STANDARD & POOR'S RATINGS SERVICES

RatingsDirect®

Pohjola Non-Life Insurance Co. Ltd.

Primary Credit Analyst:
Linas Grigaliunas, London (44) 20-7176-7072; linas_grigaliunas@standardandpoors.com

Secondary Contact:
Peter McClean, London (44) 20-7176-7075; peter_mcclean@standardandpoors.com

Table Of Contents

Table Of Contents (cont.)

Pohjola Non-Life Insurance Co. Ltd.

Major Rating Factors

Operating Company Covered By This Report
Financial Strength Rating
Local Currency
AA-/Negative/--

Strengths:

- "Core" status within the Pohjola group.
- Strong competitive position.

Weaknesses:

- Good investments.
- Good capitalization.

Rationale

The ratings on Finland-based Pohjola Non-Life Insurance Co. Ltd. (Pohjola) reflect its core status for Pohjola Bank PLC (AA-/Negative/A-1+). The stand-alone characteristics also reflects Pohjola's strong competitive position in its domestic market offset by its investment strategy, which we assess as high risk, especially given a capital strategy that constrains capital adequacy at just a good level, as defined by our criteria.

We consider Pohjola to be a core subsidiary of Pohjola Bank, according to our group criteria for financial institutions. Pohjola is a very important subsidiary and forms a key part of the retail strategy of the group. We think it is highly unlikely that it would be sold. Its risk profile is in line with the group's conservative profile. We also think there is a strong commitment from the group to support Pohjola in good and bad times. As such, under our group rating methodology it benefits from ratings equalization at the same level as the group.

We assess Pohjola's competitive position as strong. This reflects its size in its domestic market, where it is the largest non-life insurer with around 29% of the market in 2011. Pohjola is also consistently ranked as a top-two Finnish insurer across all its main businesses. Pohjola's competitive advantage is further enhanced by its proven ability to grow the distribution of its products through the bank infrastructure and cross-selling. In our base-case scenario, Pohjola will grow around 6%-9% in 2012-2014.

We view the company's investments as good but we consider them to be a weakness to the profile. The insurer maintains a material allocation to high risk, potentially volatile assets, in particular equity investments. This is partially offset by a very strongly rated bond portfolio. While the long payment tail on some of the insurer's liability classes means that equities provide a useful inflation hedge, they do produce significant earnings volatility and, as was seen in 2008, can lead to significant investment losses. Pohjola reduced its risky assets exposure in Q2 2012 to 6% from 11% at end of 2011 and is planning to continue a gradual reduction in order to lower earnings and capital adequacy volatility. We view this positively; however, the time horizon is long and we need to see a track record of improvements.

Capitalization, in our view, is good, however a relative weakness to the profile. Pohjola Bank's approach is to centralize

1048691 | 301071283

capital within the group to maximize flexibility and liquidity and make capital available when needed. Consequently, excess capital is reduced and Pohjola's capital adequacy is constrained by this approach. Pohjola has a targeted solvency ratio of 70% (regulatory capital/net premiums) and the actual ratio stood at 86% at June 30, 2012. According to our risk-based capital model, Pohjola's capital adequacy strengthened and is regarded as strong at the half year 2012. This was achieved due to reduced listed equity exposure and good profitability. In our base-case scenario, in the short-to-medium term, Pohjola's capital adequacy according our risk based capital model is expected to be strong. However, Pohjola is exposed to risky asset classes and the group continues a policy of centralized excess capital. Therefore, in our view, the long-term capital adequacy at Pohjola is expected to be good supported by adequate reserving and highly rated reinsurance protection.

Outlook

We expect Pohjola to maintain its core status to the group. The negative outlook on Pohjola reflects the negative outlook on Pohjola Bank due to rising economic risks. Any rating change or change of the outlook would be replicated at Pohjola.

On a stand-alone basis we expect Pohjola to continue grow faster than market, with overall premium growth of around 6%-9% for 2012 and 2013. We also expect underwriting performance to remain strong, with an anticipated underlying GAAP combined ratio of under 95%, and for risk based capital adequacy to remain supportive of the profile, measured by our capital model. We also anticipate a stable investment portfolio mix.

