MOODY'S INVESTORS SERVICE

CREDIT OPINION
7 August 2023

Update

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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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EMEA	44-20-7772-5454

Pohjola Insurance Ltd

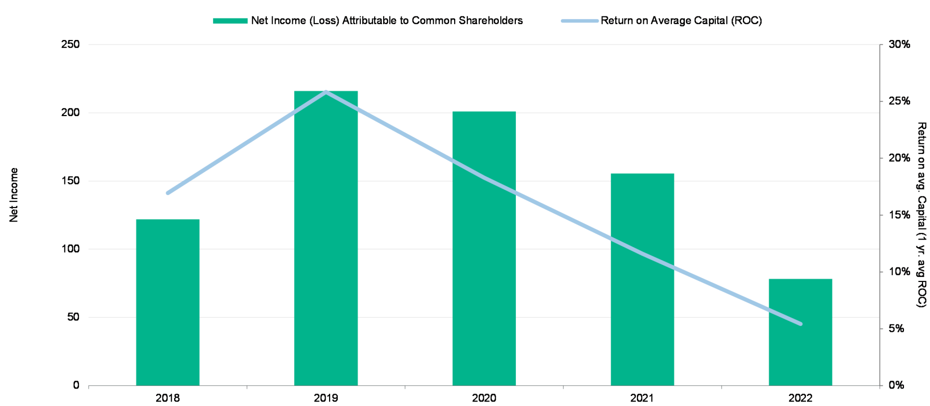
Update to credit analysis

Summary

The A2 insurance financial strength rating (IFSR), stable outlook on Pohjola Insurance Ltd (Pohjola) reflects its strong position in the Finnish property-casualty sector, as well as its good financial fundamentals with consistent profitability, enhanced capital adequacy and limited financial leverage relative to the overall rating level. These strengths are partly offset by Pohjola's relative lack of brand reach and geographic diversification outside of Finland, a relatively high proportion of longer tailed commercial business for which claims reserves are susceptible to changes in longevity experience and in discounting rates, as well as a high proportion of high risk assets. The rating also reflects the issuer's strong integration into the OP Financial Group (OPFG), in terms of both business and capital management.

Exhibit 1

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



Source: Moody's Investors Service and company filings

Credit strengths

» Strong market position in Finland

» Strong profitability but sensitive to market movements

» Solid capitalisation

» Relatively low leverage and strong earnings coverage

» Strong integration into the larger OPFG

Credit challenges

» Lack of geographic diversification beyond the domestic Finnish market

» High exposure to equity risk with potential for earnings volatility

» Elevated product risk with reserves susceptible to interest rate movements

Rating outlook

The stable outlook for Pohjola reflects our expectation that the company will retain its leading market position as well as strong profitability and capital adequacy. It also reflects the expectation that Pohjola will remain highly integrated into the larger OPFG, having access to financial support by the group.

Factors that could lead to an upgrade

Upward pressure on Pohjola's ratings could result from an upgrade of OPFG's ratings; or a significant strengthening of Pohjola's standalone credit profile as reflected in:

» meaningful strengthening of its business profile via geographic diversification and product risk profile improvement;

» Solvency II ratio consistently above 200%; and

» sustained improvement in profitability with no material deterioration in asset quality.

Factors that could lead to a downgrade

Conversely, downward pressure on Pohjola's ratings could arise from a downgrade of the ratings of OPFG or lower degree of integration within the broader group. At the same time, a significant weakening of Pohjola's standalone credit profile could also result in downward pressure, as reflected in:

» material weakening of market position;

» decline in capital adequacy, including Solvency II capital coverage falling to levels below 130% over a sustained period of time; and

» meaningful deterioration in underwriting performance reflecting a combined ratio close to 100% over a sustained period of time.

