

OP Mortgage Bank: Financial Statements Bulletin for 1 January–31 December 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 14,335 million (13,771) on 31 December 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 intermediary loans. In addition, OP MB issued a 1 billion-euro fixed-rate covered bond with a maturity of seven years in international capital markets in November. Out of the proceeds of the bond, 929.7 million euros were intermediated to OP cooperative banks in the form of intermediary loans. On 31 December 2019, 122 OP cooperative banks had a total of EUR 8,706 million (6,776) in intermediary loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Earnings before tax amounted to EUR 14.9 million (16.2).

*The comparatives for 2018 are given in brackets. For income statement and other aggregated figures, January–December 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 31 December 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 Act on Mortgage Credit Banks (688/2010) totalled EUR 14,551 million.

Capital adequacy and capital base

OP MB's Common Equity Tier 1 (CET1) ratio stood at 69.8% (136.4) on 31 December 2019. The CET1 ratio decreased due to the decision issued by the ECB in April concerning covered retail exposures. The decision 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.

As part of OP Financial Group, OP MB will adopt a new definition of default. The process based on the new definition recognises defaulted customers earlier, for example, based on information in external credit registers, or in retail customers by extending the default to cover all exposures of an individual obligor. This new definition is expected to mean a larger number of default observations and to weaken credit risk parameters. When adopting the new definition, a so-called Two-Step Approach will be applied. The first step involves the change of the definition of default, which is planned to take place in March 2020. The second step to be taken later involves the calibration of credit risk parameters. The supervisory obligation related to the adoption of the new definition of default is expected to weaken OP MB's CET1 ratio by 16 percentage points in the first stage. Growth in the expected credit losses (ECL) caused by the change in the definition of default has been taken into account in the effect on capital adequacy. The growth is estimated to be less than 5% of the earnings for 2019.

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 31 December 2019, OP Cooperative's member credit institutions comprised 147 OP cooperative banks as well as OP Corporate Bank plc, OP MB and OP Card Company Plc.

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 Act on Mortgage Credit Banks, 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 31 December 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.

On 28 February 2019, member of the Board Elina Ronkanen-Minogue resigned from OP Financial Group and, consequently, from membership of the Board of Directors of OP Mortgage Bank.

Kaisu Christie, Director of Mortgages and Housing-related Services, was appointed to member of the Board of Directors to replace Elina Ronkanen-Minogue as of 19 March 2019.

Board member Hanno Hirvinen resigned from OP MB's Board of Directors 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 home 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.

Events after the reporting period

In January 2020, OP MB issued a one-billion euro bond with a maturity of 8.25 years in international capital markets.

Outlook

It is expected that OP MB's capital adequacy will 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.

Proposal by the Board of Directors for profit distribution

OP Mortgage Bank's equity capital on 31 December 2019

+ Share capital	60,000,000.00
+ Reserve for invested non-restricted equity	245,000,000.00
+ Profit for the financial year	11,891,635.35
+ Retained earnings	<u>59,724,366.71</u>
Total	376,616,002.06

Distributable funds totalled EUR 316,616,002.06.

As shown in the financial statements of 31 December 2019, the company's distributable earnings, which include EUR 11,891,635.35 in profit for the financial year, totalled EUR 71,616,002.06. The company's distributable funds totalled EUR 316,616,002.06.

The Board of Directors proposes that a dividend of EUR 155.25 be distributed per share, totalling EUR 11,890,908.00, and that following dividend distribution, the remaining amount of EUR 727.35 be recognised in retained earnings. Following dividend distribution, the company's distributable earnings total EUR 59,725,094.06 and its distributable funds total EUR 304,725,094.06.

The company's financial position has not undergone any material changes since the end of the financial year 2019. The company's liquidity is good and will not be jeopardised by the proposed profit distribution, in the Board of Directors' view.

Accounting policies

The Financial Statements Bulletin for 1 January–31 December 2019 has been prepared in accordance with IAS 34 (Interim Financial Reporting).

This Financial Statements Bulletin 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 Financial Statements Bulletin 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 and their close family members. 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. On 31 December 2019, the right-of-use asset was EUR 0.

Interest rate benchmark reform

In September 2019, the IASB published a document entitled Interest Rate Benchmark Reform that amended IFRS9, IAS 39 and IFRS 7. The European Union adopted the amendments on 15 January 2020 and they are effective for accounting periods beginning on or after 1 January 2020. Earlier application is allowed. OP MB already applied amendments to IAS 39 during the financial year 2019. The interest rate benchmark reform has a significant effect on OP Financial Group's processes, and the Group proceeds with the changes according to its business continuity plan related to reference rates. Following the reform, the EONIA rate is calculated on the €STR by adding a fixed rate of 8.5 basis points to it until the EONIA rate ceases to exist on 31 December 2021. The determination principles of the Euribor too changed during 2019. Changes in the determination methods of the EONIA and Euribors will not affect the continuity of contract terms. The adoption of €STR in OP Financial Group will involve system changes, process changes, changes in risk and valuation models and in accounting. When it comes to hedge accounting, the change means a relief, for example, in the way that OP MB can still continue with cash flow and fair value hedging despite the fact that the method of determination of the reference rate originally defined as the hedged one changes. In cash flow hedges, future cash flows can still be considered to be highly likely insofar as they depend on the reference interest rate.