Corporate Profile: Largest Finnish Non-Life Insurer

Pohjola is a wholly owned subsidiary of Pohjola Bank. In turn, the bank is majority controlled by the OP-Pohjola group, which consists of 196 cooperative banks sharing cross guarantees (end of September 2012). Including its subsidiary entities, Pohjola is the largest non-life insurer in the Finnish market, with a market share of around 29% in 2011, slightly ahead of its main competitor If P&C Insurance Co. Ltd. (If; A/Stable/--), which has around 25%. As an independent insurance group, Pohjola also had a short history of life and asset-management operations. The life business was sold to the OP-Pohjola Group during the 2005 acquisition of Pohjola by Pohjola Bank (formerly OKO Bank PLC). Pohjola is once again a pure non-life player, operating predominantly in the Finnish market.

Pohjola owns the specialist Finnish travel insurer Vakuutusosakeyhtio Eurooppalainen (not rated) and Pohjola Bank owns A-Insurance Ltd. (not rated), which provides professional transport insurance in Finland. Pohjola also operates in the Baltics under the Seesam brand and has an estimated market share of about 7%, but only really has scale in Estonia. During 2010, the ownership of the Seesam companies was transferred from the group to Pohjola. International revenues account for about 5% of the total.

Competitive Position: Bancassurance Model Provides Main Platform For Future Growth

Table 1

Pohjola Non-Life Insurance Co. Ltd. Competitive Position					
	--Year-ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Total revenue	1,035.1	971.6	866.0	866.2	872.4
Gross premium written	1,039.8	935.2	862.2	837.6	795.9
Annual change in gross premiums written (%)	11.2	8.5	2.9	5.2	2.9
Net premium earned	943.4	874.1	793.5	774.6	716.2
Annual change in net premium earned (%)	7.9	10.2	2.4	8.1	3.1
Net premium written	984.5	895.9	812.1	796.9	748.7
Annual change in net premiums written (%)	9.9	10.3	1.9	6.4	3.6

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

In our view, Pohjola has a strong competitive position in the Finnish non-life insurance market. It benefits from being able to leverage the bank's infrastructure, information, and client relationships. This produces a powerful distribution strategy that has strengthened over the last few years, and, in our view, is likely to strengthen further over time through access to OP-Pohjola Group's more-than four million clients. The strength of the Pohjola brand was clearly demonstrated by the rebranding of the OP Bank Group to OP-Pohjola Group. Pohjola's competitive position is diversified by business line but concentrated by region, although its parent bank provides greater opportunities in rural Finland.

Pohjola has grown at a measured pace over the last five years to become Finland's largest non-life insurer. While it has a stronger presence in commercial lines, it is also close to attaining market leadership in personal lines. During 2010, the personal lines premium volumes overtook commercial premiums for the first time (52% personal, 48% commercial in 2011), partly reflecting the effects of the recession on the latter sector. The company considers that personal lines business is more profitable than commercial lines, on a risk-adjusted basis. It ranks in the top three by market share for each of the main classes of business.

Following the acquisition of Pohjola, the OP-Pohjola group has built successfully on the synergies available from a bancassurance model. The group now has 300 offices selling both insurance and bank products in Finland; this distribution capability represents a meaningful competitive advantage for Pohjola. In addition, the parent's banking relationships give the insurer access to commercial clients--a further source of competitive advantage. Exploiting this potential for cross-selling is a key strategic aim for the group, and is producing tangible results. A large and increasing proportion of Pohjola customers pay their premiums with loyalty bonuses accrued through using the bank; this has provided a clear rationale for the member cooperative banks' customers to become Pohjola policyholders. The number of joint bank and insurance customers increased to nearly 1.3 million by year-end 2011, up from around 706,000 at the end of 2005, representing more than 60% of Pohjola's client base and 31% of OP-Pohjola Group's client base. The group continues to set apparently demanding targets for selling insurance to banking customers, and has consistently exceeded these targets. Loyal Pohjola customers (those buying more than one insurance product) comprise one-quarter of the total customer base and there remains potential for growth.

