

OP Mortgage Bank: Interim Report 1 January–30 September 2019

OP Mortgage Bank (OP MB) is part of OP Financial Group and its role is to raise, together with OP Corporate Bank plc, funding for OP from money and capital markets. OP MB is responsible for the Group's funding for the part of covered bond issuance.

Financial standing

The intermediary loans and loan portfolio of OP MB totalled EUR 13,724 million (13,771)* on 30 September 2019. OP MB issued a 1.25 billion-euro fixed-rate covered bond with a maturity of 10 years in international capital markets in February. Out of the proceeds of the bond, one billion euros were intermediated to OP cooperative banks in the form of intermediate loans. On 30 September 2019, 121 OP cooperative banks had a total of EUR 7,776 million (6,776) in intermediate loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Earnings before tax for January–September amounted to EUR 11.8 million (12.1).

*The comparatives for 2018 are given in brackets. For income statement and other aggregated figures, January–September 2018 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2018) serve as comparatives.

Collateralisation of bonds issued to the public

On 30 September 2019, loans as collateral in security of the covered bonds issued under the Euro Medium Term Covered Note programme worth EUR 20 billion established on 12 November 2010 under the Covered Bond Act (Laki kiinnityspankkitoiminnasta (688/2010)) totalled EUR 13,804 million.

Capital adequacy

OP MB's Common Equity Tier 1 (CET1) ratio stood at 65.8% (136.4) on 30 September 2019. The CET1 ratio decreased due to the ECB's decision on covered retail exposures which practically doubled the average risk weights on mortgages. The minimum CET1 capital requirement is 4.5% and the requirement for the capital conservation buffer is 2.5%, i.e. the total CET1 capital requirement is 7%. The minimum total capital requirement is 8% and 10.5% with increased capital conservation buffer. Earnings for the financial year were not included in CET1 capital.

OP MB uses the Internal Ratings Based Approach (IRBA) to measure its capital adequacy requirement for credit risk. OP MB uses the Standardised Approach to measure its capital adequacy for operational risk.

Joint and several liability of amalgamation

Under the Act on the Amalgamation of Deposit Banks, the amalgamation of the cooperative banks comprises the organisation's central cooperative (OP Cooperative), the central cooperative's member credit institutions and the companies belonging to their consolidation groups as well as credit and financial institutions and service companies in which the above together hold more than half of the total votes. This amalgamation is supervised on a consolidated basis. On 30 September 2019, OP Cooperative's member credit institutions comprised 149 OP cooperative banks as well as OP Corporate Bank plc, OP MB, OP Card Company Plc and OP Customer Services Ltd (formerly OP Process Services Ltd).

The central cooperative is responsible for issuing instructions to its member credit institutions concerning their internal control and risk management, their procedures for securing liquidity and capital adequacy as well as for compliance with harmonised accounting policies in the preparation of the amalgamation's consolidated financial statements.

As a support measure referred to in the Act on the Amalgamation of Deposit Banks, the central cooperative is liable to pay any of its member credit institutions an amount that is necessary to prevent the credit institution from being placed in liquidation. The central cooperative is also liable for the debts of a member credit institution which cannot be paid using the member credit institution's assets.

Each member bank is liable to pay a proportion of the amount which the central cooperative has paid to either another member bank as part of support action or to a creditor of such member bank in payment of an amount overdue which the creditor has not received from the member bank. Furthermore, in the case of the central cooperative's default, a member bank has unlimited refinancing liability for the central cooperative's debts as referred to in the Co-operatives Act.

Each member bank's liability for the amount the central cooperative has paid to the creditor on behalf of a member bank is divided between the member banks in proportion to their last adopted balance sheets. OP Financial Group's insurance companies do not fall within the scope of joint and several liability.

According to section 25 of the Covered Bond Act, the holder of a covered bond has the right to receive a payment for the entire term of the bond from the assets entered as collateral before receivables without this being prevented by OP MB's liquidation or bankruptcy.

Personnel

On 30 September 2019, OP MB had six employees. OP MB has been digitising its operations and purchases all the most important support services from OP Cooperative and its Group members, reducing the need for its own personnel.

Management

The Board composition is as follows:

Chair	Vesa Aho	Chief Financial Officer, OP Cooperative
Members	Kaisu Christie	Director, Mortgages and Housing-related Services, OP Cooperative
	Lauri Iloniemi	Head of Treasury and Asset and Liability Management, OP Corporate Bank plc

OP MB's Managing Director was Lauri Iloniemi until 31 May 2019. On 1 June 2019, Sanna Eriksson became OP MB's Managing Director.

