

OP Mortgage Bank: Half-year Financial Report 1 January–30 June 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 14,071 million (13,771)*. 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 June 2019, 123 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-June amounted to EUR 8.4 (7.6) million.

*The comparatives for 2018 are given in brackets. For income statement and other aggregated figures, January-June 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 June 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 14,108 million.

Capital adequacy

OP MB's Common Equity Tier 1 (CET1) ratio stood at 62.4% (136.4) on 30 June 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 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 June 2019, OP Cooperative's member credit institutions comprised 153 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 other receivables without this being prevented by OP MB's liquidation or bankruptcy.

Personnel

On 30 June 2019, OP MB had five 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.

Administration

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 ALM and Group Treasury, OP Corporate Bank

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 Hirvonen resigned from the Board of Directors of OP Mortgage Bank on 31 May 2019.

To replace Hirvonen on the Board, Lauri Iloniemi, Head of ALM and Group Treasury, was appointed Board member on 1 June 2019.

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 Half-year Financial Report for 1 January–30 June 2019 has been prepared in accordance with IAS 34 (Interim Financial Reporting).

This Half-year Financial 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 Half-year Financial 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	H1/2019	H1/2018	Q2/2019	Q2/2018	Q1-4/2018
Net interest income	32,079	36,338	15,664	17,531	71,893
Interest income	20,359	28,512	9,949	13,707	52,587
Interest expenses	-11,721	-7,826	-5,715	-3,824	-19,306
Net comissions and fees	-20,901	-25,923	-10,274	-12,759	-49,193
Net investment income	1	1	0	0	1
Other operating income	0	2	0	0	3
Total income	11,180	10,419	5,390	4,772	22,704
Personnel costs	170	185	88	97	191
Depreciation/amortisation and impairment loss	105	418	54	209	783
Other operating expenses	2,499	2,381	1,151	1,170	5,099
Total expenses	2,774	2,983	1,292	1,476	6,073
Impairment loss on receivables	-56	168	43	112	-382
Earnings before tax	8,350	7,604	4,141	3,408	16,248
Income tax expense	1,670	1,520	828	682	3,249
Profit for the period	6,680	6,083	3,313	2,726	12,999

Statement of comprehensive income, TEUR	H1/2019	H1/2018	Q2/2019	Q2/2018	Q1-4/2018
Profit for the period	6,680	6,083	3,313	2,726	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	6,680	6,083	3,313	2,726	13,047

Key ratios	H1/2019	H1/2018	Q2/2019	Q2/2018	Q1-4/2018
Return on equity (ROE), %	3.6	3.2	3.6	3.0	3.4
Cost/income ratio, %	25	29	24	31	27

Cash flow from operating activities, TEUR	H1/2019	H1/2018
Profit for the financial year	6,680	6,083
Adjustments to profit for the financial year	6,261	5,893
Increase (-) or decrease (+) in operating assets	-294,388	-39,467
Receivables from credit institutions	-1,000,000	-1,000,000
Receivables from the public and public-sector entities	705,391	972,933
Other assets	221	-12,400
Increase (+) or decrease (-) in operating liabilities	28,420	-957,048
Liabilities to credit institutions and central banks	20,000	-967,000
Other liabilities	8,420	9,952
Income tax paid	-1,933	-1,392
Dividends received	1	1
A. Net cash from operating activities	-254,958	-985,929
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	0
Dividends paid and interest on cooperative capital	-12,998	-15,472
C. Net cash used in financing activities	220,864	979,940
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)	-34,094	-5,989
Cash and cash equivalents at year-start	133,460	363,609
Cash and cash equivalents at year-end	99,472	358,038
Change in cash and cash equivalents	-33,989	-5,571
Interest received	20,482	18,412
Interest paid	-20,979	-19,210
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	56	-168
Price difference recognised on debt securities issued to the public	4,536	4,542
Other	1,668	1,519
Total adjustments	6,261	5,893
Cash and cash equivalents		
Receivables from credit institutions payable on demand	99,472	358,038
Total cash and cash equivalents	99,472	358,038

