OP MORTGAGE BANK
Stock exchange release 1 November 2017
Interim Report

OP Mortgage Bank: Interim Report for January–September 2017

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 the Group from money and capital markets. OP MB is responsible for the Group's funding for the part of covered bond issuance.

Financial standing

The intermediate loans and loan portfolio of OP MB increased to EUR 11,913 million (10,892)* during the reporting period. OP MB issued one fixed-rate covered bond with a maturity of seven years in international capital markets in March and another with a maturity of ten years in June. OP MB intermediated the bonds with a nominal value of EUR 1,000 million in intermediate loans in their entirety to OP cooperative banks. On 30 September, OP cooperative banks had a total of EUR 3,863 million (1,853) in intermediate loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Operating profit for January–September amounted to EUR 13.2 (16.0) million.

*The comparatives for 2016 are given in brackets. For income statement and other aggregated figures, January–September 2016 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2016) serve as comparatives.

Collateralisation of bonds issued to the public

On 30 September 2017, loans as collateral in security of the covered bonds issued under the Euro Medium Term Covered Note programme worth EUR 15 billion established on 12 November 2010 under the Laki kiinnityspankkitoiminnasta (688/2010) (Covered Bond Act) totalled EUR 11,488 million.

Capital adequacy

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

The Common Equity Tier 1 (CET1) ratio stood at 114.6 % (109.5) on 30 September 2017. The 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 capital conservation buffer. Earnings for the financial year were not included in CET1 capital.

OP MB's highest minimum capital requirement is determined by the Basel I floor. OP MB's capital base exceeded the Basel I floor by EUR 50 million in September. Information on the Basel I floor and capital surplus can be found in note "Capital base and capital adequacy". The Basel I floor will not apply as of the beginning of 2018.

The Financial Supervisory Authority has decided to set a 15% minimum risk weight on housing loans from the beginning of 2018 for at least two years. According to the Authority, this floor is aimed at preparing for a systemic risk related to household indebtedness. Contrary to the previous information, the minimum risk weight floor does not apply to OP MB but applies only to OP Financial Group level.

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 2017, OP Cooperative's members comprised 167 member 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 other receivables without this being prevented by OP MB's liquidation or bankruptcy.

Personnel

On 30 September 2017, OP MB had five employees. OP MB purchases all the most important support services from OP Cooperative and its Group members, reducing the need for its own personnel.

Administration

The Board composition is as follows:

Chairman	Harri Luhtala	Chief Financial Officer, OP Cooperative
Members	Elina Ronkanen-Minogue	Head of Asset and Liability Management and Group Treasury, OP Cooperative
	Hanno Hirvinen	Group Treasurer, OP Corporate Bank plc

OP MB's Managing Director is Lauri Iloniemi and Hanno Hirvinen is his deputy.

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 plc, 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, intermediate loan interest and interest on issued bonds into the same basis rate. OP MB has entered into all derivative contracts for hedging purposes, with OP Corporate Bank plc being their counterparty. The interest rate risk of OP MB may be considered to be low.

Outlook

It is expected that the OP MB's capital adequacy will remain strong, risk exposure favourable and the overall quality of the loan portfolio good. This will make it possible to issue new covered bonds in the fourth quarter too.

Accounting policies

The Interim Report for 1 January–30 September 2017 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 that 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 9 Financial Instruments:

OP MB will apply IFRS 9 as of 1 January 2018. The comparatives will not be restated.

The quantitative effect of the application of the standard on the 2018 financial statements cannot yet be assessed reliably since it will depend on the amount of the financial instruments held at that time, the financial position at that time and the choice of the calculation principles and management judgement. The new standard requires OP MB to examine the calculation and monitoring processes for financial instruments. The changes to be made in them are not yet completed. OP MB has updated the effects of the IFRS 9 transition presented in the financial statements for 2016, as follows:

Classification and measurement

The changes in the classification of OP MB’s financial instruments will be small and will have no significant effect on OP MB’s CET1 ratio.

Impairment

The expected credit losses are calculated on all balance sheet items amortised at cost and those recognised at fair value through other comprehensive income (FVOCI) and on off-balance-sheet loan commitments and guarantee agreements.