The small size of the Finnish market, the relatively limited reach of the Finnish language, and the necessity of a branch network for distribution, together act as a significant barrier to entry into the Finnish market. This combination underlies Pohjola's strong competitive position. Offsetting these strengths is the stability of the Finnish non-life market, which has seen limited premium growth in recent years. While these factors protect Pohjola's strong position in Finland, they also provide an ultimate limit to the amount of growth available. In addition, the company is geographically concentrated. Pohjola's Baltic businesses theoretically offer some geographic diversification and long-term growth prospects, but Pohjola's position in these markets is small. In common with other Scandinavian peers, the company lacks the competitive advantages it holds in its home market.

We expect Pohjola to continue enhancing its market position, mainly through the financial incentives it offers to its existing clients and those of OP-Pohjola Group. We expect Pohjola to grow at around 8% in 2012-2014. Although this growth is derived from the personal and commercial lines businesses in almost equal proportions, the underlying drivers are different. The increased volumes in commercial lines largely reflect an upturn in the Finnish economy, the extent and sustainability of which are currently uncertain. On the other hand, growth in personal lines is largely attributable to Pohjola's own initiatives, notably in building on the relationship with banking clients and loyal customers. Growth in common customers continues and cross-selling proves to be a very successful strategy.

We foresee that economic growth considerations will continue to constrain revenues in Pohjola's business in the Baltic states.

Management And Corporate Strategy: Successful Bancassurance And Cross-Selling Strategy

In our view, Pohjola has a highly experienced and stable management team, supported by strong operational and financial discipline. The company has a comprehensive planning process in place. It has shown a successful track record of execution of its strategy, in particular capitalizing on its successful bancassurance model, to become the largest provider of both commercial and personal lines in the Finnish market. Pohjola has comprehensive financial standards and risk tolerances explained in written policies and risk limits for the major risks. However its risk tolerances for market risk are higher when compared with international peers.

Strategic positioning

Pohjola follows the strategic planning processes prescribed by the OP-Pohjola Group, with a written strategic plan that has specific financial and operational goals. This is reviewed by the board and cascaded to its business units. Progress against plan for each business is measured via Long-Term Performance Indicators, namely Risk-bearing Capacity (solvency ratio 70%); Profitability (combined ratio 92%); Efficiency (expense ratio < 20%); and Growth (above industry average). In our view, these targets are ambitious, but consistent with company's capabilities and market conditions and supported by successful track record of execution.

Operational effectiveness

The management team has largely been in place since the acquisition of Pohjola by Pohjola Bank in 2005 and is highly experienced in its chosen business sectors. It has a good breadth and depth across all significant business lines. The company absorbed the loss of its president (replaced by the Group CFO) in 2010 without significantly disrupting operations.

Over half of OP-Pohjola's banking network is now actively selling insurance products, and Pohjola's sales agents in these offices are employed by the bank, benefitting Pohjola's fixed cost base.

Financial management

We consider that Pohjola has comprehensive financial standards and risk tolerances, in line with the group standards. Multiple measures are used to measure and control the main risks, including for Solvency II. In our view, Pohjola's tolerance for investment risk is high, relative to only adequate capital adequacy. However, it is mitigated by the parent's centralized management of capital and its demonstrated willingness to provide support when necessary.

Enterprise Risk Management: Adequate For The Business Written And Benefiting From Basel II Experience

We find Pohjola's enterprise risk management (ERM) program to be adequate, with adequate controls for its main risks, namely insurance risks in long-tail lines and related ALM risks. We do not expect Pohjola to experience losses outside of normal ranges from traditional risk areas. Pohjola adheres to the principles of control and risk management of its parent OP-Pohjola Group, which we also consider adequate, and reports its risk positions regularly to the OP-Pohjola Group risk function.

Risk controls are viewed as adequate overall. Risk-management culture is adequate, with a detailed governance structure that promotes consistency of oversight, procedures, controls, and reporting through designated risk-management executives and committees responsible for the use of limits, profit performance, and the overall quality of the processes. They also monitor the allocation of capital to different risks. Pohjola's asset-liability management model cannot model different risks on a consistent basis, so we view strategic risk management as adequate.

