

IF P&C Insurance AS

Annual Report 2010

Annual Report

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Main field of activity:	non-life insurance services (EMTAK 65121)
Beginning of financial year:	1 January 2010
End of financial report:	31 December 2010
CEO:	Andris Morozovs
Auditor:	Ernst & Young Baltic AS

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MANAGEMENT REPORT

ORGANIZATION

P&C Insurance AS (Company) is fully-owned by the leading Nordic P&C insurance group If P&C Insurance Holding Ltd, which in turn is owned by Sampo Plc, a Finnish company listed on the Helsinki Stock Exchange. In addition to the property and casualty insurance operations conducted within *If*, the Sampo Group also conducts life insurance operations.

The company is registered in Estonia and it also operates in Latvia and Lithuania through its branch offices. The current structure further helps to increase operational efficiency and to improve the customer service and claims handling processes in the Baltic area. The company's business functions are pan-Baltic; however, the Sales and Customer Service functions remain country-based in order to adjust to the local clientele needs and practices.

The new Baltic company is managed by the Baltic Management Team (BMT) which includes the members of the board of Directors.

ECONOMIC OUTLOOK

The Baltic region's economy started to improve during the second half of 2010. Estonian gross domestic product (GDP) increased by 5% in the third quarter of 2010; forecast for the year 2010 is 2%. In the third quarter, Latvian GDP increased by 3%, while the Lithuanian economy showed the slowest stabilization with a GDP increase of just 1.1%. Both Latvian and Lithuanian GDP is still expected to fall by 0.5% in annual terms in the year 2010. Recovery has been mostly driven by exports, reviving private consumption as well as continuing increase in industrial output. On the other hand unemployment rate continues to be at very high level and only slow improvement is expected in upcoming years.

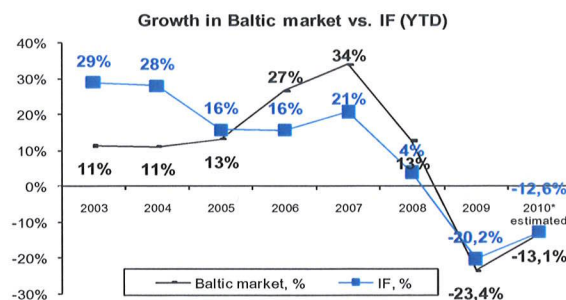
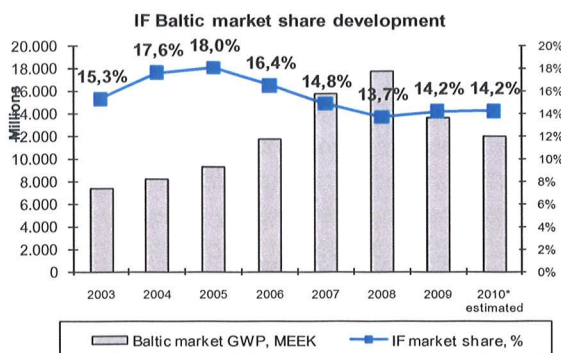
During 2010 inflation in Estonia picked up faster than was expected, at a rate of 3%. This was caused by a global increase in the price of raw materials for food, which in turn affected consumer prices more than anticipated. Increases in inflation figures were also noticed in Lithuania, 1.3%, due mainly to increased prices for housing, water, electricity, gas as well as food products and transport goods and services. In Estonia and Lithuania in 2011 the consumer price index is expected to follow the trends of year 2010. In Latvia furthermore, a deflation rate of -1% was observed in 2010, primarily caused by low private demand – especially for services. Inflation is expected to return early in 2011.

The economic development of the Baltic region's economy in 2011 is likely to be fragile and relatively slow. In Estonia, the economic outlook is expected to become more optimistic as Estonia has introduced Euro as the national currency at the beginning of 2011. Stabilization and a small rate of growth is also expected in Latvia and Lithuania in 2011; however economic development in 2011 and beyond depends on the economic recovery of the major export partners, namely the EU and Russia.