OP MB’s credit risk models and the development of related systems are not yet finalised. The expected credit losses are calculated using modelled risk parameters and formula PDxLGDxEAD for the majority of the portfolios. The expected credit losses are calculated for each contract for 12 months or lifetime, depending on whether the instrument’s credit risk on the reporting day has increased significantly since initial recognition. OP MB assesses any significant increase in credit risk through both qualitative and quantitative criteria. Qualitative factors consist of various credit risk indicators (e.g. forbearance measures) to be mainly taken into account in credit rating models. Credit ratings will affect lifetime PDs which are used for quantitative assessment of a significant increase in credit risk. In addition, credit risk has increased significantly if payment is over 30 days past due. Contratcts are classified into three stages. Stage 1 class includes contracts whose credit risk has not increased significantly from the original level and for which a 12-month expected loss is calculated. Stage 2 includes contracts whose credit risk has increased significantly from the original level and for which a lifetime expected loss is calculated. Stage 3 includes defaulted contracts for which a lifetime expected loss is also calculated. In the assessment of a significant increase in credit risk, OP MB does not apply a transitional provision permitted by IFRS 9 to contracts for which it is not possible, without undue cost or effort, to calculate the original lifetime PDs. In the definition of default, OP MB uses a uniform definition in capital adequacy measurement.

OP MB will include forward-looking information and macroeconomic scenarios in the model. The macroeconomic scenarios are the same that OP MB uses otherwise in its financial annual planning. Three scenarios will be used: baseline, upside and downside.

Expected credit loss provisions under IFRS 9 are assessed to increase slightly from its current level based on IAS 39 and it varies by portfolio. The provisions will reduce equity capital on the date of transition. Based on preliminary assessments, the increase in expected credit loss provisions is not expected to have any significant effect on OP MB's CET1 ratio on the date of transition because the IFRS 9 compliant expected credit loss provisions are not expected to exceed the expected loss calculated in capital adequacy and the effect of used floors. The European Commission's proposal under preparation to amend the calculation of the CET1 ratio by gradually phasing in the effects of impairment loss measurement under IFRS 9 during five years will, if implemented, also reduce the effects on capital adequacy.

Hedge accounting

For portfolio hedges, OP MB will continue to apply hedge accounting under IAS 39. OP MB has not yet made the decision to adopt IFRS 9 compliant hedge accounting.

IFRS 15 Revenue from Contracts with Customers

OP MB will apply IFRS 15 as of 1 January 2018. This standard will replace the current IAS 11 and IAS 18. In OP MB, IFRS 15 mainly applies to fees not included in the calculation of the effective interest rate. The new standard will have no effect of the revenue recognition of financial instruments. IFRS 15 will lead to added information presented in the notes to the financial statements. IFRS 15 will not change the revenue recognition time of the fees included the scope of application of the standard in comparison with the current practices. Thus, the adoption of IFRS 15 will not have any significant effect on OP MB's financial result. OP MB will apply IFRS 15 using the retrospective transition method.

Formulas for Alternative Performance Measures

The Alternative Performance Measures Guidelines issued by the European Securities and Markets Authority (ESMA) came into force on 3 July 2016. The Alternative Performance Measures are presented to illustrate the financial performance of business operations and to improve comparability between reporting periods. They should not be considered to be replacements for the performance measures defined in IFRS governing financial reporting.

The formulas for the used Alternative Performance Measures are presented below and they correspond to the previously presented performance indicators in terms of content.

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–Q3/2017	Q1–Q3/2016	Q3/2017	Q3/2016	Q1–Q4/2016
Net interest income	54,735	56,601	18,477	18,562	76,171
Interest income	49,407	65,439	15,207	19,541	84,978
Interest expenses	-5,328	8,838	-3,270	979	8,807
Net comissions and fees	-37,080	-36,110	-12,189	-11,934	-47,757
Net investment income	1	2	0	0	7
Other operating income	1	22		21	22
Total income	**17,656**	**20,514**	**6,288**	**6,649**	**28,443**
Personnel costs	241	243	72	72	321
Depreciation/amortisation and impairment loss	627	627	209	209	836
Other operating expenses	3,352	3,442	1,222	1,331	4,243
Total expenses	**4,221**	**4,313**	**1,503**	**1,613**	**5,400**
Impairment loss on receivables	-239	-179	-107	-21	-400
Earnings before tax	**13,197**	**16,023**	**4,678**	**5,015**	**22,643**
Income tax expense	2,639	3,243	936	1,003	4,566
Profit for the period	**10,558**	**12,780**	**3,742**	**4,012**	**18,077**

Statement of comprehensive income, TEUR	Q1–Q3/2017	Q1–Q3/2016	Q3/2017	Q3/2016	Q1–Q4/2016
Profit for the period	10,558	12,780	3,742	4,012	18,077
Items that will not be reclassified to profit or loss					
Gains/(losses) arising from remeasurement of defined benefit plans					-138
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans					28
Total comprehensive income	**10,558**	**12,780**	**3,742**	**4,012**	**17,967**