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	Q4/2019	Q4/2018	Q1-4/2019	Q1-4/2018
Net interest income	14,273	17,279	61,521	71,893
Interest income	5,403	11,500	33,996	52,587
Interest expenses	-8,870	-5,779	-27,525	-19,306
Net commissions and fees	-9,201	-11,317	-40,055	-49,193
Net investment income	0	0	1	1
Other operating income	1	1	1	3
Total income	5,073	5,962	21,468	22,704
Personnel costs	117	-69	399	191
Depreciation/amortisation and impairment loss	0	156	123	783
Other operating expenses	1,640	1,308	5,865	5,099
Total expenses	1,756	1,395	6,387	6,073
Impairment loss on receivables	-258	-417	-217	-382
Earnings before tax	3,059	4,150	14,865	16,248
Income tax expense	612	830	2,973	3,249
Profit for the period	2,447	3,320	11,892	12,999

Statement of comprehensive income, TEUR	Q4/2019	Q4/2018	Q1-4/2019	Q1-4/2018
Profit for the period	2,447	3,320	11,892	12,999
Items that will not be reclassified to profit or loss				
Gains/(losses) arising from remeasurement of defined benefit plans	3	60	3	60
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans	-1	-12	-1	-12
Total comprehensive income	2,449	3,368	11,894	13,047

Key ratios	Q4/2019	Q4/2018	Q1-4/2019	Q1-4/2018
Return on equity (ROE), %	2.6	3.5	3.2	3.4
Cost/income ratio, %	35	23	30	27

Cash flow from operating activities, TEUR	Q1-4/2019	Q1-4/2018
Profit for the financial year	11,892	12,999
Adjustments to profit for the financial year	11,999	12,327
Increase (-) or decrease (+) in operating assets	-558,011	-171,108
Receivables from credit institutions	-1,929,700	-2,000,000
Receivables from the public and public-sector entities	1,370,769	1,812,031
Other assets	920	16,861
Increase (+) or decrease (-) in operating liabilities	-377,766	37,365
Liabilities to credit institutions and central banks	-380,000	58,000
Other liabilities	2,234	-20,635
Income tax paid	-3,890	-2,505
Dividends received	1	1
A. Net cash from operating activities	-915,775	-110,920
Cash flow from investing activities		
B. Net cash used in investing activities	0	0
Cash flow from financing activities		
Increases in debt securities issued to the public	2,233,893	995,413
Decreases in debt securities issued to the public	-1,000,000	-1,100,000
Dividends paid and interest on cooperative capital	-12,998	-15,424
C. Net cash used in financing activities	1,220,894	-120,012
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)	305,118	-230,932
Cash and cash equivalents at year-start	133,460	363,609
Cash and cash equivalents at year-end	438,702	133,460
Change in cash and cash equivalents	305,242	-230,148
Interest received	34,089	68,928
Interest paid	-30,660	-478
Adjustments to profit for the financial year		
Impairment losses on receivables	224	396
Price difference recognised on debt securities issued to the public	8,804	8,683
Other	2,972	3,248
Total adjustments	11,999	12,327
Cash and cash equivalents		
Receivables from credit institutions payable on demand	438,702	133,460
Total cash and cash equivalents	438,702	133,460

Balance sheet, TEUR	31 Dec. 2019	31 Dec. 2018
Receivables from credit institutions	9,144,571	6,909,630
Derivative contracts	291,146	139,668
Receivables from customers	5,628,716	6,994,873
Investments assets	40	40
Intangible assets	0	120
Other assets	31,605	32,525
Tax assets	908	0
Total assets	15,096,986	14,076,856
Liabilities to credit institutions	2,516,000	2,896,000
Derivative contracts	14,470	8,597
Debt securities issued to the public	12,135,974	10,742,840
Provisions and other liabilities	53,861	51,625
Tax liabilities	64	74
Total liabilities	14,720,370	13,699,135
Shareholders' equity		
Share capital	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000
Retained earnings	71,616	72,720
Total equity	376,616	377,720
Total liabilities and shareholders' equity	15,096,986	14,076,856

Off-balance-sheet commitments, TEUR	31 Dec. 2019	31 Dec. 2018
Irrevocable commitments given on behalf of customers	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			12,999	12,999
Other comprehensive income for the period			48	48
Other changes			-15,472	-15,472
Shareholders' equity 31 Dec. 2018	60,000	245,000	72,720	377,720
Shareholders' equity 1 Jan. 2019	60,000	245,000	72,720	377,720
Reserve for invested unrestricted equity				
Profit for the period			11,892	11,892
Other comprehensive income for the period			2	2
Other changes			-12,998	-12,998
Shareholders' equity 31. Dec 2019	60,000	245,000	71,616	376,616