NON-LIFE INSURANCE MARKET

The economic environment has also influenced the development of the insurance market. The Baltic non-life insurance market fell by -13% in 2010 (insurance market information for December is based on the forecast), but some positive signs were noticed during the fourth quarter. The main reason for this negative growth is the decrease in private and corporate income, a contraction in the loan and leasing market, an increase in unemployment and a fall in overall consumption. Strongly affected by this contraction were motor product lines (motor own damage and motor third part liability insurance) as new cars sales in the Baltics were at a very low level during 2010. However it has already reached its lowest point and a small but positive development has been recognized in the markets. Motor fleet in all three countries is getting older and due to tough competition and the very good profitability results for the previous year, a big pressure is put on rates reduction. *If* market share is stable in the

Baltic non-life insurance market (in 2010 14.2%) the non-life insurance market is expected to follow the overall economic development.



OPERATIONS

Despite the unstable economic situation in the Baltic States over recent years, *If* managed to retain a secure and acknowledged position in 2010. As an indicator of this, If P&C Insurance AS received the title of the “Most Competitive Financial Brokerage Enterprise”, awarded by the Republic of Estonia. For the purposes of the award success, performance and competitiveness in the future were assessed. In addition to this financial success, *If* was also recognised as a responsible enterprise by being placed at a noteworthy 9th place in the rankings of responsible enterprises chosen by the Estonian Ministry of Economic Affairs and Communications.

The company’s business activities involve both direct sales of insurance products to corporate and private clients, and sales through brokers and partners. The company has 36 sales and customer service offices all over Estonia, with the largest centres located in Tallinn, Tartu and Pärnu. There are four offices in Latvia and 10 in Lithuania, located in the major towns. The number of customers in the Baltics is approximately 310 000 and this includes both private individuals as well as companies.

Looking to the future, whilst hoping to maintain the reputation of an innovative participant that directs the market, the company will increasingly contribute to the development of e-channels. In Estonia, the company has brought a fully functional e-self service channel for business customers on to the market. As with the Latvia and Lithuania branches, the company expanded the selection of e-channels in 2010 and opened a new Internet-based self-service channel Poliis.ee in Estonia as well. In Latvia and Lithuania, similar channels (*letakpasam.lv* and *drauskpats.lt*) were launched as early as 2009; the company now has the discounted brand for customers in all three countries. Considering the changed consumption habits of customers, *If*, in cooperation with mobile phone supplier EMT, launched the new mobile travel insurance. EMT customers who travel abroad can obtain travel insurance via EMT text messaging services.

In order to ensure customer satisfaction, the company has continuously been contributing to the development of insurance products and introduced a bonus program for regular customers on the market in Estonia. With the deductible bonus the customer can now collect a bonus which will reduce the direct expenses of the customer in cases of an insurance claim. The introduction of this program brought along positive sales figures in Estonia, and projecting to the future has established a unique competitive advantage in the local insurance market.

An important contribution to the strengthening of competitiveness has been made by the implementation of the new compulsory motor third party liability insurance system, which is independent from the Traffic Insurance Found sales program. This gave an advantage to using independent pricing modelling, and also allowed the introduction of new services in the Internet-based e-office, where customers can now purchase a new policy without signing contract in *If*’s office.

As a result of its extensive preparations, the company has successfully implemented the Euro, and unplanned business interruptions have been avoided.

In Latvia, the new sales program for selling private health insurance and commercial customers services were launched. Furthermore the issuing of motor third part liability renewal policies was automated, which allowed us to improve the service level and efficiency of internal processes.

The main direction for development in Lithuania was dedicated to make the claims handling process smoother and to improve the cooperation with mediators. New functionality gives customers quicker resolution of a claim registered either via a partner or via the internet.

