

OP Mortgage Bank Interim Report for January–September 2016

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 10,477 million (10,354)* during the reporting period. The company increased its on-balance sheet loan portfolio by buying mortgage-backed loans from OP Financial Group's member banks worth a total of EUR 413 million. In May, OP MB issued a fixed-rate covered bond with a maturity of seven years in international capital markets. Out of the bond with a nominal value of EUR 1,250 million, OP MB intermediated EUR 1,119 million in intermediate loans to OP Financial Group member cooperative banks. A total of 84 member cooperative banks have intermediate loans from OP MB, worth a total of EUR 1,863 million (743)*.

The company's financial standing remained stable throughout the reporting period. Operating profit for January–September amounted to EUR 16.0 (18.6) million.

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 comparatives for 2015 are given in brackets. For income statement and other aggregated figures, January–September 2015 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2015) serve as comparatives.

Collateralisation of bonds issued to the public

On 30 September 2016, 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 10,048 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 137.6% (140.2) on 30 September 2016. The CET1 capital requirement is 4.5% and the requirement for the capital conservation buffer is 2.5%, or a total of 7%. The minimum total capital requirement is 8% and 10.5% with increased capital conservation buffer.

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 43.7 million in September. Information on the Basel I floor and capital surplus can be found in note "Capital base and capital adequacy".

The Finnish Financial Supervisory Authority continues to take measures to set a 10% minimum risk weight on housing loans in an effort, according to the Authority, to prepare for an increased systemic risk. OP MB's loan portfolio consists of low-risk home loans, on which the Authority's possible decision will relatively have the strongest impact. Based on an assessment, OP MB's capital adequacy will, however, remain solid even after the entry into force of the floor and be clearly above the minimum requirements set by the authorities; the minimum level of capital will continue to be determined according to the Basel I floor even after the setting of the floor. The Financial Supervisory Authority's decision will probably take effect in mid-2017.

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 2016, OP Cooperative's members comprised 178 member cooperative banks as well as OP Corporate Bank plc, OP Mortgage Bank, OP Card Company Plc and 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 2016, OP MB had five employees. The Bank 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. The interest rate risk may be considered to be low.

Outlook

The existing issuance programme makes it possible to issue new covered bonds in 2016. It is expected that the Bank's capital adequacy will remain strong, risk exposure favourable and the overall quality of the loan portfolio good.

Accounting policies

The Interim Report for 1 January–30 September 2016 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 financial year saw no major changes in related-party transactions.

The income statement layout grouping has been updated for the Interim Report for 1 January–30 September 2016. Comparatives have been restated to correspond to the new grouping. This has no effect on profit for the period. Comparatives have not been presented in a separate table due to the minor effect of the update on the income statement.

Changes caused by the new grouping are as follows:

Net interest income after impairment loss is not presented separately. Impairment loss on receivables is presented in its own line after expenses. "Net trading income" previously presented in its own line has been incorporated into "Net investment income". Expenses have been divided into personnel costs, amortisation/depreciation and other operating expenses. Expenses were previously divided into personnel costs, other administrative expenses and other operating expenses.

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–Q3/2016	Q1–Q3/2015	Q3/2016	Q3/2015	2015
Net interest income	56,601	53,482	18,562	18,652	73,355
Interest income	65,439	80,044	19,541	25,298	106,362
Interest expenses	8,838	26,563	979	6,647	33,007
Net commissions and fees	-36,110	-32,033	-11,934	-11,900	-43,361
Net investment income	2	22	0	21	22
Other operating income	22	1	21	0	1
Total income	20,514	21,472	6,649	6,773	30,016
Personnel costs	243	288	72	84	382
Depreciation/amortisation and impairment loss	627	507	209	192	716
Other operating expenses	3,442	2,352	1,331	732	3,821
Total expenses	4,313	3,146	1,613	1,008	4,918
Impairment loss on receivables	-179	245	-21	-48	210
Earnings before tax	16,023	18,571	5,015	5,717	25,308
Income tax expense	3,243	3,709	1,003	1,139	5,020
Profit for the period	12,780	14,862	4,012	4,578	20,288

