

CREDIT OPINION

11 May 2020

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

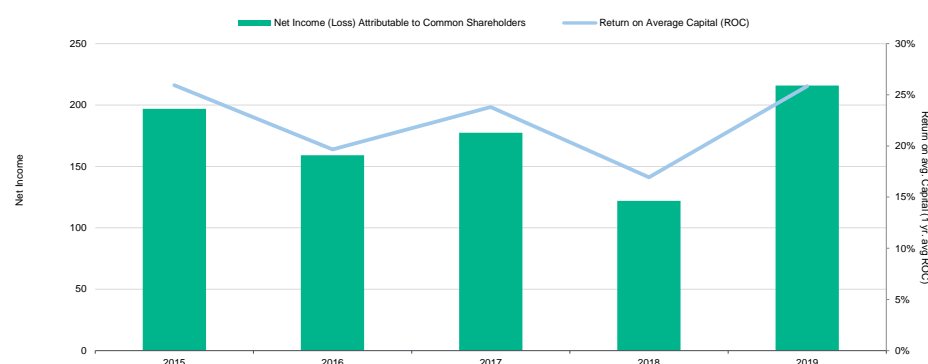
Moody's A2 (stable outlook) insurance financial strength rating (IFSR) on Pohjola Insurance Ltd (Pohjola) reflects its close integration into its direct parent [OP Corporate Bank plc](#) (Aa3/Aa3 stable, a3¹) and [OP Financial Group](#) in terms of both business and capital management. The rating also 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 modest regulatory capital position, on a stand-alone basis, as well as by the susceptibility of its claims reserves to falling interest rates.

As with other insurers, Pohjola's credit profile may become more vulnerable to the coronavirus induced downturn, should the economic shock broaden or lengthen.

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
- » Moderately strong 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.moodys.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]	2019	2018	2017	2016	2015
As Reported (Euro Millions)					
Total Assets	4,218	4,039	4,048	3,914	3,710
Total Shareholders' Equity	530	312	370	392	563
Net Income (Loss) Attributable to Common Shareholders	217	122	178	159	197
Gross Premiums Written	1,339	1,337	1,280	1,281	1,257
Net Premiums Written	1,298	1,298	1,241	1,236	1,209
Moody's Adjusted Ratios					
High Risk Assets % Shareholders' Equity	150.9%	168.3%	158.4%	168.3%	129.0%
Reinsurance Recoverable % Shareholders' Equity	16.0%	20.5%	16.7%	13.3%	13.9%
Goodwill & Intangibles % Shareholders' Equity	13.6%	17.9%	17.7%	15.7%	9.5%
Gross Underwriting Leverage	5.9x	8.2x	7.4x	7.0x	5.5x
Return on Average Capital (ROC)	25.8%	16.9%	23.8%	19.7%	25.9%
Sharpe Ratio of ROC (5 yr.)	562.8%	339.0%	435.3%	381.9%	192.0%
Adv. (Fav.) Loss Dev. % Beg. Reserves	2.8%	0.3%	2.2%	1.2%	0.4%
Adjusted Financial Leverage	19.7%	20.1%	18.8%	18.2%	15.2%
Total Leverage	19.7%	20.1%	18.8%	18.2%	15.2%
Earnings Coverage	16.2x	10.7x	20.0x	28.4x	42.1x
Cash Flow Coverage	NA	NA	NA	NA	NA

[1]Information based on IFRS financial statements as of the fiscal year ended 12/31/2019.

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

Sources: 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.

Recent developments: Coronavirus outbreak

The rapid global spread of the Coronavirus is creating a severe and extensive credit shock across many sectors. Currently, most insurers are well positioned at their rating levels, but their credit profiles could become vulnerable to the extent the economic shock broadens and lengthens relative to our baseline macroeconomic assumption.

Market volatility has been negatively influencing Pohjola's investment results but the negative effect on the issuer's Solvency II ratio so far has been limited. Pohjola's exposure to lines of business most susceptible to Coronavirus related increases in claims expenditures appears to be limited at this stage, with some offsetting effect from lower frequency of claims in other lines of business. We will continue to monitor the implications for Pohjola's credit profile as events unfold.

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 OP 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. 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, which combined should help to sustain its strong market position.