During 2010, the company has continuously contributed to loss prevention projects for schools, kindergartens and sports clubs via security funds. With the aim of increasing prominence among various interest groups we began cooperation in sponsoring the Estonian Tennis Association in 2010. The sponsorship of leaders in the particular field of sports sets a good pattern and contributes to a healthier society. In the field of culture, *If* continued investments in the development of the Insurance Museum by improving cooperation with associations and universities. The most important event of the year for the Insurance Museum was the celebration of the 30th anniversary of the museum in December.

RESULTS FROM OPERATIONS

in thousands of Estonian kroons

	<u>2 010</u>	<u>2 009</u>
Premiums written, gross	1 697 185	1 937 681
Premiums earned, net of reinsurance	1 709 964	2 017 918
Claims incurred, net of reinsurance	1 011 348	1 146 292
Total operating expenses	490 474	586 375
Technical result	214 495	292 298
Net profit	253 279	392 213
Combined ratio	87,2%	85,1%
Expense ratio	28,1%	28,3%
Loss ratio	59,1%	56,8%
Financial assets	2 820 693	2 561 802
Return on investments per annum	1%	4%
Balance sheet volume	3 513 688	3 330 530
Owner's equity	1 400 740	1 147 518
Formulas	Total contract conclusion fees and administrative expenses (-) investment expenses (+) reinsurance commissions	
Expense ratio	<hr/> Premiums earned, net of reinsurance	
Loss ratio	<hr/> Claims incurred, net of reinsurance	
Combined ratio	<hr/> Premiums earned, net of reinsurance	
Annual return on investments	Expense ratio + loss ratio	
	<hr/> Return on investments (-) investment expenses	
	Weighted average volume of financial investments in the period	

Results

In 2010, the technical result decreased in comparison to the year before, and ended at Millions EEK 214 (2009: 292 Millions EEK). A fall in the technical result was affected by a decrease in premiums and claims outcomes – a higher outcome of large claims and increased claims frequency.

Premium earned

Gross written premiums decreased Millions EEK 241 to Millions EEK 1,697 (2009: 1,938 Millions EEK). This decrease is in line with the overall market fall, followed by the macroeconomic development. Premium volumes decreased in all three Baltic countries.

Claims and operating expenses

Claims, including claims handling expenses, decreased Millions EEK 135 to Millions EEK 1,011 (2009: 1,146 Millions EEK).

Operating expenses, excluding claims handling expenses, decreased Millions EEK 91 to Millions EEK 490 (2009: 581 Millions EEK). Continuous efforts to create more cost-efficient processes in distribution, customer service and claims handling had a favourable impact on costs development during the year.

Net profit and tax cost

Net profit decreased to 253 Millions EEK (2009: 392 Millions EEK). Of total taxes, current tax costs accounted for 10 Millions EEK (2009: 16 Millions EEK) and the deferred tax income for 9 Millions EEK (2009: 4 Millions EEK)

Financial ratios

The company's expense ratio fell to 28.1% (2009: 28.3 %).

The loss ratio, excluding claims handling expenses, worsened during 2010 and amounted to 59.1% (56.8 %). This worsening in the risk ratio is explained by the higher outcome of large claims and increased claims frequency in motor and property products. Large claims were three times higher than usual in Lithuania. The results for motor products were negatively affected by harsh winter weather at the beginning and end of the year, and the results of property products were negatively affected by complicated weather conditions throughout the year.

Combined ratio increased slightly to 87.2% (85.1 %).

INVESTMENT RESULT

In 2010 If P&C Insurance AS continued to invest conservatively, with the majority of funds invested into Euro term deposits and short-term Western European government bonds. Credit and interest rate risks were held at a moderate level for the portfolio throughout the year. As of 31 December, 2010, the interest rate risk measured by the weighted average modified duration of the fixed income instruments was at 1.3 years. The average weighed credit rating for the holdings in the investment portfolio as of 31 December, 2010 was AA- (using Standard & Poor's scale).

As at the end of December 2010, close to 60% of funds were invested in term deposits, approximately 38% of funds in government bonds and the rest in corporate bonds. Investments into Western European government bonds consisted primarily of bonds from Germany, Finland, the Netherlands and France. The portfolio did not have any exposure to government bonds from Greece, Ireland, Portugal or Spain. There was no open currency exposure in the investment portfolio, that is, all investments were in Euros (99,9%) or EEK-denominated instruments.

