

CREDIT OPINION

3 May 2021

Update

✓ Rate this Research

RATINGS

Pohjola Insurance Ltd

Domicile	HELSINKI, Finland
Long Term Rating	A2
Type	Insurance Financial Strength
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Pohjola Insurance Ltd

Update to credit analysis

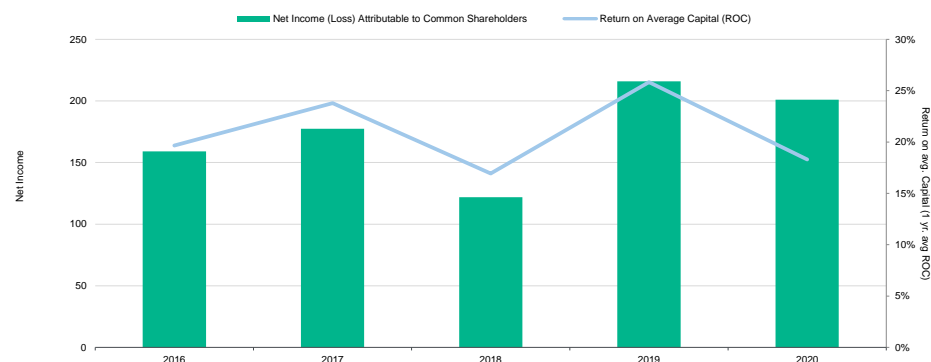
Summary

Moody's A2 (stable outlook) insurance financial strength rating (IFSR) on Pohjola Insurance Ltd (Pohjola) reflects its close integration into its direct parent [OP Corporate Bank plc](#) (Aa3/Aa3 stable, a3⁻) and [OP Financial Group](#) in terms of both business and capital management. The rating also continues to reflect the strong position in the Finnish property-casualty sector, 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 its relative lack of brand reach and geographic diversification outside of Finland, a high proportion of high risk assets and a moderately strong regulatory capital position, on a stand-alone basis, as well as by the susceptibility of its claims reserves to falling interest rates.

Exhibit 1

Net income and return on capital (1 yr. avg.)



Source: Company reports, Moody's Investors Service

Credit strengths

- » Strong market position in Finland
- » Strong profitability but sensitive to market movements
- » Relatively low leverage and strong earnings coverage
- » Strong integration into the larger OP Financial Group

Credit challenges

- » Lack of geographic diversification
- » Elevated asset risk
- » Moderate capital adequacy as reflected in the Solvency II ratio
- » Reserves susceptible to interest rate movements

Rating outlook

The rating outlook is stable.

Factors that could lead to an upgrade

In the medium term, positive rating pressure could arise from the following:

- » an upgrade of OP Corporate Bank plc's ratings;
- » a material reduction in high risk assets;
- » meaningful geographic and product line diversification with no material impact on profitability

Factors that could lead to a downgrade

Negative pressure could arise from:

- » a downgrade of OP Corporate Bank plc's ratings;
- » material weakening of market position;
- » a deterioration in capital adequacy with regulatory solvency coverage falling to levels below 120%;
- » a deterioration in the level of capacity and/or willingness of its shareholders and affiliates to provide support

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Key indicators

Exhibit 2

Pohjola Insurance Ltd [1][2]

Pohjola Insurance Ltd [1][2]	2020	2019	2018	2017	2016
As Reported (Euro Millions)					
Total Assets	4,794	4,218	4,039	4,048	3,914
Total Shareholders' Equity	802	530	312	370	392
Net Income (Loss) Attributable to Common Shareholders	201	217	122	178	159
Gross Premiums Written	1,507	1,339	1,337	1,280	1,281
Net Premiums Written	1,458	1,298	1,298	1,241	1,236
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	119.0%	150.9%	168.3%	158.4%	168.3%
Reinsurance Recoverable % Shareholders' Equity	13.9%	16.0%	20.5%	16.7%	13.3%
Goodwill & Intangibles % Shareholders' Equity	10.6%	13.6%	17.9%	17.7%	15.7%
Gross Underwriting Leverage	4.6x	5.9x	8.2x	7.4x	7.0x
Return on Average Capital (ROC)	18.3%	25.8%	16.9%	23.8%	19.7%
Sharpe Ratio of ROC (5 yr.)	555.0%	562.8%	339.0%	435.3%	381.9%
Adv. (Fav.) Loss Dev. % Beg. Reserves	0.4%	2.8%	0.3%	2.2%	1.2%
Adjusted Financial Leverage	12.8%	19.7%	20.1%	18.8%	18.2%
Total Leverage	12.8%	19.7%	20.1%	18.8%	18.2%
Earnings Coverage	16.5x	16.2x	10.7x	20.0x	28.4x
Cash Flow Coverage	NA	NA	NA	NA	NA

[1]Information based on Finnish GAAP financial statements as of the fiscal year ended 12/31/2020.