Pohjola is the leading insurer in the Finnish non-life sector, which is moderately sized compared to other European sectors. Pohjola reported gross premiums written of €1.5 billion (2019) and a market share of 34% (2018). Pohjola segments its business into private customers and corporate customers, which account for approximately 56% and 44% of total gross premiums written, respectively. The company had sold its operations in the Baltics in 2018. 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, but with the economy expected to shrink significantly in 2020, we believe growth will be difficult to attain in at least in 2020.

With Pohjola, in line with the larger group, increasingly investing into the digitalisation of its business model, expense ratios had risen significantly since 2015, but we expect this trend to revert in 2020 and beyond, based on lower new investments and savings coming through.

Product risk and Diversification: good diversification by lines 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 44% of total business, rendering Pohjola's product risk moderately high. 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) 2019 fixed income investments accounted for 76%, equity and alternative investments for 17% and property investments for 8% of total invested assets. Credit risk is limited, with 61% of the fixed income portfolio rated at least A and with non-grade or non-rated investments accounting for 13%. While many Nordic peers operate with higher asset risk - mainly through higher equity investments - Pohjola's high-risk asset ratio is elevated based on the relatively smaller capital base.

At Q1 2020, following the Coronavirus induced financial market volatility, Pohjola's asset allocation has remained virtually stable compared to YE 2019.

At year-end 2019, 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 moderately strong, as capital is managed on the group basis, and the company operates with a minimum target Solvency II ratio of 120%. On this basis, Pohjola has been a strong payer of dividends to the parent company in recent years with high payout ratios, but did not pay a dividend in 2019. The company's Solvency II ratio is relatively resilient, with its main sensitivity to falling equity markets and no significant sensitivity to interest rate movements.

At YE 2019, Pohjola's Solvency II ratio was 144% (YE 2018: 131%). The increase reflected increasing own funds, partially driven by not paying a dividend and thus strengthening shareholders' equity, more than offsetting the increase in solvency capital requirement (SCR). At YE 2019, market risk and, as part of that equity risk, dominated the SCR, at 43% of pre-diversification SCR.

At Q1 2020, Pohjola's Solvency II ratio has weakened moderately to 137%. This results from lower own funds driven by lower market value of investments which is partially offset by the resulting decrease in SCR for investment risks, helped by the application of the symmetrical adjustment.

Profitability: Very good historic profitability but significantly weaker in 2019 and 2020

Pohjola's 2015-2019 five-year average return on capital (excluding fair value gains/losses not through profit and loss) is a very strong 22.4%, 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, however the years 2015-2019 were characterized by benign financial markets with limited volatility. As a result, the 5 years the Sharpe ratio was also strong.

Underwriting profitability has been strong over the last 5 years on average (reported combined ratio of 95.0%) but it has deteriorated somewhat. One of the drivers for the deterioration was the increase in the expense ratio, which rose to 21.4% in 2019 from 16.9% in 2015, reflecting significant investments in the digitalisation of the business model. At the same time, changes in discounting rates resulting in reserve strengthening have had a meaningful impact on claims ratios in 2017 and 2019. Investment returns have also been strong, reflecting good performance of equity investments partially offsetting the negative effect of low yields.

For 2019, Pohjola reported a combined ratio of 103.0%, up from 92.4% for 2018. The increase in the combined ratio was predominantly driven by the change in the discount rate, with lower reserve releases and higher attritional claims also adding to the increase.

For Q1 2020, OPFG reported insurance earnings before tax decreasing by 33% to €59 million (Q1 2019: €88 million), reflecting an increase in the technical result to €138 million (Q1 2019: €117), based on an improved operating combined ratio (excluding the impact of changes in discounting factors) of 92.7% (Q1 2019: 97.5%), and significantly lower investment result of €51 million (Q1 2019: €21 million).

Going forward, we believe that premium volumes will be under pressure both from an exposure and pricing perspective, owing to weaker economic activity, which however should have a positive offsetting effect on claims expenditure. The combined ratio should benefit from slightly lower expenses. We expect investment results to largely fluctuate with market volatility.

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

For the period 2015-2019, Pohjola reported a weighted average reserve strengthening of 1.7% 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 2019, Pohjola changed the discounting factor to 1.0% from 1.5% after a similar action in 2017. Excluding these effects, run-off results have been close to 0% in 2015-2019.