OP-Pohjola Group's preparations for Basel II, the EU's directive on the regulation of banks, have helped to ensure that preparations for Solvency II, the equivalent for the insurance sector, are sufficiently advanced. The company's long track-record of using economic capital modeling provides a solid base for using a partial internal model within Solvency II.

Accounting: Analysis Based Upon GAAP, With Adjustments To Capital For Fair Value Of Investments And Discounting

We have based our analysis on accounts compliant with local generally accepted accounting principles (GAAP) since 2006, as IFRS is no longer available on a stand-alone basis. However, the OP-Pohjola Group reports on an IFRS basis. These numbers have been used in this report where they are more representative of the underlying business. In addition, interim numbers quoted are based on the group IFRS interim disclosures. The main differences are in investments which are carried at the lower of cost and market value, as opposed to fair value under IFRS accounting.

Operating Performance: Strong Underwriting Performance Offset By Volatile Investment Results And Large One Offs

Table 2

Pohjola Non-Life Insurance Co. Ltd. Operating Performance					
	--Year-ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Return on revenue (%)	15.0	8.9	9.4	9.5	17.3
Return on revenue including realized and unrealized gains/(losses) (%)	3.5	15.1	22.1	(24.3)	17.7
Return on equity (%)	7.2	49.4	109.3	(109.5)	97.2
EBIT adjusted to Total equity adjusted (%)	24.7	13.8	15.7	18.8	38.0
EBITDA adjusted to Capital (%)	26.3	14.5	16.8	20.2	38.4
EBIT	31.4	157.7	223.0	(153.5)	155.3
EBIT adjusted	155.7	86.7	81.0	82.0	150.9
EBITDA	31.4	157.7	223.0	(153.5)	155.3
EBITDA adjusted	155.7	86.7	81.0	82.0	150.9
Net loss ratio (%)	78.4	76.4	72.0	75.5	74.3
Total net expense ratio (%)	21.4	23.5	21.0	20.8	19.7
Net combined ratio (%)	99.8	99.9	93.0	96.3	94.0
P/C: Net loss ratio (%)	78.4	76.4	72.0	75.5	74.3
P/C: Net combined ratio (%)	99.8	99.9	93.0	96.3	94.0
P/C: Gross loss ratio (%)	80.5	76.6	68.6	76.5	70.7
Net investment yield (%)	3.7	2.5	3.3	4.5	7.6

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

In our view, operating performance is good. We view Pohjola's underwriting performance as good with a five-year average combined ratio of 97%. It has weakened since 2010 due to additional mortality provisions and reductions in the discount rate. This caused the combined ratio to rise to just below 100% in 2011 (97% end-September 2012). Nevertheless, the underlying underwriting performance remains strong at around 90% in 2011. The company has outperformed the Finnish market average CR. In our base-case scenario the underlying CR is expected to remain around or below 90% for the next two years, but reported CR to be just above 100% for 2012 and below 95% for 2013.

We view Pohjola's underwriting performance as good with an underlying five-year average CR of 97%. However it has been weakened by one-off events: 2010, additional mortality provision on the workers' compensation negative effect of EUR36 million; 2011, additional mortality provision and reduction in the discount rate negative effect of EUR56 million; 2012 estimated the discount rate negative effect of EUR52 million and EUR6 million reorganization cost.

The bottom-line results have been volatile with profit before tax ranging from minus EUR155 million in 2008, to profit of EUR219 million in 2009 (EUR27 million in 2011). Return on revenue has been also volatile, ranging from 9% to 17% during the last five years. The main reason for this volatility is high equity exposure further exacerbated by large one-offs on the underwriting side. Pohjola has been taking actions to address both of these issues and we expect a more stable and predictable bottom-line performance in future with ROR of above 10%.