The deputy Managing Director was Sanna Eriksson until 31 May 2019. As of 1 June 2019, the deputy Managing Director is Pekka Moisio, Head of Funding and Liquidity Management.

Board member Hanno Hirvinen resigned from the Board of Directors of OP Mortgage Bank on 31 May 2019.

To replace Hirvinen on the Board, Lauri Iloniemi, Head of Treasury and Asset and Liability Management was appointed Board member on 1 June 2019.

The Annual General Meeting of 19 March 2019 re-elected KPMG Oy Ab, an audit firm, to act as the auditor for the financial year 2019, with Tiia Kataja, APA, acting as the chief auditor, appointed by KPMG Oy Ab.

Risk exposure

The most typical types of risks related to OP MB are credit risk, structural funding risk, liquidity risk and interest rate risk. The key credit risk indicators in use show that OP MB's credit risk exposure is stable and the limit for liquidity risk set by the Board of Directors has not been exceeded. The liquidity buffer for OP Financial Group, managed by OP Corporate Bank, is exploitable by OP MB. OP MB has used interest rate swaps to hedge against its interest rate risk. Interest rate swaps

have been used to swap housing loan interest, intermediary loan interest and interest on issued bonds into the same basis rate. OP MB has concluded all derivative contracts for hedging purposes, with OP Corporate Bank plc being their counterparty. The interest rate risk of OP MB may be considered low and it has been within the set limit.

Outlook

It is expected that OP MB's capital adequacy will still remain extremely strong and the overall quality of the loan portfolio good. This will make it possible to issue new covered bonds in the future as well.

Accounting policies

The Interim Report 1 January–30 September 2019 has been prepared in accordance with IAS 34 (Interim Financial Reporting).

This Interim Report is based on unaudited figures. Given that all figures have been rounded off, the sum total of individual figures may deviate from the presented sums.

The Interim Report is available in Finnish and English. The Finnish version is official and will be used if there is any discrepancy between the language versions.

OP MB's related parties include the parent company OP Cooperative and its subsidiaries, the OP Financial Group pension insurance companies OP Bank Group Pension Fund and OP Bank Group Pension Foundation, and the company's administrative personnel. Standard loan terms and conditions are applied to loans granted to the related parties. Loans are tied to generally used reference interest rates. The reporting period saw no major changes in related-party transactions.

New standards and interpretations

IFRS 16 Leases adoption on 1 January 2019

OP MB adopted IFRS 16 Leases from 1 January 2019. The new standard changed the lessor's accounting and affected accounting for operating leases. As a result, all the lessor's leases were recognised in the balance sheet since operating leases and finance leases will no longer be separated from each other. OP MB applied a retrospective approach in the transition to a limited extent, which is why it did not restate comparatives for 2018. The adoption of the standard did not have any major effect on OP MB's balance sheet total.

Formulas for Alternative Performance Measures

The Alternative Performance Measures are presented to illustrate the financial performance of business operations and to improve comparability between reporting periods.

The formulas for the used Alternative Performance Measures are presented below.

Return on equity (ROE), % = Annualised profit for the period / Equity capital (average equity capital at the beginning and end of the period) × 100

Cost/income ratio, % = (Personnel costs + Depreciation/amortisation and impairment loss + Other operating expenses) / (Net interest income + Net commission and fees + Net investment income + Other operating income) × 100

Income statement, TEUR	Q1-3/2019	Q1-3/2018	Q3/2019	Q3/2018	Q1-4/2018
Net interest income	47,248	54,615	15,169	18,276	71,893
Interest income	28,593	41,088	8,234	12,575	52,587
Interest expenses	-18,656	-13,527	-6,935	-5,701	-19,306
Net commissions and fees	-30,854	-37,876	-9,954	-11,953	-49,193
Net investment income	1	1	0	0	1
Other operating income	0	2	0	0	3
Total income	16,395	16,742	5,215	6,323	22,704
Personnel costs	282	260	113	76	191
Depreciation/amortisation and impairment loss	123	627	18	209	783
Other operating expenses	4,226	3,791	1,726	1,410	5,099
Total expenses	4,631	4,678	1,857	1,695	6,073
Impairment loss on receivables	42	35	97	-133	-382
Earnings before tax	11,806	12,098	3,456	4,494	16,248
Income tax expense	2,361	2,419	691	899	3,249
Profit for the period	9,445	9,679	2,765	3,596	12,999

Statement of comprehensive income, TEUR	Q1-3/2019	Q1-3/2018	Q3/2019	Q3/2018	Q1-4/2018
Profit for the period	9,445	9,679	2,765	3,596	12,999
Items that will not be reclassified to profit or loss					
Gains/(losses) arising from remeasurement of defined benefit plans					60
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans					-12
Total comprehensive income	9,445	9,679	2,765	3,596	13,047