Key indicators

Exhibit 2
Pohjola Insurance Ltd

Pohjola Insurance Ltd [1][2]	2022	2021	2020	2019	2018
As Reported (Euro Millions)					
Total Assets	4,808	5,099	4,794	4,218	4,039
Total Shareholders' Equity	937	958	802	530	312
Net Income (Loss) Attributable to Common Shareholders	79	156	201	217	122
Gross Premiums Written	1,699	1,625	1,507	1,339	1,337
Net Premiums Written	1,612	1,570	1,458	1,298	1,298
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	92.4%	102.4%	119.0%	150.9%	168.3%
Reinsurance Recoverable % Shareholders' Equity	26.5%	14.5%	13.9%	16.0%	20.5%
Goodwill & Intangibles % Shareholders' Equity	7.4%	8.3%	10.6%	13.6%	17.9%
Gross Underwriting Leverage	3.8x	3.9x	4.6x	5.9x	8.2x
Return on Average Capital (ROC)	5.4%	11.6%	18.3%	25.8%	16.9%
Sharpe Ratio of ROC (5 yr.)	204.5%	340.0%	555.0%	NA	NA
Adv. (Fav.) Loss Dev. % Beg. Reserves	-3.5%	-0.9%	0.4%	2.8%	0.3%
Adjusted Financial Leverage	10.5%	11.2%	12.8%	19.7%	20.1%
Total Leverage	10.5%	11.2%	12.8%	19.7%	20.1%
Earnings Coverage	7.6x	12.2x	16.5x	16.2x	10.7x
Cash Flow Coverage	NA	NA	NA	NA	NA

[1] Information based on local GAAP financial statements as of the fiscal year ended 12/31/2022. [2] Certain items may have been relabeled and/or reclassified for global consistency.
Source: Moody's Investors Service

OPFG started reporting under the new insurance accounting regime, IFRS 17, as of 1 January 2023. The application of IFRS 17 may significantly affect the overall presentation of financial statements as well as certain reported amounts, including shareholders' equity, insurance liabilities, revenue and net income. While we take into consideration OPFG's segment reporting based on IFRS as part of our analysis, Pohjola's scorecard metrics are calculated based on the company's audited accounts under local GAAP. Therefore, the inputs for the calculation of the scorecard metrics are not going to be affected by the application of IFRS 17.

Profile

Pohjola is part of the Finnish cooperative banking group OPFG, a leading cooperative financial conglomerate on its domestic market. In 2021, Pohjola's shares have been transferred from the direct ownership of OP Corporate Bank plc (Aa3/Aa3 stable, a3[1]) to OP Cooperative, which is the central cooperative of OPFG. Pohjola represents the main non-life insurance legal entity of the group, providing a wide range of non-life insurance services for personal, corporate and institutional clients. 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 in line with the adjusted score indicated by our rating scorecard. The scorecard and associated text below are based on Pohjola Insurance Ltd on an unconsolidated basis unless otherwise stated.

Market Position, Brand and Distribution: Market leadership in Finnish non-life market and very strong Pohjola brand

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 32.6% (2022). 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 2022, the company reported gross premiums written of €1.7 billion, increasing by 4.6% from 2021.

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. As part of OPFG's strategic priorities, cross-selling between the banking and insurance operations has been increasing over the past years, though there remains significant potential. As of YE 2022, 35% of total number of OPFG's customers were combined banking and non-life insurance customers.

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 2022, digital sales continued to gain traction.

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 the insurance premium revenue, rendering Pohjola's product risk moderately high. Over the past years, Pohjola has gradually increased the share of private customers in its portfolio.

Longer-tail lines of business, such as motor third party liability and workers' compensation, accounts for relatively high share of Pohjola's technical provisions, making it susceptible to reserving risk.

Pohjola is operating solely in Finland and therefore has limited geographic diversification.

Asset Quality: Elevated high risk assets exposure partially offset by enhanced capital base and low intangibles

Moody's considers Pohjola's 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) 2022 fixed income investments accounted for 77%, equity and alternative investments for 15% and property investments for 8% of total invested assets. Credit risk is limited, with 56% of the fixed income portfolio rated at least A and with below investment grade or non-rated investments accounting for 8%.

The high risk asset ratio of Pohjola has considerably improved over the recent years, decreasing to 92.4% in 2022 from 168.3% in 2018, which was driven by the strong increase in shareholder's equity. At the same time, Pohjola's overall exposure to asset risk has gradually increased reflecting higher equity and illiquid assets exposure, as well as higher proportion of Baa-rated and non-rated debt in its fixed income portfolio.

In 2020, Pohjola announced it would strengthen its Solvency II ratio as part of its long-term target (see capital adequacy section below) and increase its risky asset exposure going forward. At this point, there hasn't been any significant change in the investment mix and we do not expect any material negative effect on the asset quality.