Capital base and capital adequacy, TEUR	31 Dec. 2019	31 Dec. 2018
Shareholders' equity	376,616	377,720
Common Equity Tier 1 (CET1) before deductions	376,616	377,720
Intangible assets	0	-120
Excess funding of pension liability	-69	-66
Share of unaudited profits	-11,892	-12,999
Shortfall of ECL minus expected losses	-5,589	-1,962
Common Equity Tier 1 (CET1)	359,066	362,573
Tier 1 capital (T1)	359,066	362,573
Excess of ECL minus expected losses	0	38
Tier 2 Capital (T2)	0	38
Total capital base	359,066	362,611
Total risk exposure amount		
Credit and counterparty risk	476,138	223,980
Operational risk	38,237	41,893
Total	514,375	265,873
Key ratios, %		
CET1 capital ratio	69.8	136.4
Tier 1 capital ratio	69.8	136.4
Capital adequacy ratio	69.8	136.4
Capital requirement		
Capital base	359,066	362,611
Capital requirement	54,012	27,924
Buffer for capital requirements	305,055	334,687

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

Net commissions and fees, TEUR	Q4/2019	Q4/2018	Q1-4/2019	Q1-4/2018
Commission income				
Lending	1,159	1,411	4,891	5,972
Total	1,159	1,411	4,891	5,972
Commission expenses				
From lending to OP cooperative banks	1,110	1,353	4,703	5,783
Loan management fee to OP cooperative banks	9,229	11,338	40,018	49,297
Issue of bonds	20	34	220	72
Other	2	3	6	13
Total	10,359	12,728	44,946	55,165
Net commissions and fees	-9,201	-11,317	-40,055	-49,193

Classification of financial assets and liabilities 31 Dec. 2019, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Recognised fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	9,144,571			9,144,571
Derivative contracts		291,146		291,146
Receivables from customers	5,628,716			5,628,716
Investment assets			40	40
Other financial assets	31,340			31,340
Financial assets	14,804,627	291,146	40	15,095,813
Other than financial assets				1,173
Total	14,804,627	291,146	40	15,096,986
		Recognised at fair value through profit or loss	Amortised cost	Total
Financial liabilities				
Liabilities to credit institutions			2,516,000	2,516,000
Derivative contracts		14,470		14,470
Debt securities issued to the public			12,135,974	12,135,974
Other liabilities			50,295	50,295
Financial liabilities		14,470	14,702,269	14,716,739
Other than financial liabilities				3,631
Total		14,470	14,702,269	14,720,370
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec. 2019			297,338	297,338

Classification of financial assets and liabilities 31 Dec. 2018, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Recognised 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
Investment assets			40	40
Other financial assets	32,291			32,291
Financial assets	13,936,794	139,668	40	14,076,501
Other than financial assets				354
Total	13,936,794	139,668	40	14,076,856
		Recognised at fair value through profit or loss	Amortised cost	Total
Financial 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			47,427	47,427
Financial liabilities		8,597	13,686,267	13,694,864
Other than financial liabilities				4,271
Total		8,597	13,686,267	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 31 Dec. 2019, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,314,788	10,518,873	4,410,800	17,244,461
Total	2,314,788	10,515,873	4,410,800	17,244,461

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	291,146	14,470	449,628
Total	291,146	14,470	449,628

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				
31 Dec. 2019	Fair Value measurement at year end			
	Balance sheet value	Level 1	Level 2	Level 3
Recurring fair value measurements of assets				
Derivate contracts	291,146		291,146	
Total	291,146	0	291,146	0
Recurring fair value measurements of liabilities				
Derivate contracts	14,470		14,470	
Total	14,470	0	14,470	0
Financial liabilities not measured at fair value				
Debt securities issued to the public	12,135,974	9,744,711	2,548,311	140,290
Total	12,135,974	9,744,711	2,548,311	140,290

Financial instruments classification, grouped by valuation technique, TEUR				
31 Dec. 2018	Fair Value measurement at year end			
	Balance sheet value	Level 1	Level 2	Level 3
Recurring fair value measurements of assets				
Derivate contracts	139,668		139,668	
Total	139,668	0	139,668	0
Recurring fair value measurements of liabilities				
Derivate contracts	8,597		8,597	
Total	8,597	0	8,597	0
Financial liabilities not measured at fair value				
Debt securities issued to the public	10,742,840	10,738,905	144,280	0
Total	10,742,840	10,738,905	144,280	0

Valuation techniques whose input parameters involve uncertainty (Level 3)

Opening balance 1 January 2019	0
Transfers to level 3	140,290
Transfers from level 3	
Other change	
Closing balance 31 December 2019	140,290

Transfers between the levels of the fair value hierarchy are considered to take place on the date when an event causes such transfer or when circumstances change. Transfers between the levels are mainly due to the number of available market quotes.

Time of publication of 2019 reports

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

Week 9

Week 9

Schedule for Interim Reports in 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

Helsinki, 4 February 2020

OP Mortgage Bank
Board of Directors

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