.9x	6.6x	43.8x	58.6x
Cash Flow Coverage (1 yr)	NA	NA	NA	NA	NA

[1] Information based on IFRS financial statements as of Fiscal YE December 31 [2] Certain items may have been relabeled and/or reclassified for global consistency

Opinion

SUMMARY RATING RATIONALE

Moody's A3 (stable outlook) insurance financial strength rating (IFSR) on Pohjola Insurance Ltd (PIL) reflects its good stand-alone fundamentals, together with its importance to Pohjola Bank (Aa3/P-1/C), which currently owns PIL, and to the Finnish cooperative banking group, OP-Pohjola Group (C BFSR/a3 BCA) whose main subsidiary is Pohjola Bank. On a stand-alone basis, credit strengths include Pohjola's strong non-life market position in

Finland, as well as its good financial fundamentals with consistent profitability and low financial leverage. These strengths are off-set by its relative lack of brand reach and geographic diversification, a relatively high proportion of high risk assets in recent years, albeit peripheral sovereign asset exposure reduced in 2012 (Pohjola's direct GIIPS sovereign debt exposure within the Pohjola Non Life Insurance (PNLI) Group was EUR 25m as of YE 2013), and although recent returns on capital have typically been very strong, investment gains and losses have caused meaningful levels of volatility in fair value profits, especially in 2008, but also in 2011 and 2012. Notwithstanding its successful and well-managed integration to-date within OP-Pohjola, PNLI is not covered by OP-Pohjola's joint and several liability support mechanism, although in October 2008, Pohjola Bank Plc injected a total of Eur 65m into PNLI to support its solvency position, followed by a further Eur 50m Central Co operative subordinated loan before the 2008 year-end, although we do not anticipate these capital injections will be a permanent feature of PNLI's capital base, as evidenced by dividends paid by PIL to Pohjola Bank plc in recent times.

Following the acquisition of Pohjola Group Plc by OKO (subsequently renamed Pohjola Bank/OP-Pohjola Group), PNLI, which has retained the Pohjola brand name and the vast majority of which is accounted for by PIL, from 1 January 2008 became one of three business divisions of Pohjola, together with banking and Asset Management. PIL is a separate legal entity to the other smaller Non-Life operation, A-Insurance Ltd, which provides insurance for commercial truckers and taxi service branches, although all employees are employed by Pohjola. Once it has acquired the minority shares in Pohjola Bank, OP-Pohjola Group Central Cooperative intends transferring ownership of PIL directly to itself from Pohjola Bank as part of its plan to form three business operations: Banking, Wealth Management and Non-life Insurance.

At the end 2013, PNLI's business, which is almost exclusively conducted in Finland, is split, in terms of the insurance premium revenue, around 50% private customers, 46% corporate customers, with the remaining 4% from the Baltic States.

On 30 May 2012, the IFSR of PIL was downgraded to A3 with a stable outlook assigned, driven primarily by the wider downgrade of the OP-Pohjola Group (please see relevant press release for further details). More recently, PIL's IFSR and outlook was unaffected by the negative outlook assigned in May 2014 to the ratings of Pohjola Bank and OP-Pohjola driven by a reassessment of systemic support for EU banks.

Credit Strengths

-Importance to OP-Pohjola Group in light of cross-selling opportunities

-Strong market position in Finland.

-Very good profitability, with significant improvement in combined ratio in recent years, although reliance on realised gains.

-Low financial leverage.

Credit Challenges

-At least 90% of premiums come from a single country, namely Finland.

-Increase market share without compromising profitability.

-Sustaining combined ratio below 95%, including all discounting/reserve assumption changes etc.

-Relatively high proportion of high risk assets has been a feature of recent years, although management has already taken action to mitigate the asset risk.

Rating Outlook

The published IFSR was downgraded on 30 May 2012 to A3 with a stable outlook.

What to Watch for:

- Potential for further market value losses on the investment portfolio due to the relatively higher risk investment portfolio.

- Seasonality of losses (particularly in Q1 due to winter related claims).

- Potential for capital repatriation from the insurance operations to the Bank/Co-operative given the solvency ratio remains above the 120% figure targeted by management on a Solvency II basis, and stood at 134% as at Q1 2014.

- Transfer of ownership of PIL to OP-Pohjola Group Central Cooperative from Pohjola Bank.

What Could Change the Rating - Up

Not considered likely in the short-term. However, in the medium term, positive rating pressure could arise from the following:

-An upgrade of Pohjola Bank's/OP-Pohjola's BFSR and senior debt ratings.

-Stand-alone fundamentals of PIL remaining good with, for example, a combined ratio, on an IFRS basis, of 90% or better.

-Solvency ratio meaningfully and consistently above 120% target level.

-Meaningful geographic and product line diversification without sacrificing profitability.

What Could Change the Rating - Down

-A material downgrading of Pohjola Bank's/OP-Pohjola's BFSR and senior debt ratings.

-Material weakening of market position.

-Failure to produce a combined ratio, on a cross-cycle and IFRS basis, of below 95%.

Notching Considerations

Not applicable.