At year-end 2022, goodwill/intangibles and reinsurance recoverables in relation to shareholders' equity remain low at 7.4% and 26.5% respectively.

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

Pohjola's Solvency II ratio is managed by the larger OPFG and has significantly improved over the recent years. In 2020, the Solvency II ratio target of Pohjola was raised to 170% from 120% previously, which we consider as credit positive. The targeted strengthening is to enable the company to take on more asset risk to support its earnings base and at the same time increase the carrier's resilience to stress.

During FY 2022, Pohjola's Solvency II ratio strongly improved to 247%, from 174% in 2021, largely driven by the rise in interest rates and the impact of lower market risk on its Solvency capital requirement (SCR). As of Q1 2023, the Solvency II ratio stood at 233%. Going forward, Moody's expects Pohjola to operate with a Solvency II ratio closer to the 170% target level, with dividends upstreamed to the group.

Pohjola was 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, in order to increase its capital buffers. The company targets a dividend payout ratio of 70% of net profit, which is more moderate than in the past. In 2022, a dividend of €110 million was proposed, which was above Pohjola's net income of the year, but in line with expectations given the considerable strengthening of its capital position.

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.

Profitability: Very good historic profitability although sensitive to market volatility

Pohjola's 2018-2022 five-year average return on capital (based on Local GAAP figures) is very strong at 15.6%. The one-year average return on capital was 5.4% in FY 2022, decreasing from 11.6% in FY 2021 as a result of lower net income.

Earnings are exposed to financial market volatility, mainly reflecting the exposure to equity and alternative investments. In 2022, Pohjola's investment income was affected by the significant increase in interest rates and weaker equity markets that reduced the investment portfolio valuation. The investment result for FY 2022 decreased to €-198 million (FY 2021: €189 million (based on IFRS figures)). The net return on insurance investments at fair value (excl. the supplementary interest rate provisions) decreased to €78 million from €222 million in 2021.

In FY 2022, Pohjola's underwriting profitability was impacted by the increase in claims expenses by 12.5% largely reflecting higher motor claims and medical treatment expenses as frequencies returned back to pre-pandemic levels, rising claims inflation, as well as a higher number of large claims than in the previous year. However, Pohjola's technical result improved over 2022, benefitting from the raise in the discount rate for insurance liabilities to 2.0% from 0.85%, which increased its net insurance income by €283 million. IFRS operating combined ratio (excluding the impact of changes in discounting factors) deteriorated to 90.5% in FY 2022 from 85.5% in FY 2021. Overall, Pohjola reported IFRS earnings before tax of €351 million, down from €382 million in 2021.

The transition to the new accounting standard IFRS 17 is expected to have only a moderate impact on Pohjola's reported IFRS earnings. While Pohjola has been previously discounting its insurance liabilities, following the adoption of the IFRS 17 the impact of changes in interest rates is now recognised in net finance income as opposed to the technical result under IFRS 4. Under the new accounting regime, the results are impacted by the difference in the timing of recognition of insurance service results. Expected losses are immediately recognised in the income statement, thereby decreasing earnings for the first quarter.

During Q1 2023, Pohjola's premiums written grew by 7.0% year-over-year (YoY) benefitting from continued rate increases and larger customer base. Despite the growth in premiums, the IFRS operating combined ratio weakened to 100.5% (Q1 2022: 97.7% (based on IFRS 17 restated figures)). The risk ratio increased to 70.3% from 69.4% in Q1 20221 driven by the increase in claims expenses by 1.7% due to raising claims inflation and higher claims volumes, particularly in medical expenses insurance, as well as by the strong rise in reinsurance costs. The cost ratio increased to 30.2% at Q1 2022 from 28.3% in Q1 2021 reflecting higher operating expenses.

Going forward, we expect Pohjola will be able to maintain the strength of its underwriting performance, although its combined ratio in 2023 will likely deteriorate compared to FY2022. While higher claims inflation and claims frequency will continue to add pressure on Pohjola's claim costs, we expect the company to be largely able to push through offsetting price increases and maintain healthy levels of revenue growth. The expense ratio will likely continue to be inflated by the significant investments Pohjola is undertaking to further digitalize its business model, although the tangible benefit of this will not show immediately. As far as investment returns are concerned, these are largely a consequence of equity market performance, however a further rise in interest rates would benefit Pohjola's earnings given the relatively short duration of its investment portfolio and potential further rise in the discount rate for its liabilities.