[2]Certain items may have been relabeled and/or reclassified for global consistency.

Source: Moody's Investors Service and company filings

Profile

Pohjola is wholly owned by OP Corporate Bank plc (OPCB) which is part of the Finnish cooperative banking group OP Financial Group (OPFG), a leading cooperative financial conglomerate on its domestic market. Pohjola, which in 2019 has been renamed to this well-established brand-name after a 5-year period of operating under the OP brand, represents the main non-life insurance legal entity, with former sister companies A-Insurance Ltd and Eurooppalainen Insurance Company Ltd now having merged into Pohjola. Through OP Life Assurance Company Ltd, OPFG also offers life insurance products to the group's customers.

Detailed credit considerations

Moody's rates Pohjola A2 for insurance financial strength which is one notch higher than the adjusted rating indicated by the Moody's insurance financial strength rating scorecard, reflecting implicit support from its parent. The scorecard and associated text below are based on Pohjola Insurance Ltd 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: Market leadership in Finnish non-life market and very strong Pohjola brand

Pohjola forms part of Finland's leading financial services group, OPFG, and it benefits from and supports the group's strong market position, based on full integration into the group's customer management approach. Whereas cross-selling between the bank's and insurance operations has been increasing, there remains significant potential.

Pohjola is continuously improving and expanding its service and product offering, with a strong focus on online and mobile communication channels, as well as its underwriting and claims management capabilities. Over 2020, digital sales have further and materially increased.

Pohjola is the leading insurer in the Finnish non-life sector, which is moderately sized compared to other European sectors, with a market share of 34% (2019). In a stagnating Finnish non-life market, Pohjola has been able to continuously grow its top-line over past years, reflecting exposure growth and rate increases. For 2020, the company reported gross premiums written of €1.5 billion in 2020 or a 1.9% growth from 2019.

Product risk and Diversification: good diversification by line of business but limited geographic diversification

Pohjola's book of business is well diversified by non-life lines of business and by customer groups. Commercial business, with a higher frequency of large losses and longer-tail, accounts for about 43% of total business, rendering Pohjola's product risk moderately high. Pohjola over the past years has gradually increase the share of private customers in its portfolio.

In 2020, Pohjola received a material number of business interruption claims by commercial customers, but Pohjola believes these are not covered based on the policies' terms and conditions, which will potentially result in disputes with policyholders.

Longer-tail lines of business - motor third party liability and workers' compensation - for which claims reserves are discounted make these lines susceptible to falling interest rates reducing discounting rates as well. Pohjola is operating solely in Finland and therefore has limited geographic diversification.

Asset Quality: Material proportion of high risk assets constrains asset quality

Moody's considers Pohjola overall asset quality to be good, reflecting elevated exposure to risky assets partially offset by low intangibles.

Pohjola, similar to some Nordic peers, follows an asset-liability management approach in the way that it aims for ordinary investment returns on bonds to cover return requirements of liabilities. On an asset allocation basis, at year-end (YE) 2020 fixed income investments accounted for 74%, equity and alternative investments for 18% and property investments for 8% of total invested assets. Credit risk is limited, with 58% of the fixed income portfolio rated at least A and with non-grade or non-rated investments accounting for 8%. While many Nordic peers operative with higher asset risk - mainly through higher equity investments - Pohjola's high-risk asset ratio is elevated based on the relatively smaller capital base. Pohjola has announced it will strengthen its Solvency II ratio (see capital adequacy section below) and increase its risky asset exposure going forward. At this point, we believe there will be no material negative effect of this on our assessment of asset quality.

At year-end 2020, goodwill/intangibles and reinsurance recoverables in relation to shareholders' equity remain at low levels.

Capital Adequacy: Moderately strong Solvency II ratio based on capital management by the group

Pohjola's Solvency II ratio is managed on the group basis and Pohjola will aim to strengthen its Solvency II ratio to 170% by 2023 which we think is credit positive. The targeted strengthening is to enable it to take on more asset risk to support its earnings base and at the same time increase the carrier's resilience to stress. Pohjola has been a strong payer of dividends to the parent company until 2018, with high payout ratios, but did not pay a dividend in 2019 and in 2020 and we understand it will further retain earnings to further build capital.

The company's Solvency II ratio is relatively resilient, with its main sensitivity to falling equity markets and moderate sensitivity to interest rate movements and credit spreads. As is common for Nordic insurers with high equity exposure, the negative effect of

moderately falling equity markets is largely offset by the symmetrical adjustment, which under Solvency II reduces the equity charge in case of falling equity markets, but this effect tapers off with more material equity stresses.