DETAILED RATING CONSIDERATIONS

Moody's rates PIL A3 for insurance financial strength which is consistent with the adjusted rating indicated by the Moody's insurance financial strength rating scorecard. Whilst we view the insurance company as highly integrated in OP-Pohjola Group and is an important part of the Group's overall earnings, the fact that the insurance operations remain outside of the joint and several liability arrangement and the May 2012 downgrade of Pohjola Bank and OP-Pohjola result in zero notches of uplift being included in the rating. The scorecard and associated text below are based on Pohjola Insurance Limited on an unconsolidated basis unless otherwise stated.

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

Market Position, Brand and Distribution: Baa - LARGE MARKET SHARE BUT CONCENTRATION IN RELATIVELY SMALL MARKET (FINLAND)

With its strong market position in Finland, in which it is currently the largest non-life player with a 30.3% market share at YE2013, PNLI's relative market share metric (of which PIL is the vast majority) remains very good. Whilst the OP-Pohjola Group connection is helping to enhance its customer base, Moody's believes that a challenge for PNLI and PIL will be to increase its market share meaningfully without compromising profitability. Notwithstanding its strong market position, Pohjola operates almost exclusively in the relatively small Finnish market which means it lacks the franchise strength and brand reach which characterises a number of other European P&C operations including some Nordic peers, and we consider the market position, brand and distribution to be overall consistent with a Baa rated company.

Product risk and Diversification: Baa - RELATIVELY STABLE BOOK OF BUSINESS, ALBEIT CONCENTRATED IN A FEW PRODUCT LINES AND IN ONE MARKET

Product focus is considered good, although with a Commercial account (c.50%) and Liability orientation (c.50%), Moody's views the portfolio as potentially more volatile than, for example, some of its Nordic peers. Product diversification is also considered good with four distinct lines of business- Motor, Workers Compensation, Accident and Health and Property- producing at least 10% of premium each. However, this is off-set by the concentration in Finland, which itself is highly concentrated, and in three business lines- Statutory Workers' Compensation, Property and Motor which together account for 71% of direct premiums.

Asset Quality: A - HIGH RISK ASSETS SOMEWHAT PRESSURIZE ASSET QUALITY

Moody's considers PIL's overall asset quality to be good, albeit high risk assets remain elevated at PIL. At YE 2013, goodwill/intangibles and reinsurance recoverables only represented around 11%/15%, respectively, of equity. However, the proportion of high risk assets to equity remains significant, particularly at the PIL level, at 198% as at YE 2013 (YE12: 201%), albeit that this is the lowest figure for 5 years. Within PIL's high risk assets, the largest holdings are equities (55%), not rated/non investment grade fixed income securities (19%), real estate (14%) and investments in associates (12%). Furthermore, Moody's notes the historically high equities concentration in the Finnish market, and the meaningful exposure to financials in the corporate bond portfolio. More positively, we note that as at the end of 2012, the overall direct exposure to sovereign debt in peripheral countries had reduced to EUR 25m (YE 2011: EUR 79m) at the PNLI level, and equities exposure has been reducing. Notwithstanding this recent improvement, invested asset risk remains higher than for most of PIL's Nordic insurance peers. However, at the PNLI level, invested asset risk (as a % of Solvency Capital) was somewhat stronger (albeit still significant) at approximately 113% as at YE 2013.

Capital Adequacy: A - ACCEPTABLE CAPITAL POSITION AT PIL WITH GROUP SUPPORT PREVIOUSLY PROVIDED

Following market volatility and recent dividend payments to the group as part of the previous 70% solvency ratio target, PIL's gross underwriting leverage(GUL) and PNLI's reported solvency ratio metrics have been volatile over the years. During 2013, PIL's GUL increased to 6.8x (YE12: 6.4x) and PNLI's solvency ratio reduced to 73% (81%). In addition, Moody's notes that during 2008, a capital injection into PNLI totalling Eur 65m plus a further Eur 50m subordinated loan was made to the insurance operations to improve the solvency position, although we do not expect this additional capital to remain deployed permanently within the non-life operations, with dividends paid to Pohjola Bank in recent times an example of this repatriation.

Moody's also considers PIL's business to be higher risk than some of its Nordic peers in view of the liability and commercial account orientation, although consistent delivery of bottom-line profits and enhanced reinsurance cover are noted, and overall we consider capitalisation to be consistent with an A rated issuer.

Going forward, PNLI is now targeting a solvency ratio of 120% on a Solvency II basis; during Q1 14 the ratio improved and remains above target at 134% (125%).