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

For the period 2018-2022, Pohjola reported a weighted average reserve release of 0.9% of initial claims reserves, based on IFRS reserve triangle. In FY 2022, Pohjola benefitted from higher reserve releases reflecting the sharp increases in discount rates that reduced the present value of the insurance liabilities. 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. Excluding these effects, run-off result have been close to 2% in 2018-2022.

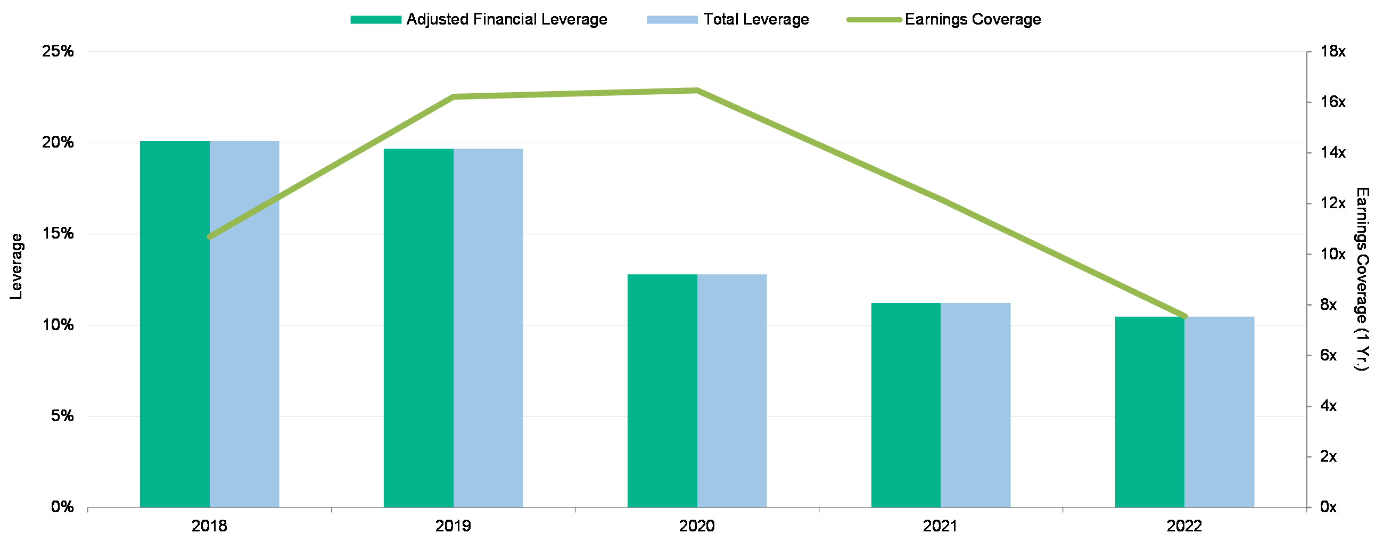
The rise in claims inflation, in particular if starting to result in increasing wage inflation, will put negative pressure on Pohjola's reserve adequacy. However, a further rise in interest rates and respective increase in discount rate for insurance liabilities would help to offset potential negative effects. In 2022, Pohjola increased the discounting rate to 2.0% from 0.85%, after a series of decreases over the recent years.

Financial flexibility: Low leverage, insurer benefits from the group's access to funding

Financial leverage is low at 10.5% at YE 2022, slightly down from 11.2% in YE 2021. Earnings coverage is strong with 5 year average earnings coverage for FY 2022 of 12.6x, 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: Moody's Investors Service and company filings

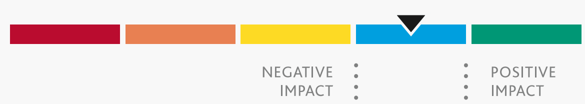
ESG considerations

Pohjola Insurance Ltd's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 4
ESG Credit Impact Score