Key ratios	Q1-3/2019	Q1-3/2018	Q3/2019	Q3/2018	Q1-4/2018
Return on equity (ROE), %	3.3	3.4	3.0	3.9	3.4
Cost/income ratio, %	28	28	36	27	27

Cash flow from operating activities, TEUR	Q1-3/2019	Q1-3/2018
Profit for the financial year	9,445	9,679
Adjustments to profit for the financial year	8,987	9,017
Increase (-) or decrease (+) in operating assets	55,286	420,199
Receivables from credit institutions	-1,000,000	-1,000,000
Receivables from the public and public-sector entities	1,054,921	1,403,677
Other assets	365	16,523
Increase (+) or decrease (-) in operating liabilities	27,479	-711,595
Liabilities to credit institutions and central banks	20,000	-692,000
Other liabilities	7,479	-19,595
Income tax paid	-2,899	-1,950
Dividends received	1	1
A. Net cash from operating activities	98,299	-274,648
Cash flow from investing activities		
Purchase of PPE and intangible assets	0	0
B. Net cash used in investing activities	0	0
Cash flow from financing activities		
Increases in debt securities issued to the public	1,233,863	995,413
Decreases in debt securities issued to the public	-1,000,000	-1,000,000
Dividends paid and interest on cooperative capital	-12,998	-15,472
C. Net cash used in financing activities	220,864	-20,060
D. Effect of foreign exchange rate changes on cash and cash equivalents	0	0
Net change in cash and cash equivalents (A+B+C+D)	319,163	-294,708
Cash and cash equivalents at year-start	133,460	363,609
Cash and cash equivalents at year-end	452,747	69,527
Change in cash and cash equivalents	319,286	-294,081
Interest received	28,435	56,436
Interest paid	-26,642	4,339
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	-39	-34
Price difference recognised on debt securities issued to the public	6,666	6,633
Other	2,360	2,418
Total adjustments	8,987	9,017
Cash and cash equivalents		
Receivables from credit institutions payable on demand	452,747	69,527
Total cash and cash equivalents	452,747	69,527

Balance sheet, TEUR	30 Sep. 2019	30 Sep. 2018	31 Dec. 2018
Receivables from credit institutions	8,228,916	5,845,696	6,909,630
Derivative contracts	436,776	94,713	139,668
Receivables from customers	5,947,913	7,401,537	6,994,873
Investments assets	40	40	40
Intangible assets	0	277	120
Other assets	32,160	32,863	32,525
Tax assets	538	213	0
Total assets	14,646,343	13,375,340	14,076,856
Liabilities to credit institutions	2,916,000	2,146,000	2,896,000
Derivative contracts	16,770	35,832	8,597
Debt securities issued to the public	11,280,226	10,766,493	10,742,840
Provisions and other liabilities	59,107	52,664	51,625
Tax liabilities	74	0	74
Total liabilities	14,272,176	13,000,988	13,699,135
Shareholders' equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	69,167	69,352	72,720
Total equity	374,167	374,352	377,720
Total liabilities and shareholders' equity	14,646,343	13,375,340	14,076,856

Off-balance-sheet commitments, TEUR	30 Sep. 2019	30 Sep. 2018	31 Dec. 2018
Irrevocable commitments given on behalf of customers	2	2	2

Statement of changes in equity, TEUR	Share capital	Other reserves	Retained earnings	Total equity
Shareholders' equity 1 Jan. 2018	60,000	245,000	75,147	380,147
Reserve for invested unrestricted equity				
Profit for the period			9,679	9,679
Other comprehensive income for the period				
Other changes			-15,474	-15,474
Shareholders' equity 30 Sep. 2018	60,000	245,000	69,352	374,352
Shareholders' equity 1 Jan. 2019	60,000	245,000	72,720	377,720
Reserve for invested unrestricted equity				
Profit for the period			9,445	9,445
Other comprehensive income for the period				
Other changes			-12,998	-12,998
Shareholders' equity 30 Sep. 2019	60,000	245,000	69,167	374,167

OP MB has presented its capital base and capital adequacy in accordance with the EU capital requirement regulation and directive (EU 575/2013).