Statement of comprehensive income, TEUR	Q1–Q3/2016	Q1–Q3/2015	Q3/2016	Q3/2015	2015
Profit for the period	12,780	14,862	4,012	4,578	20,288
Items that will not be reclassified to profit or loss					
Gains/(losses) arising from remeasurement of defined benefit plans					231
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans					-46
Total comprehensive income	12,780	14,862	4,012	4,578	20,473

Key ratios	Q1–Q3/2016	Q1–Q3/2015	Q3/2016	Q3/2015	2015
Return on equity (ROE), %	4.6	5.5	4.4	5.0	5.6
Cost/income ratio, %	21	15	24	15	16

Cash flow from operating activities, TEUR	Q1–Q3/2016	Q1–Q3/2015
Profit for the financial year	12,780	14,864
Adjustments to profit for the financial year	2,656	7,426
Increase (-) or decrease (+) in operating assets	-90,568	143,887
Receivables from credit institutions	-1,119,400	-19,969
Receivables from the public and public- sector entities	994,722	132,018
Other assets	34,110	31,839
Increase (+) or decrease (-) in operating liabilities	-126,183	-114,254
Liabilities to credit institutions and central banks	-87,000	-80,000
Other liabilities	-39,183	-34,254
Income tax paid	-4,745	-1,450
Dividends received	2	22
A. Net cash from operating activities	-201,315	51,923
Cash flow from investing activities		
Purchase of PPE and intangible assets		-681
B. Net cash used in investing activities		-681
Cash flow from financing activities		
Increases in debt securities issued to the public		15,057
Dividends paid and interest on cooperative capital	-16,282	-4,997
C. Net cash used in financing activities	229,021	10,060
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)	27,705	61,301
Cash and cash equivalents at year-start	245,120	109,046
Cash and cash equivalents at year-end	273,453	170,854
Change in cash and cash equivalents	28,332	61,808
Interest received	99,282	112,129
Interest paid	47,808	61,063
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	181	-243
Other	2,474	7,669
Total adjustments	2,656	7,426
Cash and cash equivalents		
Receivables from credit institutions payable on demand	273,453	170,854
Total cash and cash equivalents	273,453	170,854

Balance sheet, TEUR	30 Sep 2016	30 Sep 2015	31 Dec 2015
Receivables from credit institutions	2,136,222	200,823	988,490
Derivative contracts	322,942	200,981	192,206
Receivables from customers	8,614,076	9,194,581	9,610,252
Investments assets	40	40	40
Intangible assets	1,948	2,784	2,575
Other assets	44,713	58,208	78,823
Tax assets	196	3	
Total assets	11,120,137	9,657,420	10,872,386
Liabilities to credit institutions	1,288,000	1,425,000	1,375,000
Derivative contracts	5,094	5,639	12,971
Debt securities issued to the public	9,389,287	7,770,710	9,002,669
Provisions and other liabilities	69,301	87,863	108,485
Tax liabilities	19	1,883	1,325
Total liabilities	10,751,702	9,291,095	10,500,450
Shareholders' equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	63,435	61,325	66,937
Total equity	368,435	366,325	371,937
Total liabilities and shareholders' equity	11,120,137	9,657,420	10,872,386

Off-balance-sheet commitments, TEUR	30 Sep 2016	30 Sep 2015	31 Dec 2015
Irrevocable commitments given on behalf of customers	19	1,583	858

Statement of changes in equity, TEUR	Share capital	Other reserves	Retained earnings	Total equity
Shareholders' equity 1 Jan 2015	60,000	245,000	51,459	356,459
Reserve for invested unrestricted equity				
Profit for the period			14,862	14,862
Total comprehensive income				
Other changes			-4,996	-4,996
Shareholders' equity 30 Sep 2015	60,000	245,000	61,325	366,325
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