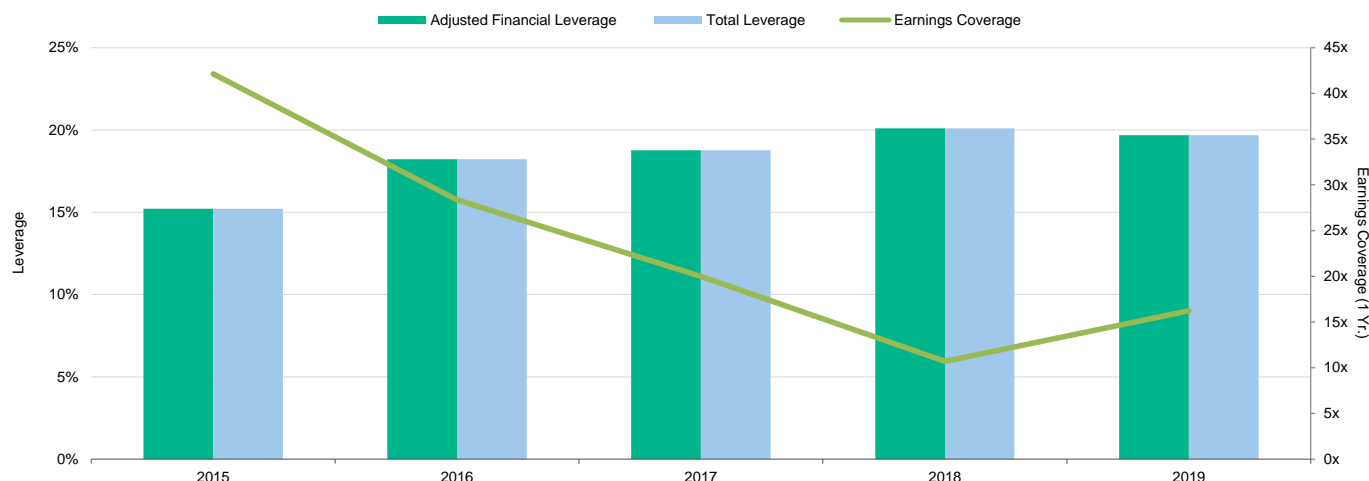
Financial flexibility: Moderate leverage and benefitting from the group's access to funding

Financial leverage remains relatively low at 19.7% at YE 2019 (YE 2018: 20.1%), the decrease thanks to higher 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.

We also regard the coronavirus outbreak as a social risk under our ESG framework, given the substantial implications for public health and safety. Furthermore, the rapid and widening spread of the coronavirus outbreak, deteriorating global economic outlook, falling oil prices, and asset price declines are creating a severe and extensive credit shock across many regions and markets including the insurance sector. While the breadth and severity of the shock is still uncertain, we expect it will have an impact on Pohjola's claims, premiums, earnings and capital, at least in 2020.

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		21.1%							
Product Focus and Diversification (10%)								A	Baa
-Product Risk			X						
-P&C Insurance Product Diversification		X							
-Geographic Diversification						X			
Financial Profile								A	A
Asset Quality (10%)								Aa	Baa
-High Risk Assets % Shareholders' Equity				150.9%					
-Reinsurance Recoverable % Shareholders' Equity		16.0%							
-Goodwill & Intangibles % Shareholders' Equity		13.6%							
Capital Adequacy (15%)								Baa	A
-Gross Underwriting Leverage				5.9x					
Profitability (15%)								Aaa	A
-Return on Capital (5 yr. avg.)		X							
-Sharpe Ratio of ROC (5 yr.)		X							
Reserve Adequacy (10%)								A	A
-Adv. (Fav.) Loss Dev. % Beg. Reserves (5 yr. wtd. avg.)			X						
Financial Flexibility (15%)								Aa	A
-Adjusted Financial Leverage		X							
-Total Leverage		X							
-Earnings Coverage (5 yr. avg.)		X							
-Cash Flow Coverage (5 yr. avg.)									
Operating Environment								Aaa - A	Aaa - A
Preliminary Standalone Outcome								A1	A3

[1]Information based on IFRS financial statements as of fiscal year ended 12/31/2019.

[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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