Capital base and capital adequacy, TEUR	30 Sep. 2019	31 Dec. 2018
Shareholders' equity	374,167	377,720
Common Equity Tier 1 (CET1) before deductions	374,167	377,720
Intangible assets	0	-120
Excess funding of pension liability	-66	-66
Share of unaudited profits	-9,445	-12,999
Shortfall of ECL minus expected losses	-6,007	-1,962
Common Equity Tier 1 (CET1)	358,649	362,573
Tier 1 capital (T1)	358,649	362,573
Excess of ECL minus expected losses	0	38
Tier 2 Capital (T2)	0	38
Total capital base	358,649	362,611
Total risk exposure amount		
Credit and counterparty risk	506,500	223,980
Operational risk	38,237	41,893
Total	544,737	265,873
Key ratios, %		
CET1 capital ratio	65.8	136.4
Tier 1 capital ratio	65.8	136.4
Capital adequacy ratio	65.8	136.4
Capital requirement		
Capital base	358,649	362,611
Capital requirement	57,215	27,924
Buffer for capital requirements	301,434	334,687

Net commissions and fees, TEUR	Q1-3/2019	Q1-3/2018	Q3/2019	Q3/2018	Q1-4/2018
Commission income					
Lending	3,733	4,561	1,241	1,454	5,972
Total	3,733	4,561	1,241	1,454	5,972
Commission expenses					
From lending to OP cooperative banks	3,593	4,430	1,191	1,407	5,783
Loan management fee to OP cooperative banks	30,789	37,959	9,896	11,989	49,297
Issue of bonds	201	38	106	8	72
Other	4	10	1	3	13
Total	34,587	42,437	11,195	13,407	55,165
Net commissions and fees	-30,854	-37,876	-9,954	-11,953	-49,193

Classification of financial assets and liabilities 30 Sep. 2019, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	8,228,916			8,228,916
Derivative contracts		436,776		436,776
Receivables from customers	5,947,913			5,947,913
Shares and participations			40	40
Other receivables	32,160			32,160
Other assets	538			538
Total	14,209,528	436,776	40	14,646,343
Financial liabilities		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities to credit institutions			2,916,000	2,916,000
Derivative contracts		16,770		16,770
Debt securities issued to the public			11,280,226	11,280,226
Other liabilities			59,180	59,180
Total		16,770	14,255,406	14,272,176
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 Sep. 2019			474,812	474,812

Classification of financial assets and liabilities 31 Dec. 2018, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	6,909,630			6,909,630
Derivative contracts		139,668		139,668
Receivables from customers	6,994,873			6,994,873
Shares and participations			40	40
Other receivables	32,525			32,525
Other assets	120			120
Total	13,937,148	139,668	40	14,076,856
Financial liabilities		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities to credit institutions			2,896,000	2,896,000
Derivative contracts		8,597		8,597
Debt securities issued to the public			10,742,840	10,742,840
Other liabilities			51,698	51,698
Total		8,597	13,690,539	13,699,135
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec. 2018			140,345	140,345

Debt securities issued to the public are carried at amortised cost. The fair value of these debt instruments has been measured using information available in markets and employing commonly used valuation techniques. The difference between the fair value and carrying amount is presented as valuation difference in the Classification of financial assets and liabilities table.

Derivative contracts 30 Sep. 2019, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	671,249	8,662,850	7,227,772	16,561,871
Total	671,249	8,662,850	7,227,772	16,561,871

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	436,776	16,770	625,691
Total	436,776	16,770	625,691

Derivative contracts 31 Dec. 2018, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,450,856	8,092,527	6,849,439	17,392,822
Total	2,450,856	8,092,527	6,849,439	17,392,822

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	139,668	8,597	319,910
Total	139,668	8,597	319,910

Financial instruments classification, grouped by valuation technique, TEUR			
30 Sep. 2019	Fair value measurement at year end		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	436,776		436,776
Total	436,776		436,776
Recurring fair value measurements of liabilities			
Derivate contracts	16,770		16,770
Total	16,770		16,770
Financial liabilities not measured at fair value			
Debt securities issued to the public	11,280,226	11,595,248	159,789
Total	11,280,226	11,595,248	159,789

31 Dec. 2018	Fair value measurement at year end		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	139,668		139,668
Total	139,668		139,668
Recurring fair value measurements of liabilities			
Derivate contracts	8,597		8,597
Total	8,597		8,597
Financial liabilities not measured at fair value			
Debt securities issued to the public	10,742,840	10,738,905	144,280
Total	10,742,840	10,738,905	144,280

OP MB does not hold any transfers between the levels of fair value valuation.

Time of publication of 2019 reports

Report by the Board of Directors and Financial Statements 2019	week 9
Corporate Governance Statement 2019	week 9

Schedule for Financial Statements Bulletin 2019 and Interim Reports in 2020

Financial Statements Bulletin FY/2019	4 February 2020
Interim Report Q1/2020	28 April 2020
Half-year Financial Report H1/2020	21 July 2020
Interim Report Q1–3/2020	22 October 2020

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OP Mortgage Bank
Board of Directors

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