

Global Credit Research - 07 May 2013

Helsinki, Finland

Ratings

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

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Key Indicators

Pohjola Insurance Ltd[1]

	2012	2011	2010	2009	2008
Total Assets (Eur Mil.)	4,434	4,166	4,118	4,036	3,729
Shareholders' Equity (Eur Mil.) [2]	864	737	782	777	591
Net Income (Eur Mil.) [3]	214	-29	103	215	-127
Gross Premiums Written (Eur Mil.)	1,215	1,120	1,023	1,005	991
Net Premiums Written (Eur Mil.)	1,165	1,064	983	955	949
High Risk Assets % Shareholders' Equity	110.3%	132.6%	131.6%	108.6%	99.0%
Reinsurance Recoverables % Shareholders' Equity	8.9%	15.1%	10.1%	9.9%	14.7%
Goodwill & Intangibles % Shareholders' Equity [4]	33.3%	39.5%	38.9%	42.3%	60.2%
Gross Underwriting Leverage	4.1x	4.7x	4.1x	4.0x	5.1x
Return on Capital (1 yr.) [5]	25.1%	-3.6%	12.4%	29.2%	-21.5%
Sharpe Ratio of ROC (5 yr.) [5]	39.7%	35.8%	---	---	---
Adv/(Fav) Dev. % Beg. Reserves (1 yr.)	0.6%	0.1%	-2.0%	-0.7%	-1.7%
Adjusted Financial Leverage	6.3%	7.0%	6.6%	6.6%	8.4%
Total Leverage	6.3%	7.0%	6.6%	6.6%	8.4%
Earnings Coverage (1 yr.) [5]	47.2x	-5.6x	24.2x	49.7x	-104.8x

[1] Information based on IFRS financial statements in relation to Pohjola Non-Life Insurance business [2] Solvency capital excluding subordinated debt but includes adjustments for unrealised gains/losses and tax liabilities [3] Net Income figures at fair value and estimated using statutory tax rates [4] Figures are for Pohjola Bank [5] Estimated where limited disclosures

Opinion

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 (bank deposits rating: Aa3, stable outlook, P-1 short term rating, a3 adjusted BCA) which is the main subsidiary of the Finnish cooperative banking group, OP-Pohjola Group (C BFSR). 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 has been reduced in the last year (Pohjola's direct GIIPS sovereign debt exposure within the Group was EUR 25m as of YE 2012), 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, Pohjola's non-life business (collectively known as Pohjola Non-Life Insurance, "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 the Eur 50m dividend paid by PIL in Q3 2012 to Pohjola Bank plc.

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 2006 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. At the end 2012, 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 with a stable outlook assigned, driven primarily by the wider downgrade of the OP-Pohjola Group (please see relevant press release for further details).

Credit Strengths

- Ownership by Pohjola Bank.
- 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 position remains above the 70% figure targeted by management, and stood at 77% as at Q1 2013.

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:

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

better.

-Solvency margin consistently above 70%.

-Meaningful geographic and product line diversification without sacrificing profitability.

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

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 under 95%.

Notching Considerations

Not applicable.

DETAILED RATING CONSIDERATIONS

Moody's rates PILA3 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.

Insurance Financial Strength Rating

The key factors currently influencing the rating and outlook are:

Market Position, Brand and Distribution: Baa - CONCENTRATION IN RELATIVELY MATURE MARKET (FINLAND) WEIGHS ON DIVERSIFICATION

With its strong market position in Finland, in which it is currently the largest non-life player with a 29.1% market share at YE2012, PNLI's market share metrics are excellent. The OP-Pohjola Group connection is helping to enhance its customer base, Moody's believes that a challenge for PNLI 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 72% of direct premiums.