Profitability: A - VOLATILE PROFITABILITY AS A RESULT OF INVESTMENT MARKET CONDITIONS, BUT IMPROVED UNDERWRITING RESULTS

PIL's 2013 five year average return on capital (excluding fair value gains/losses) is an excellent 24% although this is off-set by a relatively low Sharpe ratio, which considers volatility, in the Baa range. Investment gains and losses have caused meaningful levels of volatility in fair value profits, for example in 2011 and 2012; the RoC in 2011 was a low 4% impacted by fair value investment losses. Furthermore, the underwriting environment for Nordic P&C players in recent years has been very favourable. Notwithstanding this, Moody's notes the excellent level of reported underwriting profitability in 2013, with a reported operating combined ratio of 86.9% (2012: 90.5%), although this excludes the unwinding of discount and changes in technical bases. At YE13, PIL reported an improved overall combined ratio of 93.5% (2012: 100.6%) which reduces to 89.8% (96.4%) excluding the unwinding of discount - 2012's underwriting performance was negatively impacted, inter alia, by another severe winter, and by the impact from mortality model changes in 2011. Overall, Moody's currently considers profitability to be consistent with an A rated company.

Reserve Adequacy: A - RELATIVELY PREDICTABLE RESERVING ALTHOUGH EXPOSURE TO LONGER-TAIL LINES OF BUSINESS

The reserve adequacy metric is good, driven by a small net reserve deterioration on a weighted average basis of 0.3% of opening net reserves over the last five years, based on IFRS reserve triangles for the 2005-2012 accident years. However, Moody's considers reserve adequacy to be good, as opposed to excellent, because of the presence of longer-tail lines which presents the challenge of associated reserving risk. Moody's also notes that there were methodological changes in the reserving process during 2010 which affected the 2009 vs. 2010 comparative figures. As has been seen in recent years, PNLI's reserves are vulnerable to longevity risk and a lowering of the discount rate, the former for example negatively impacting the 2010 combined ratio by 3% points, with further potential discount rate reductions a possibility in light of the low interest rate environment as evidenced in 2013 where the discount rate was reduced further from 3.0% to 2.8%, leading to a Eur 33m pre-tax charge.

Financial Flexibility: A - EXCELLENT METRICS BUT ACCESS TO CAPITAL MARKETS MORE RESTRICTED THAN LISTED PEERS

Overall financial flexibility is considered good. Financial leverage remains low at around 9% at YE 13, with earnings coverage consequently excellent. However, Moody's notes that a Eur 50m internal subordinated loan was issued during 2008 to improve the solvency position and that on a stand-alone basis, none of the Pohjola non-life companies are listed in their own right. Therefore, access to capital is not viewed as comparable to larger European players.

Other considerations

Nature and Terms of Implicit Support

PIL's published A3 insurance financial strength rating reflects PIL's stand-alone A3 IFSR but no additional uplift as a result of its ownership by Pohjola Bank, the issuer rating of which benefits from it being the central bank and main subsidiary of the OP-Pohjola Group. The integration to-date of Pohjola's non-life business into Pohjola Bank and OP-Pohjola Group has been successful and well-managed, with over 350 OP service outlets currently providing both banking and non-life insurance services. Furthermore, OKO Bank plc renamed itself as Pohjola Bank plc, effective as of 1 March 2008. Most Pohjola non-life branch offices have now moved to premises of the member banks, and most IT and administrative services have been combined with corresponding functions of OP-Pohjola. Furthermore, the risk management functions of PNLI and OP-Pohjola Group are integrated.

However, OP-Pohjola Group's support mechanism in which all the member banks provide each other with joint and several guarantees providing immediate and direct support in case of distress, does not cover, by law, insurance operations and thus the adjusted BCA of Pohjola Bank (including cooperative support) and the BCA of OP-Pohjola co-operative is used as a reference point for the maximum rating of PIL.

Rating Factors

Pohjola Insurance Ltd[1][2]

Financial Strength Rating Scorecard	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adjusted Score
Business Profile								**A**	**Baa**
Market Position and Brand (25%)								**Aa**	**Baa**
- Relative Market Share Ratio			**X**						
- Underwriting Expense Ratio % Net Premiums Written	**16.7%**								
Product Focus and Diversification (10%)								**A**	**Baa**
- Product Risk			**X**						
- P&C Insurance Product Diversification		**X**							
- Geographic Diversification						**X**			
Financial Profile								**A**	**A**
Asset Quality (10%)								**A**	**A**
- High Risk Assets % Shareholders' Equity					**197.9%**				
- Reinsurance Recoverable % Shareholders' Equity	**15.4%**								
- Goodwill & Intangibles % Shareholders' Equity	**10.6%**								
Capital Adequacy (15%)								**Baa**	**A**
- Gross Underwriting Leverage				**6.8x**					
Profitability (15%)								**A**	**A**
- Return on Capital (5 yr avg)	**24.1%**								

- Sharpe Ratio of ROC (5 yr avg)				181.9%					
Reserve Adequacy (10%)								**A**	**A**
- Adv (Fav) Loss Dev % Beginning Reserves (5 yr. wtd avg)			**0.3%**						
Financial Flexibility (15%)								**Aaa**	**A**
- Financial Leverage	**9.3%**								
- Total Leverage	**9.3%**								
- Earnings Coverage (5 yr avg)	**44.6x**								
- Cash Flow Coverage (5 yr avg)									
Operating Environment								**Aaa - A**	**Aaa - A**
Aggregate Profile								**A1**	**A3**

[1] Information based on IFRS financial statements as of Fiscal YE December 31 [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis

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