Investments: High Appetite For Market Risk Relative To Capital

Table 3

Pohjola Non-Life Insurance Co. Ltd. Liquidity And Investments					
	--Year-ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Invested assets to total assets (%)	83.8	86.7	87.5	84.0	86.9
Invested assets to loss and unearned premium reserve (%)	117.5	127.0	126.8	111.0	117.7
P/C: Liquid assets to technical reserves	95.7	101.1	99.9	88.6	94.9
High-risk assets to total invested assets (%)	26.9	24.9	22.9	21.9	25.0
Common equity investments to capital (%)	93.7	84.5	79.9	93.5	105.1
Real estate investments to capital (%)	23.5	17.0	12.4	18.2	17.8
Total invested assets adjusted	2,458.7	2,511.9	2,372.1	2,030.1	2,077.9
Investment portfolio composition					
Cash and cash equivalents (%)	0.0	2.1	0.9	0.1	0.6
Total bonds (%)	73.1	72.9	76.2	78.0	74.4
Common stock (%)	21.4	20.7	19.7	18.2	21.3
Real estate (%)	5.4	4.2	3.1	3.5	3.6
Investments in affiliates (%)	0.1	0.1	0.1	0.1	0.1
Total portfolio composition (%)	100.0	100.0	100.0	100.0	100.0

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

We view the company's investments as good, however we consider them to be a weakness to the profile. The insurer maintains a material allocation to high-risk, potentially volatile assets, in particular equity investments. This is partially offset by a very strongly rated bond portfolio. While the long payment tail on some of the insurer's liability classes means that equities provide a useful inflation hedge, they do produce significant earnings volatility and, as was seen in 2008, can lead to significant investment losses. Pohjola reduced its risky assets exposure in Q2 2012 and is planning to continue a gradual reduction in order to lower earnings and capital adequacy volatility. We view this positively, however the time horizon is long and we need to see a track record of improvements.

Strategy

We consider Pohjola's investment strategy to be high risk, relative to its capital position. Pohjola historically had high investments in equity, partly as a hedge for its long-tail reserves. While Pohjola has reduced its exposure to the most high-risk asset classes from historic levels, investment risk tolerance remains high relative to the shareholders equity, which can absorb investment risk (x2.4 end of 2011).

Market risk

The volatility experienced in 2008 led Pohjola to re-examine its acceptance of earnings volatility. In common with its Finnish peers, we view Pohjola's tolerance for investment risk as high, particularly for a nonlife insurer. The company has allocated fewer investments to equities than the market average, but it has a much lower solvency level. Pohjola is aiming gradually to reduce its market exposure. At end of first-half 2012 it retained 9% of its investment portfolio in equities. In addition, it is willing to accept additional market risk through hedge funds, private equity, and high-yield bonds. Exposure to these high-risk asset classes remained around 22% at June 30, 2012.

Credit risk

Credit risk in our view is well managed and relatively low. Bonds and bond funds amount to above 70% of total invested assets with average credit quality regarded as very strong ('AA').

Asset-liability management

Pohjola had a duration mismatch of approximately five years at year-end 2011 because of the long tail of its liabilities. The €1 billion of annuities, mostly comprising workers' compensation and motor liabilities, have an average duration of 12 years. Due to the relatively low inflation risk in the reserves, relative to other Nordic markets, investment primarily is made in nominal rather than inflation-linked bonds.

Liquidity: Highly Liquid Balance Sheet

We regard liquidity as strong, based on Pohjola's highly liquid balance sheet, strong operating cash flows, and long-tail liabilities. Over 90% of investments are held in cash, bonds, and equity-like instruments, together covering net technical reserves by 113%. Pohjola reported positive operating cash flow of €208 in 2011 (€148 million in 2010). Committed external bank lines are considered unnecessary given Pohjola's ownership. Commissions, which are increasingly paid to the bank following the restructuring, require initial cash outflows but are not material.