Key ratios	Q1–Q3/2017	Q1–Q3/2016	Q3/2017	Q3/2016	Q1–Q4/2016
Return on equity (ROE), %	3.8	4.6	5.3	4.4	4.8
Cost/income ratio, %	24	21	24	24	19

Cash flow from operating activities, TEUR	**Q1–Q3/2017**	**Q1–Q3/2016**
Profit for the financial year	10,558	12,780
Adjustments to profit for the financial year	9,011	2,656
Increase (-) or decrease (+) in operating assets	**-1,005,353**	**-90,568**
Receivables from credit institutions	-2,010,000	-1,119,400
Receivables from the public and public-sector entities	989,451	994,722
Other assets	15,196	34,110
Increase (+) or decrease (-) in operating liabilities	**74,875**	**-126,183**
Liabilities to credit institutions and central banks	90,000	-87,000
Other liabilities	-15,125	-39,183
Income tax paid	-3,032	-4,745
Dividends received	1	2
A. Net cash from operating activities	**-913,939**	**-201,315**
Cash flow from investing activities		
Purchase of PPE and intangible assets		
B. Net cash used in investing activities		
Cash flow from financing activities		
Increases in debt securities issued to the public	1,986,645	245,303
Decreases in debt securities issued to the public	-1,350,000	
Dividends paid and interest on cooperative capital	-9,038	-16,282
C. Net cash used in financing activities	**627,608**	**229,021**
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)	**-286,332**	**27,705**
Cash and cash equivalents at year-start	**451,787**	**245,120**
Cash and cash equivalents at year-end	**166,082**	**273,453**
Change in cash and cash equivalents	**-285,705**	**28,332**
Interest received	65,156	99,282
Interest paid	9,919	47,808
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	239	181
Other	8,771	2,474
Total adjustments	**9,011**	**2,656**
Cash and cash equivalents		
Receivables from credit institutions payable on demand	166,082	273,453
Total cash and cash equivalents	**166,082**	**273,453**

Balance sheet, TEUR	30 Sep. 2017	30 Sep. 2016	31 Dec. 2016
Receivables from credit institutions	4,028,851	2,136,222	2,304,556
Derivative contracts	148,566	322,942	220,461
Receivables from customers	8,050,192	8,614,076	9,039,563
Investments assets	40	40	40
Intangible assets	1,113	1,948	1,739
Other assets	41,016	44,713	56,212
Tax assets	852	196	460
Total assets	**12,270,630**	**11,120,137**	**11,623,031**
Liabilities to credit institutions	1,978,000	1,288,000	1,888,000
Derivative contracts	32,915	5,094	6,233
Debt securities issued to the public	9,822,322	9,389,287	9,277,801
Provisions and other liabilities	62,250	69,301	77,375
Tax liabilities		19	
Total liabilities	**11,895,488**	**10,751,702**	**11,249,409**
Shareholders’ equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	70,142	63,435	68,622
Total equity	375,142	368,435	373,622
Total liabilities and shareholders’ equity	**12,270,630**	**11,120,137**	**11,623,031**

Off-balance-sheet commitments, TEUR	30 Sep. 2017	30 Sep. 2016	31 Dec. 2016
Irrevocable commitments given on behalf of customers	3	19	8

Statement of changes in equity, TEUR	Share capital	Other reserves	Retained earnings	Total equity
Shareholders’ equity 1 Jan. 2016	**60,000**	**245,000**	**66,937**	**371,937**
Reserve for invested unrestricted equity				
Profit for the period			12,780	12,780
Total comprehensive income				
Other changes			-16,282	-16,282
Shareholders’ equity 30 Sep. 2016	**60,000**	**245,000**	**63,435**	**368,435**
Shareholders’ equity 1 Jan. 2017	**60,000**	**245,000**	**68,622**	**373,622**
Reserve for invested unrestricted equity				
Profit for the period			10,558	10,558
Total comprehensive income				
Other changes			-9,038	-9,038
Shareholders’ equity 30 Sep. 2017	**60,000**	**245,000**	**70,142**	**375,142**

