MOODY'S
INVESTORS SERVICE

Rating Action: Moody's upgrades OP Insurance Ltd's IFSR to A2 with a stable outlook

15 Jan 2019

London, 15 January 2019 -- Moody's Investors Service (Moody's) has today upgraded to A2 from A3 the insurance financial strength rating (IFSR) on OP Insurance Ltd (OPIL). The outlook is stable.

OPIL is 100% owned by OP Corporate Bank plc (OPCB; senior unsecured and long-term bank deposits: Aa3 stable) and is the main insurance operating entity within the OP Financial Group (OPFG), a leading cooperative financial conglomerate in its domestic market of Finland. OPIL represents the vast majority of OPFG's non-life insurance business.

RATINGS RATIONALE

The upgrade reflects OPIL's closer integration over recent years to OPCB and OPFG in terms of both business and capital management. The rating also continues to reflect the strong non-life market position in Finland, as well as its good financial fundamentals with consistent profitability and limited financial leverage relative to the overall rating level. These strengths are partially offset by OPIL's relative lack of brand reach and geographic diversification outside Finland, a high proportion of high risk assets and a modest regulatory capital position, on a standalone basis, when compared to most Nordic and European peers.

In terms of business, non-life insurance operations are an integral part of the group, having contributed on average over 20% of OPFG's earnings before tax between 2013 and 2017. In addition, meaningful cross-selling relationships are demonstrated by a significant overlap in the customer base, with more than 40% of customers shared between the insurance and banking businesses, up from just over 30% in 2012.

Integration within OPFG is also evidenced by capital management being centrally driven at the group level. OPIL has meaningfully contributed to the capitalisation of the broader group as demonstrated by an average dividend pay-out ratio of 101% between 2012 and 2017, supported by its strong profitability. OPIL has a relatively low floor level of 120% for its regulatory capital position on a Solvency II basis but Moody's also takes into account the robust capital position of the group given the centralised capital management. The estimated Solvency II coverage ratio of 169% as at Q3 2018 was well above the floor level but Moody's expects it to decrease following the 2018 dividend payment to the parent and eventually to be closer to the 138% reported at year-end 2017.

A credit strength for OPIL is its strong market position in Finland where it is the largest non-life player with a market share above 30%. OPIL continues growing its market share, benefiting from its position within OPCB which helps enhance its customer base. Other credit strengths include limited financial leverage, a relatively low level of intangible and reinsurance recoverable assets, and sustained profitability. OPIL's 2017 5-year average return on capital (reported basis) is excellent at 25.8%, although this metric has been materially supported by relatively high net realised gains since 2014. For the first nine months of 2018 earnings before taxes reported by OPFG for its non-life business were stable, however the net investment income declined significantly by 73% to EUR34 million compared to previous year. We expect OPIL's 2018 profitability to be negatively impacted by the further weakening of the investment income in Q4 due to unfavorable market movements. However, profitability is also supported by consistent underwriting performances as demonstrated by a reported combined ratio of 92% for the first nine months of 2018 which is in line with historical performance. Going forward, Moody's expects the issuer to continue taking advantage of relatively stable market conditions in Finland, which should support OPIL's underwriting performance and profitability.

With regard to credit challenges, OPIL operates 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 players including some Nordic peers. Also, with its commercial account and liability orientation, Moody's views the portfolio as more volatile than some of its Nordic peers, and OPIL's reserves are sensitive to further lowering of the discount rate. In 2017 the issuer reduced its liability discount rate to 1.50% from 1.97% resulting in a pre-tax cost of EUR102 million. Moody's believes the downside risk of further decreases is now lower than in the past but it cannot be completely ruled out. Furthermore, the proportion of high risk assets to equity remains significant at 158% as at year-end 2017 (year-end 2016: 168%), which is above expectations for the overall rating level.

RATING DRIVERS

In terms of rating drivers going forward, Moody's said that in the medium term, positive rating pressure could arise from: (i) an upgrade of OP Corporate Bank plc's ratings; (ii) a material reduction in high risk assets; (iii) meaningful geographic and product line diversification with no material impact on profitability. Conversely, negative rating pressure could arise from: (i) a downgrade of OP Corporate Bank plc's ratings; (ii) material weakening of market position; (iii) failure to achieve a cross-cycle combined ratio, on an IFRS basis, of below 95%; (iv) a deterioration in capital adequacy with regulatory solvency coverage falling to levels below 120%; (v) a deterioration in the level of capacity and/or willingness of its shareholders and affiliates to provide support.

Based in Helsinki, Finland, OPIL reported gross premiums written of EUR1,280 million and net income of EUR178 million at year-end 2017.

The following rating was upgraded with a stable outlook:

OP Insurance Ltd: A2 insurance financial strength rating, upgraded from A3

PRINCIPAL METHODOLOGY

The principal methodology used in this rating was Property and Casualty Insurers published in May 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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