CIS-2

Neutral-to-Low



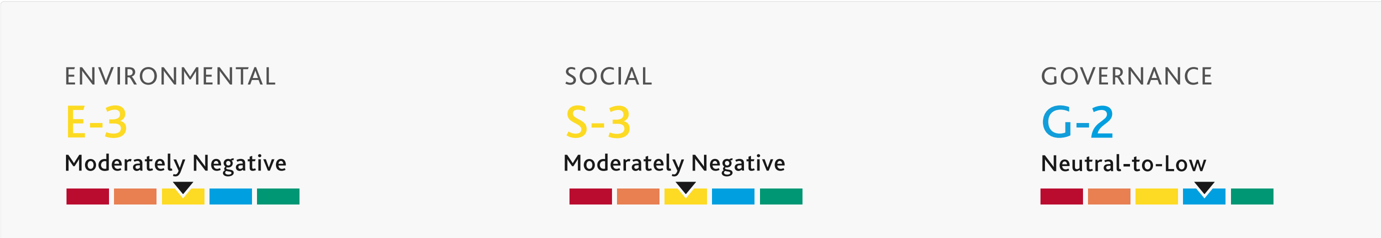
For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

Source: Moody's Investors Service

Pohjola's ESG Credit Impact Score is neutral to low (CIS2), reflecting the limited impact of environmental and social risks on the rating to date. Pohjola's risk management and effective governance mitigate the group's exposure to environmental and social risks, in particular physical risk and customer relations risk.

Exhibit 5

ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

Pohjola faces moderate environmental risks, in particular physical climate risk related to the effects of natural catastrophes on its P&C insurance operations. The company has a good track record of managing this risk through underwriting, pricing and reinsurance. As the frequency and severity of natural catastrophes increase over time, Pohjola and its peers could find mitigating this risk more challenging.

Social

Pohjola is exposed to moderate social risk, most notably with respect to customer relations and changing societal and demographic trends in its retail P&C insurance business. Customer relations risks are elevated in relation to Pohjola's insurance products and significant interactions with retail customers. This is mitigated by well-developed policies and procedures. Changes in societal attitudes and the legal environment can impact P&C claims costs and reserve development. Rising digitization and interconnectedness of devices will increase customer privacy and data security risks.

Governance

Pohjola faces neutral-to-low governance risks. Being part of the larger OP Financial Group, Pohjola benefits from strong governance and risk management structures in place at the group. Pohjola' capital base has significantly strengthened recently as a result of its more conservative financial strategy, which helps mitigate the volatility inherent to its investment portfolio that is associated with significant risk exposures.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

Exhibit 6

Pohjola Insurance Ltd

Financial Strength Rating Scorecard [1][2]	Aaa	Aa	A	Baa	Ba	B	Caa	Score	Adj Score
Business Profile								Aa	A
Market Position, Brand and Distribution (25%)								Aa	A
-Relative Market Share Ratio			X						
-Underwriting Expenses % Net Premiums Written	18.3%								
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	A
-High Risk Assets % Shareholders' Equity			92.4%						
-Reinsurance Recoverable % Shareholders' Equity	26.5%								
-Goodwill & Intangibles % Shareholders' Equity	7.4%								
Capital Adequacy (15%)								A	A
-Gross Underwriting Leverage			3.8x						
Profitability (15%)								Aa	A
-Return on Capital (5 yr. avg.)	15.6%								
-Sharpe Ratio of ROC (5 yr.)			204.5%						
Reserve Adequacy (10%)								A	A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)			-0.9%						
Financial Flexibility (15%)								Aa	A
-Adjusted Financial Leverage	10.5%								
-Total Leverage	10.5%								
-Earnings Coverage (5 yr. avg.)	12.6x								
-Cash Flow Coverage (5 yr. avg.)									
Operating Environment								Aaa - A	Aaa - A
Preliminary Standalone Outcome								Aa3	A2

[1] Information based on LOCAL GAAP financial statements as of fiscal year ended 12/31/2022. [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 7

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

Moody's related publications

Sector in-depth:

» Insurance Europe – Broad trends emerge as European insurers adopt IFRS 17 (June 7, 2023)

» Property & Casualty Europe – Nordic P&C insurers sustain strong underwriting performance (March 6, 2023)

Outlook:

» Nordics Insurance – 2023 Outlook stable for P&C and life (November 1, 2022)

» Insurance Europe – Inflation underpins negative P&C outlook, life stable on higher interest rates (January 30, 2023)

Methodology:

» Property and Casualty Insurers Methodology (January 19, 2023)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Endnotes

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

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