Over 2020, Pohjola's Solvency II has held up relatively well, also helped by it not paying a dividend, and with the recovery of financial markets, particularly in the fourth quarter, its Solvency II ratio strengthened. At YE 2020, Pohjola's Solvency II ratio was moderately strong at 158% (YE 2019: 144%) and the ratio remained almost stable at Q1 2021 at 160%.

Profitability: Very good historic profitability, the pandemic mainly put pressure on investment income

Pohjola's 2016-2020 five-year average return on capital (excluding fair value gains/losses not through profit and loss) is a very strong 20.9%, reflecting good earnings paired with a moderate capital base.

Earnings are exposed to financial market volatility, mainly reflecting the exposure to equity and alternative investments. The pandemic induced market volatility in 2020 has hit the company's investment return as shown by the reduction of net return on insurance investments at fair value to €25 million from €96 million in 2019.

Underwriting profitability is exposed to the business consequence of the pandemic via its travel insurance and some of business interruption insurance policies. The company reported that claims incurred due to the pandemic amounted to €37 million in 2020, which we consider as limited. However we note that a number of claims in business interruption and event cancellation has not been settled yet and could potentially negatively influence reported underwriting profitability going forward, should reserves show to be insufficient.

Overall in 2020, total reported underwriting profitability has significantly improved from 2019, mainly benefitting from a material decrease in claims especially motor due to travel and mobility restriction during the lock-down period. At the same time, the decrease in discount rate increased claims incurred by €45 million. As a result, the combined ratio materially decreased to 91.2% from 103.0% in 2019.

As of Q1 2021, Pohjola's profit benefitted from improved economic condition and financial market compared to one year before resulting in an improved investment income. The underwriting result is also higher than in Q1 2020 as level of traffic has not yet recovered to pre-crisis level, resulting in lower claims. IFRS operating combined ratio (excluding the impact of changes in discounting factors) improved to 86.0% in Q1 2021 from 92.7% in Q1 2020. Overall, Pohjola reported IFRS earnings before tax of €89 million, up from €39 million in Q1 2020.

For 2021, we expect that underwriting results will trend towards previous years' levels, as claims ratios will not benefit from lower claims frequency to the same extent once mobility restrictions will be lifted. The expense ratio will be hampered by significant investments Pohjola is undertaking to further digitalize its business model, the tangible benefit of which will not show immediately. As far as investment returns are concerned, these are largely a consequence of equity market performance, but continuously low yields will continue to be a negative factor.

Reserve Adequacy: No material reserve releases on a normalized basis paired with high sensitivity to changes in discounting factors

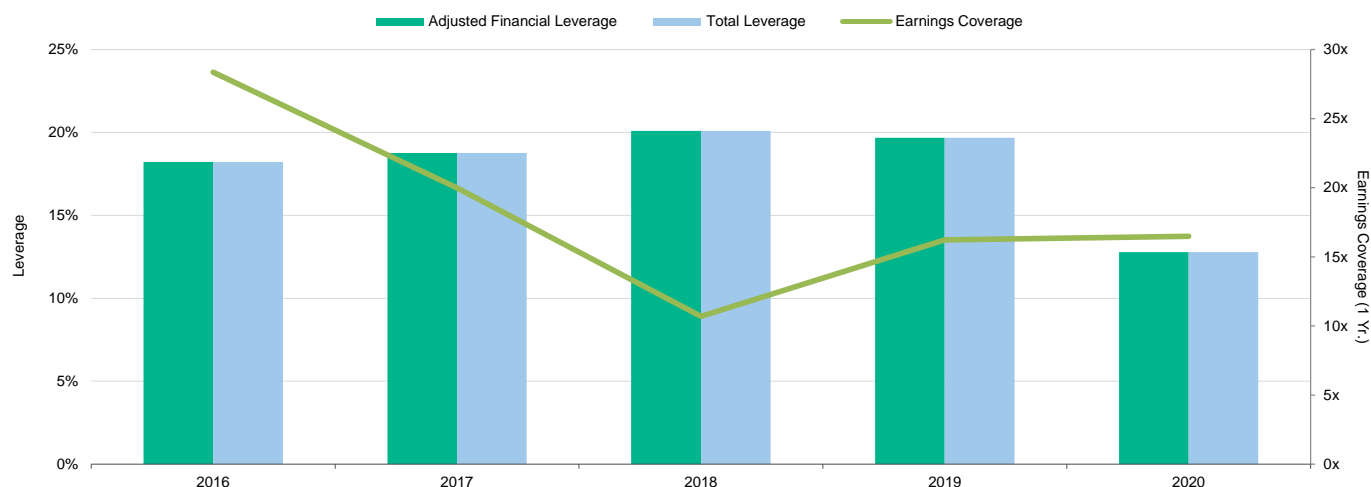
For the period 2016-2020, Pohjola reported a weighted average reserve strengthening of 1.3% of initial claims reserves. Reserves for annuities, which account for almost half of total technical reserves, are long-tail and sensitive to changes in longevity experience and in discounting rates, the latter of which are driven mainly by changes in interest rates. In 2020, Pohjola changed the discounting factor to 0.85% from 1.0% after a similar action in 2019 and 2017. Excluding these effects, run-off results have been close to 0% in 2015-2019.

