MOODY'S
INVESTORS SERVICE

Rating Action: Moody's affirms Pohjola Insurance's A3 IFSR; stable outlook

Global Credit Research - 15 May 2015

London, 15 May 2015 --

Moody's Investors Service has affirmed the A3 insurance financial strength rating (IFSR) on Pohjola Insurance Ltd ("PIL"); the outlook remains stable.

RATINGS RATIONALE

The rating affirmation reflects 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, and a relatively low target Solvency II ratio. The A3 IFSR of PIL, which represents the vast majority of Pohjola's non-life insurance business, receives no uplift as a result of its ownership by the Finnish cooperative banking group, OP Financial Group, given the a3 BCA of the banking operation.

A credit strength for Pohjola is its strong market position in Finland in which it is currently the largest non-life player with a market share of over 30%. Pohjola continues to grow its market share, benefiting from its position within the OP Financial Group which helps to enhance its customer base. Other credit strengths include low financial leverage, a low level of intangible and reinsurance recoverable assets, and Pohjola's very good profitability. PIL's 2014 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 (181%), which considers volatility. Furthermore, Pohjola's recent underwriting performance has been very good with an overall reported combined ratio of 91% at YE14. Going forward, Moody's expects Pohjola to continue to benefit from the relatively stable market conditions in Finland, and its underwriting performance to remain good.

With regard to credit challenges, Pohjola operates almost exclusively in the relatively small Finnish market which means it lacks the franchise strength, brand reach and geographic diversification which characterises a number of other European P&C operations including some Nordic peers. Also, with its commercial account and liability orientation, Moody's views the portfolio as more volatile than, for example, some of its Nordic peers, and Pohjola's reserves are vulnerable to longevity risk and a further lowering of the discount rate. During 2014, Pohjola reduced its liability discount rate to 2.5% from 2.8% at a cost of Eur 62 million and we expect this to continue given the low interest rate environment. Furthermore, the proportion of high risk assets to equity remains significant, particularly at the PIL level, at 143% as at YE 2014 (YE13: 163%), albeit it has reduced over the last five years.

In terms of capital adequacy, Pohjola is targeting a solvency ratio of 120% on a Solvency II basis by the end of 2015 which Moody's views as relatively low. At YE14, the estimated ratio, excluding the effect of transition provisions, reduced below the target to 117% (YE13: 125%) impacted by lower interest rates and a higher dividend payment, and at Q1 15 the ratio declined further to 109%. Meaningful dividend payments to its parent have been a recent feature for PIL representing around 79% and 87% of 2014 and 2013 net income respectively.

The A3 IFSR of PIL receives no uplift as a result of its ownership by OP Financial Group, given the a3 BCA of the banking operation. The adjusted a3 BCA of Pohjola Bank (including cooperative support) and the a3 BCA of OP Cooperative, which is intended to directly own Pohjola's non-life business in the future, are used as a reference point for the maximum rating of PIL. The integration to-date of Pohjola's non-life business into Pohjola Bank and OP Financial Group has been successful and well-managed. However, OP Financial 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.

In terms of rating drivers going forward, Moody's said that in the medium term, positive rating pressure could arise from: 1) an upgrade of OP Financial's BCA; 2) A material reduction in high risk assets; 3) Meaningful geographic and product line diversification without sacrificing profitability. Conversely, negative rating pressure could arise from: 1) A downgrading of OP Financial's BCA; 2) Material weakening of market position; 3) Failure to produce a combined ratio, on a cross-cycle and IFRS basis, of below 95% 4) A weakening of capital adequacy

The following rating was affirmed with a stable outlook:

Pohjola Insurance Ltd: A3 insurance financial strength

Based in Helsinki, Finland, PIL reported gross premiums written of Eur 1,259m and net income of Eur 228m at year end 2014.

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Global Property and Casualty Insurers published in August 2014. Please see the Credit Policy page on www.moodys.com for a copy of this methodology.

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