If P&C Insurance AS investment portfolio earned a return of 1 % in 2010 (4% in 2009). In general, factors affecting the return of the If P&C Insurance AS investments the most in 2010 were the continually low level of interest rates in the Euro zone and the rise of interest rates in the second half of the year. The latter enabled to achieve only moderate returns from the bond portfolio as rising interest rates are negative for bondholders.

SOLVENCY CAPITAL

Solvency capital increased to 1,354 Millions EEK, compared with Millions EEK 1,113 in 2009.

RISK IN OPERATIONS

Risk comprises an essential part of the company's operations and is managed by using clearly defined strategies and responsibilities, in addition to a strong commitment to risk management processes. The main risks within the insurance operations are underwriting risks and provision risks. Furthermore, market risks (such as changes in interest rates, exchange rates and equity and commodity prices as well as in their volatility) and credit risks affect the market values of financial assets and liabilities.

PERSONNEL

As an employer, If P&C Insurance AS strives to create a work environment and an atmosphere where talented people can and want to grow. We know that we owe our current and future success largely to the quality and high ambition level of our staff. Consequently, personnel issues such as performance, competence and leadership development, compensation and health management are the focus areas within the company.

On December the 31, 2010 the number of full time employees in the company was 534 (2009: 560), two-thirds of them women and one-third men. The company's personnel expenses totalled 233 Millions EEK in 2010, having decreased by 12 % in a year (2009: 264 Millions EEK).

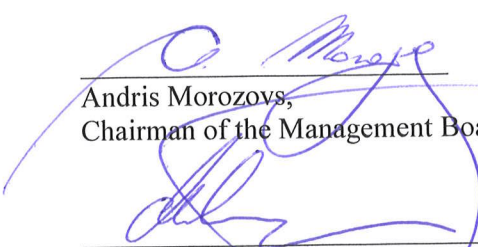
Over the last few years, a constant theme in the company has been the strengthening of the competence of our employees and the increasing of employee engagement and commitment. To accelerate this work even more during 2010 a strategic theme known as "skills and initiatives" was launched. The aim of the initiative is to forcefully influence the culture of the company to generate even more focus on competence building, innovation and customer focus, the pillars of our value creation.

Special variable compensation programmes have been created in the company to provide motivating and engaging reward systems that drive individual performance in line with If's overall goals and as a result increase commitment to and interest in If's overall result. In addition to the aforementioned, several benefits which support healthy life style, important family events and education are also made available to employees.

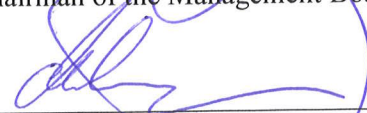
APPLIED ACCOUNTING PRINCIPLES

2010 Annual Accounts of the Company have been prepared in accordance with the International Financial Reporting Standards (IFRS) adopted by the EU.


The financial statements include the accounts of the Company with its branches and the subsidiary AS If Kinnisvarahaldus.



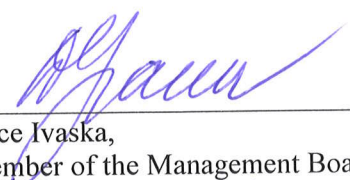
Andris Morozovs,
Chairman of the Management Board



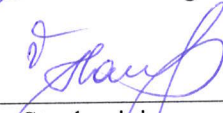
Mihkel Uibopuu,
Member of the Management Board



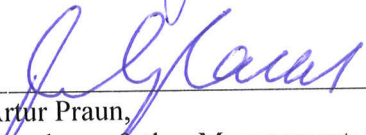
Heinar Olak,
Member of the Management Board



Dace Ivaska,
Member of the Management Board



Žaneta Stankevičiene,
Member of the Management Board



Artur Praun,
Member of the Management Board