Balance sheet, TEUR	30 June 2019	30 June 2018	31 Dec. 2018
Receivables from credit institutions	7,875,641	6,134,207	6,909,630
Derivative contracts	346,060	124,424	139,668
Receivables from customers	6,295,149	7,832,253	6,994,873
Investments assets	40	40	40
Intangible assets	17	486	120
Property, plant and equipment (PPE)	13	0	0
Other assets	32,305	61,786	32,525
Tax assets	263	554	0
Total assets	14,549,489	14,153,750	14,076,856
Liabilities to credit institutions	2,916,000	1,871,000	2,896,000
Derivative contracts	14,461	16,722	8,597
Debt securities issued to the public	11,187,492	11,813,060	10,742,840
Provisions and other liabilities	60,060	82,211	51,625
Tax liabilities	74	0	74
Total liabilities	14,178,086	13,782,993	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	66,402	65,756	72,720
Total equity	371,402	370,756	377,720
Total liabilities and shareholders' equity	14,549,489	14,153,750	14,076,856

Off-balance-sheet commitments, TEUR	30 June 2019	30 June 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 shareholders' equity
Shareholders' equity 1 Jan. 2018	60,000	245,000	75,147	380,147
Reserve for invested unrestricted equity				
Profit for the period			6,083	6,083
Other comprehensive income for the period				
Other changes			-15,474	-15,474
Shareholders' equity 30 June 2018	60,000	245,000	65,757	370,757
Shareholders' equity 1 Jan. 2019	60,000	245,000	72,720	377,720
Reserve for invested unrestricted equity				
Profit for the period			6,680	6,680
Other comprehensive income for the period				
Other changes			-12,998	-12,998
Shareholders' equity 30 June 2019	60,000	245,000	66,402	371,402

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 June 2019	31 Dec. 2018
Shareholders' equity	371,402	377,720
Common Equity Tier 1 (CET1) before deductions	371,402	377,720
Intangible assets	-17	-120
Excess funding of pension liability	-66	-66
Share of unaudited profits	-6,680	-12,999
Shortfall of ECL minus expected losses	-6,095	-1,962
Common Equity Tier 1 (CET1)	358,544	362,573
Tier 1 capital (T1)	358,544	362,573
Excess of ECL minus expected losses	0	38
Tier 2 Capital (T2)	0	38
Total capital base	358,544	362,611
Total risk exposure amount		
Credit and counterparty risk	536,406	223,980
Operational risk	38,237	41,893
Total	574,643	265,873

Key ratios, %		
CET1 capital ratio	62.4	136.4
Tier 1 capital ratio	62.4	136.4
Capital adequacy ratio	62.4	136.4

Capital requirement		
Capital base	358,544	362,611
Capital requirement	60,352	27,924
Buffer for capital requirements	298,192	334,687

Net commissions and fees, TEUR	H1/2019	H1/2018	Q2/2019	Q2/2018	Q1-4/2018
Commission income					
Lending	2,492	3,107	1,283	1,556	5,972
Total	2,492	3,107	1,283	1,556	5,972
Commission expenses					
From lending to OP cooperative banks	2,402	3,023	1,234	1,511	5,783
Loan management fee to OP cooperative banks	20,893	25,970	10,307	12,771	49,297
Issue of bonds	95	30	15	27	72
Other	3	7	2	6	13
Total	23,392	29,030	11,557	14,315	55,165
Net commissions and fees	-20,901	-25,923	-10,274	-12,759	-49,193

Classification of financial assets and liabilities 30 June 2019, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Assets				
Receivables from credit institutions and central banks	7,875,641			7,875,641
Derivative contracts		346,060		346,060
Receivables from customers	6,295,149			6,295,149
Shares and participations			40	40
Other receivables	32,318			32,318
Other assets	280			280
Total	14,203,388	346,060	40	14,549,489
		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities				
Liabilities to credit institutions			2,916,000	2,916,000
Derivative contracts		14,461		14,461
Debt securities issued to the public			11,187,492	11,187,492
Other liabilities			60,134	60,134
Total		14,461	14,163,625	14,178,086
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 June 2019			398,926	398,926

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
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
		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities				
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" note.

Derivative contracts 30 June 2019, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	667 707	8 662 850	7 618 145	16 948 702
Total	667 707	8 662 850	7 618 145	16 948 702

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	346 060	14 461	537 710
Total	346 060	14 461	537 710

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 June 2019	Fair value measurement at year end		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	346,060		346,060
Total	346,060		346,060
Recurring fair value measurements of liabilities			
Derivate contracts	14,461		14,461
Total	14,461		14,461
Financial liabilities not measured at fair value			
Debt securities issued to the public	11,187,492	11,419,455	166,963
Total	11,187,492	11,419,455	166,963

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.

Schedule for Interim Reports in 2019:

Interim Report Q1–3/2019

29 October 2019

Helsinki, 30 July 2019

OP Mortgage Bank Board of Directors

For more information, please contact:

Sanna Eriksson, Managing Director, tel. +358 10 252 2517

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