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 2016	31 Dec 2015
Shareholders' equity	368,435	371,937
Common Equity Tier 1 (CET1) before deductions	368,435	371,937
Intangible assets	-1,948	-2,575
Excess funding of pension liability, indirect holdings and deferred tax assets for losses	-75	-74
Share of unaudited profits	-12,780	-20,288
Impairment loss – shortfall of expected losses	-2,515	-2,046
Common Equity Tier 1 (CET1)	351,116	346,954
Tier 1 capital (T1)	351,116	346,954
Total capital base	351,116	346,954
Risk-weighted assets		
Credit and counterparty risk	221,297	219,560
Operational risk	33,898	27,846
Total	255,195	247,407
Key ratios, %		
CET1 capital ratio	137.6	140.2
Tier 1 capital ratio	137.6	140.2
Capital adequacy ratio	137.6	140.2
Basel I floor		
Capital base	351,116	346,954
Basel I capital requirements floor	307,409	324,461
Capital buffer for Basel I floor	43,707	22,493

Classification of financial assets and liabilities 30 Sep 2016, TEUR				
Financial assets	Loans and other receivables	Recognised at fair value through profit or loss	Available for sale	Total
Receivables from credit institutions	2,136,222			2,136,222
Derivative contracts		322,942		322,942
Receivables from customers	8,614,076			8,614,076
Shares and participations			40	40
Other receivables	44,713			44,713
Other assets	2,144			2,144
Total	10,797,155	322,942	40	11,120,137
		Recognised at fair value through profit or loss	Other liabilities	Total
Financial liabilities				
Liabilities to credit institutions			1,288,000	1,288,000
Derivative contracts		5,094		5,094
Debt securities issued to the public			9,389,287	9,389,287
Other liabilities			69,321	69,321
Total		5,094	10,746,608	10,751,702
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 Sep 2016			408,841	408,841

Classification of financial assets and liabilities 31 Dec 2015, TEUR				
Financial assets	Loans and other receivables	Recognised at fair value through profit or loss	Available for sale	Total
Receivables from credit institutions	988,490			988,490
Derivative contracts		192,206		192,206
Receivables from customers	9,610,252			9,610,252
Shares and participations			40	40
Other receivables	78,823			78,823
Other assets	2,575			2,575
Total	10,680,140	192,206	40	10,872,386
		Recognised at fair value through profit or loss	Other liabilities	Total
Financial liabilities				
Liabilities to credit institutions			1,375,000	1,375,000
Derivative contracts		12,971		12,971
Debt securities issued to the public			9,002,669	9,002,669
Other liabilities			109,810	109,810
Total		12,971	10,487,479	10,500,450
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec 2015			219,641	219,641

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 2016, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,778,260	8,216,977	6,412,272	17,407,509
Total	2,778,260	8,216,977	6,412,272	17,407,509

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	322,942	5,094	505,778
Total	322,942	5,094	505,778

Derivative contracts 31 Dec 2015, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,387,456	8,816,977	7,118,958	18,323,391
Total	2,387,456	8,816,977	7,118,958	18,323,391

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	192,206	12,971	411,985
Total	192,206	12,971	411,985

Financial instruments classification, grouped by valuation technique, TEUR

30 Sep 2016			
	Fair value measurement at year end		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	322,942		322,942
Total	322,942		322,942
Recurring fair value measurements of liabilities			
Derivate contracts	5,094		5,094
Total	5,094		5,094
Financial liabilities not measured at fair value			
Debt securities issued to the public	9,389,287	9,411,634	386,494
Total	9,389,287	9,411,634	386,494
OP MB does not hold any transfers between the levels of fair value valuation.			
31 Dec 2015			
	Fair value measurement at year end		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	192,206		192,206
Total	192,206		192,206
Recurring fair value measurements of liabilities			
Derivate contracts	12,971		12,971
Total	12,971		12,971
Financial liabilities not measured at fair value			
Debt securities issued to the public	9,002,669	8,872,880	349,430
Total	9,002,669	8,872,880	349,430

Financial reporting 2017

Schedule for Financial Statements Bulletin for 2016 and Interim Reports in 2017:

Financial Statements Bulletin 2016	2 February 2017
Interim Report Q1/2017	27 April 2017
Interim Report H1/2017	2 August 2017
Interim Report Q1–3/2017	1 November 2017

Helsinki, 2 November 2016

OP Mortgage Bank Board of Directors

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