Financial flexibility: Moderate leverage and benefitting from the group's access to funding

Financial leverage is low at 12.8% at YE 2020, down from 19.7% in YE 2019, reflecting an increase in shareholders' equity. Earnings coverage is strong, reflecting strong earnings and moderate interest expenses.

On a stand-alone basis, Pohjola's access to external 3rd party funding is limited, also when compared to some Nordic peers which are either publicly listed or issue debt more frequently. However, Pohjola is part of the capital and funding management of the larger OPFG, which is a regular issuer.

Exhibit 3
Financial Leverage



Source: Company reports, Moody's Investors Service

Environmental, Social and Governance Considerations

Environmental

Like its P&C insurance peers, Pohjola is exposed to the economic consequences of climate change, primarily through the unpredictable effect of climate change on the frequency and severity of weather-related catastrophic events, such as floods, storms, drought and wildfires. Pohjola's exposure to environmental risks is mainly through property coverage throughout the Nordics, where climate change can result in increased claims frequency and amounts from natural catastrophe events, such as storm, hailstorms, torrential rain and drought. The ability to re-underwrite exposures on an annual basis is a mitigating factor.

Social

Like its P&C peers, Pohjola's social risks arise primarily from underwritten exposures to a wide range of liability claims against individuals and corporations.

Governance

Like all other corporate credits, the credit quality of Pohjola is influenced by a wide range of governance-related issues, relating to financial, managerial, ownership or other factors, all of which can be exacerbated by regulatory oversight and intervention. However, Moody's believes Pohjola and the larger OPFG to have adequate corporate governance and risk management in place.

Support and structural considerations

The A2 IFSR of Pohjola receives a one notch uplift as a result of its ownership by OP Corporate Bank plc reflecting the closer integration over recent years between Pohjola and its immediate and ultimate parents OPCB and OPFG in terms of both business and capital management.

Moody's however notes that OP Financial Group's support mechanism in which all the member banks provide each other with joint liability providing immediate and direct support in case of distress, does not cover, by law, insurance operations.

Rating methodology and scorecard factors

Exhibit 4

Pohjola Insurance Ltd

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	ScoreAdj	Score
Business Profile								A	A
Market Position, Brand and Distribution (25%)								Aa	A
-Relative Market Share Ratio			X						
-Underwriting Expenses % Net Premiums Written	19.0%								
Product Focus and Diversification (10%)								A	Baa
-Product Risk			X						
-P&C Insurance Product Diversification		X							
-Geographic Diversification						X			
Financial Profile								Aa	A
Asset Quality (10%)								Aa	Baa
-High Risk Assets % Shareholders' Equity				119.0%					
-Reinsurance Recoverable % Shareholders' Equity	13.9%								
-Goodwill & Intangibles % Shareholders' Equity	10.6%								
Capital Adequacy (15%)								A	A
-Gross Underwriting Leverage			4.6x						
Profitability (15%)								Aaa	A
-Return on Capital (5 yr. avg.)	20.9%								
-Sharpe Ratio of ROC (5 yr.)	555.0%								
Reserve Adequacy (10%)								A	A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)			1.3%						
Financial Flexibility (15%)								Aa	A
-Adjusted Financial Leverage	12.8%								
-Total Leverage	12.8%								
-Earnings Coverage (5 yr. avg.)	18.3x								
-Cash Flow Coverage (5 yr. avg.)									
Operating Environment								Aaa - A	Aaa - A
Preliminary Standalone Outcome								Aa3	A3

[1] Information based on LOCAL GAAP financial statements as of fiscal year ended December 31, 2020. [2] The Scorecard rating is an important component of the company's published rating, reflecting the standalone financial strength before other considerations (discussed above) are incorporated into the analysis.

Source: Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
POHJOLA INSURANCE LTD	
Rating Outlook	STA
Insurance Financial Strength	A2
OP CORPORATE BANK PLC	
Rating Outlook	STA
Senior Unsecured	Aa3
Senior Unsecured MTN	(P)Aa3
Subordinate	Baa1
Commercial Paper	P-1
LT Issuer Rating	Aa3
LT Bank Deposits	Aa3

Source: Moody's Investors Service

Endnotes

1 The ratings shown are OP Corporate Bank's deposit rating, senior unsecured debt rating and Baseline Credit Assessment.

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