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

Moody's considers PNLI's overall asset quality to be good. At YE 2012, reinsurance recoverables only represented around 9% of net assets, but this is off-set by the amount of goodwill and other intangibles at the group level (33% of group equity at year-end 2012), and in particular by the relatively high proportion of high risk assets, at around 110% of shareholders' equity as at YE 2012, although it improved from 133% at YE 2011. Of the high risk assets, the largest holdings are equities (39%), alternative investments (9%), property (30%), and not rated/non investment grade fixed income securities (22%). Furthermore, Moody's notes the historically high equities concentration in the Finnish market. More positively, we note that as at the end of 2012, the overall direct exposure to sovereign debt in peripheral countries has reduced to EUR 25m (YE 2011: EUR 79m).

Capital Adequacy: A - RESILIENT CAPITAL POSITION WITH GROUP SUPPORT PREVIOUSLY PROVIDED

Following market volatility and recent dividend payment to the group as part of the 70% solvency ratio target, PNL's gross underwriting leverage and reported solvency ratio metrics have remained volatile, although they stood at a reasonably healthy 4.1x and 81% in 2012 (2011: 4.7x and 77%). At the end of the 1Q 2013 the solvency ratio slightly decreased to 77%. At YE 2012, solvency capital stood at EUR 914m (2011: Eur 787m). In addition, Moody's notes that during 2008, a capital injection 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 a Eur 50m dividend paid to Pohjola Bank in Q3 2012 an example of this repatriation.

Moody's considers PNL'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.

Profitability: A - VOLATILE PROFITABILITY AS A RESULT OF INVESTMENT MARKET CONDITIONS

PNL's 2012 five year average return on capital (excluding fair value gains/losses) is a good 8% although this is offset by a Sharpe ratio, which considers volatility, in the Ba range and 2008 RoC was a poor -22%, driven primarily by unrealised investment losses, with the 2011 result of -4% similarly 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 2012, with a reported operating combined ratio of 90.5% (2011: 89.8%), although PNL reported an overall 2012 combined ratio of 97.1% (2011: 97.7%) impacted, inter alia, by another severe winter in 2012, by the lowering of the discount rate from 3.3% to 3.0% in 2012 and also by the impact from mortality model changes in 2011. At the end of the 1Q 2013 the reported combined operating ratio stood at 92.4% (the company estimates the FY figure to be within the 89%-93% range), whereas the overall combined ratio stood at 94.2%. Overall, Moody's currently considers profitability to be consistent with an A rated company.

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

The reserve adequacy metric is good, driven by a net reserve release on a weighted average basis of 0.4% 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, PNL'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 Q3 2012 where the discount rate was reduced from 3.3% to 3.0%, leading to a Eur 52m pre-tax charge in the quarter).

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

Overall financial flexibility is considered good. Financial leverage is low at around 6.3% at YE 12, 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 300 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								Aa	Baa
Market Position, Brand and Distribution (25%)								Aa	Baa
Relative Market Share Ratio		X							
Underwriting Expense Ratio % Net Premiums Written		X							
Product Risk 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				110.3%					
Reinsurance Recoverables % Shareholders' Equity	8.9%								
Goodwill & Intangibles % Shareholders' Equity [3]			33.3%						
Capital Adequacy (15%)								A	A
Gross Underwriting Leverage			4.1x						
Profitability (15%)								Baa	A
Return on Capital (5 yr. avg) [4]		8.3%							
Sharpe Ratio of ROC (5 yr. avg) [4]					39.7%				
Reserve Adequacy (10%)								Aaa	A
Adv./(Fav.) Loss Dev. % Beg. Reserves (5 yr. avg.)	-0.4%								
Financial Flexibility (15%)								A	A
Adjusted Financial Leverage	6.3%								
Total Leverage	6.3%								
Earnings Coverage (5 yr. avg.) [4]				2.16x					
Cashflow Coverage (5 yr. avg.)									
Operating Environment (0%)								Aaa - A	Aaa - A
Aggregate Profile								A1	A3

[1] Information based on IFRS financial statements in relation to Pohjola Non-Life Insurance business [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 [3] Figures are for Pohjola Bank [4] Estimated where limited disclosures

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