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. 2017**	**31 Dec. 2016**
Shareholders' equity	375,142	373,622
Common Equity Tier 1 (CET1) before deductions	**375,142**	**373,622**
Intangible assets	-1,113	-1,739
Excess funding of pension liability	-68	-67
Share of unaudited profits	-10,558	-18,077
Impairment loss – shortfall of expected losses	-2,754	-2,612
Common Equity Tier 1 (CET1)	**360,650**	**351,126**
Tier 1 capital (T1)	**360,650**	**351,126**
Total capital base	**360,650**	**351,126**
Total risk exposure amount		
Credit and counterparty risk	274,056	286,845
Operational risk	40,554	33,898
Total	**314,609**	**320,743**
Key ratios, %		
CET1 capital ratio	114.6	109.5
Tier 1 capital ratio	114.6	109.5
Capital adequacy ratio	114.6	109.5
Basel I floor		
Capital base	360,650	351,126
Basel I capital requirements floor	310,642	322,006
Capital buffer for Basel I floor	50,008	29,120

Classification of financial assets and liabilities 30 Sep. 2017, TEUR				
Financial assets	**Loans and other receivables**	**Recognised at fair value through profit or loss**	**Available for sale**	**Total**
Receivables from credit institutions	4,028,851			4,028,851
Derivative contracts		148,566		148,566
Receivables from customers	8,050,192			8,050,192
Shares and participations			40	40
Other receivables	41,016			41,016
Other assets	1,965			1,965
Total	**12,122,024**	**148,566**	**40**	**12,270,630**
Financial liabilities		**Recognised at fair value through profit or loss**	**Other liabilities**	**Total**
Liabilities to credit institutions			1,978,000	1,978,000
Derivative contracts		32,915		32,915
Debt securities issued to the public			9,822,322	9,822,322
Other liabilities			62,250	62,250
Total		**32,915**	**11,862,573**	**11,895,488**
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 Sep. 2017			171,700	**171,700**

Classification of financial assets and liabilities 31 Dec. 2016, TEUR				
Financial assets	**Loans and other receivables**	**Recognised at fair value through profit or loss**	**Available for sale**	**Total**
Receivables from credit institutions	2,304,556			2,304,556
Derivative contracts		220,461		220,461
Receivables from customers	9,039,563			9,039,563
Shares and participations			40	40
Other receivables	56,212			56,212
Other assets	2,199			2,199
Total	**11,402,530**	**220,461**	**40**	**11,623,031**
Financial liabilities		**Recognised at fair value through profit or loss**	**Other liabilities**	**Total**
Liabilities to credit institutions			1,888,000	1,888,000
Derivative contracts		6,233		6,233
Debt securities issued to the public			9,277,801	9,277,801
Other liabilities			77,375	77,375
Total		**6,233**	**11,243,176**	**11,249,409**
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec. 2016			277,485	**277,485**

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" note.

Derivative contracts 30 Sep. 2017, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,503,604	7,924,977	6,882,445	17,311,026
Total	**2,503,604**	**7,924,977**	**6,882,445**	**17,311,026**

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	148,566	32,915	325,289
Total	**148,566**	**32,915**	**325,289**

Derivative contracts 31 Dec. 2016, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,759,875	8,216,977	6,838,247	17,815,099
Total	**2,759,875**	**8,216,977**	**6,838,247**	**17,815,099**

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	220,461	6,233	414,976
Total	**220,461**	**6,233**	**414,976**

Financial instruments classification, grouped by valuation technique, TEUR			
30 Sep. 2017	**Fair value measurement at year end**		
	Balance sheet value	**Level 1**	**Level 2**
Recurring fair value measurements of assets			
Derivate contracts	148,566		148,566
Total	**148,566**		**148,566**
Recurring fair value measurements of liabilities			
Derivate contracts	32,915		32,915
Total	**32,915**		**32,915**
Financial liabilities not measured at fair value			
Debt securities issued to the public	9,822,322	9,749,832	244,190
Total	**9,822,322**	**9,749,832**	**244,190**
31 Dec. 2016	**Fair value measurement at year end**		
	Balance sheet value	**Level 1**	**Level 2**
Recurring fair value measurements of assets			
Derivate contracts	220,461		220,461
Total	**220,461**		**220,461**
Recurring fair value measurements of liabilities			
Derivate contracts	6,233		6,233
Total	**6,233**		**6,233**
Financial liabilities not measured at fair value			
Debt securities issued to the public	9,277,801	9,189,185	366,101
Total	**9,277,801**	**9,189,185**	**366,101**

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

Financial reporting 2018

Schedule for Financial Statements Bulletin for 2017 and Interim Reports in 2018:

Financial Statements Bulletin 2017	8 February 2018
Interim Report Q1/2018	3 May 2018
Interim Report H1/2018	1 August 2018
Interim Report Q1–3/2018	31 October 2018

Helsinki, 1 November 2017

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