Capitalization: Tightly Managed, And Pressured By Investment Leverage

Table 4

Pohjola Non-Life Insurance Co. Ltd. Capitalization					
	--Year-ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
Reinsurance utilization (%)	5.3	4.2	5.8	4.9	5.9
P/C: Net loss reserves to gross loss reserves (%)	95.2	96.6	97.0	96.1	97.7
P/C: Loss reserves to total adjusted equity (%)	631.3	661.0	746.2	1,997.5	1,133.6
P/C: Loss reserves to net premium written (%)	174.3	183.4	198.3	198.8	206.3

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Capitalization, in our view, is good, however a relative weakness to the profile. Pohjola Bank's approach is to centralize capital within the group to maximize flexibility and liquidity and make capital available when needed. Consequently, excess capital is reduced and Pohjola's capital adequacy is constrained by this approach. Pohjola has a targeted solvency ratio of 70% (regulatory capital/net premiums) and the actual ratio stood at 86% at June 30, 2012. According to our risk-based capital model, Pohjola's capital adequacy strengthened and is regarded as strong at the half year 2012. This was achieved due to reduced listed equity exposure and good profitability. In our base-case scenario for the short-to-medium term Pohjola's capital adequacy according our risk-based capital model is expected to be strong. However, Pohjola is exposed to risky assets classes and the group continues its policy of centralized excess capital. Therefore, in our view, the long-term capital adequacy at Pohjola is expected to be good supported by adequate reserving and highly rated reinsurance protection.

Capital adequacy

Pohjola's capital adequacy improved and is now regarded as strong. The company is focusing on reducing capital adequacy volatility by gradually reducing exposure to risky assets. During the first half of 2012, Pohjola reduced listed equity exposure to total invested assets to 6% from 11% at the end of 2011. The improvements were also helped by good profitability. Our view on capitalization is constrained by the group's commitment to keep excess capital within Pohjola Bank and by volatility coming from exposure to risky assets.

The quality of capital is good, mainly consisting of shareholders' equity and equalization reserves. The only financial leverage relates to the Tier 2 instrument, which is eligible as hybrid capital in our capital analysis. It is a €50 million perpetual subordinated loan from OP-Pohjola Group Central Cooperative. Following the adverse experience of 2008, and given the potential for Solvency II to increase solvency capital requirements, we expect any distributions to the parent to be limited in the near term.

Reserves

Reserving is considered conservative. Pohjola allocates provisions to a safety margin on the collective (or incurred but not reported) reserves, which are inflation-adjusted (3.0%, or 4.0% for medical expenses). A change to the mortality model and a reduction in the discount rate resulted in a reserve addition of €59 million in 2011. At end-2011 loss reserves to net premiums written was 174%, which in our view is a prudent cover relative to the business mix.

Reinsurance

Reinsurance utilization is very low at around 5% for 2011, but the exclusively non-proportional program still provides significant protection against large losses. Finland is not a country exposed to major catastrophe risks, but the company has reinsurance protection against catastrophic storms. Reinsurance is placed mostly with reinsurers rated 'A' or higher.

Financial Flexibility: Financial Support Of Pohjola Bank Underpins The Rating

Table 5

Pohjola Non-Life Insurance Co. Ltd. Financial Flexibility					
	--Year-ended Dec. 31--				
(Mil. €)	**2011**	**2010**	**2009**	**2008**	**2007**
EBITDA interest coverage (x)	32.0	27.0	18.7	17.0	22.2
EBITDA fixed-charge coverage (x)	32.0	27.0	18.7	17.0	22.2
Debt leverage including additional pension deficit as debt (%)	0.0	0.0	0.0	0.0	1.1
Financial leverage including additional pension deficit as debt (%)	0.0	0.0	0.0	0.0	1.1

N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

We assess Pohjola's financial flexibility (defined as the ability to source capital relative to capital requirements) as part of Pohjola Bank as very strong. Given the financial strategy of the group to keep capital centrally, we think the group will support Pohjola as and when needed, as demonstrated in 2008 when Pohjola Bank made €115 million of solvency capital available to Pohjola. In the short-to-medium term we don't see any significant needs for extra capital.

Related Criteria And Research

- Group Methodology, April 22, 2009

Ratings Detail (As Of December 13, 2012)	
Operating Company Covered By This Report	
Pohjola Non-Life Insurance Co. Ltd.	
Financial Strength Rating	
Local Currency	AA-/Negative/--
Counterparty Credit Rating	
Local Currency	AA-/Negative/--
Domicile	Finland

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

Additional Contact:
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com