

OP Mortgage Bank: Interim Report 1 January–31 March 2020

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 14,217 million (14,335) on 31 March 2020. In January, OP MB issued a 1 billion-euro fixed-rate covered bond with a maturity of 8.25 years in international capital markets. In February, a new extension of an intermediary loan model was performed on a bond issued in February 2019 that will mature in 2029. As part of this extension, seven OP cooperative banks applied for an intermediary loan from OP MB at a total amount of EUR 185 million. On 31 March 2020, 120 OP cooperative banks had a total of EUR 8,891 million (8,706) in intermediary loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Earnings before tax amounted to EUR 1.8 million (4.2).

*The comparatives for 2019 are given in brackets. For income statement and other aggregated figures, January–March 2019 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2019) serve as comparatives.

Collateralisation of bonds issued to the public

On 31 March 2020, 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 (Laki kiinnitysluottopankkitoiminnasta (688/2010)) totalled EUR 14,475 million.

Capital adequacy

OP MB's Common Equity Tier 1 (CET1) ratio stood at 55.1% (69.8) on 31 March 2020. Capital adequacy decreased because the average risk weights rose in connection with the adoption of the new definition of default as a result of the risk parameter factors set by the ECB. 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.

OP MB has presented its capital base and capital adequacy in accordance with the EU Capital Requirements Regulation (EU 575/2013).

Capital base and capital adequacy, TEUR	31 Mar. 2020	31 Dec. 2019
Shareholders' equity	366,202	376,616
Common Equity Tier 1 (CET1) before deductions	366,202	376,616
Excess funding of pension liability	-69	-69
Share of unaudited profits	-1,477	-11,892
Shortfall of ECL minus expected losses	-5,666	-5,589
Common Equity Tier 1 (CET1)	358,989	359,066
Tier 1 capital (T1)	358,989	359,066
Tier 2 Capital (T2)	0	0
Total capital base	358,989	359,066
Total risk exposure amount		
Credit and counterparty risk	616,625	476,138
Operational risk	34,748	38,237
Total	651,373	514,375
Key ratios, %		
CET1 capital ratio	55.1	69.8
Tier 1 capital ratio	55.1	69.8
Capital adequacy ratio	55.1	69.8
Capital requirement		
Capital base	358,989	359,066
Capital requirement	68,394	54,012
Buffer for capital requirements	290,595	305,055

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 March 2020, OP Cooperative's member credit institutions comprised 142 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 March 2020, OP MB had seven 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 is Sanna Eriksson. The deputy Managing Director is Pekka Moisio, Head of Funding and Liquidity Management.

Risk exposure

When entering 2020, OP MB has a strong capital base, capital buffers and risk-bearing capacity. The coronavirus pandemic (COVID 19) that spread widely in early 2020 has had a global effect on societies, which has further affected economic development and operating conditions in the financial sector. This is the case in Finland too.

The pandemic may especially affect risks associated with lending, liquidity maintenance and business processes. The capital base of OP MB is sufficient to secure business continuity.

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 April, OP MB issued a 500 million-euro retained covered bond with a maturity of two years. In April, OP MB also issued a 300 million-euro retained covered bond with a maturity of eight years. These bond issues were performed as internal issues within OP Financial Group.

On 21 April 2020, OP MB intermediated a total of EUR 1,284 million as intermediary loans. Of this amount, EUR 984 million is related to a bond issued in January, and EUR 300 million to a 300-million euro bond issued in April.

On 28 April 2020, the date of release of this Interim Report, 123 banks hold intermediary loans totalling EUR 10,175 million.

Outlook

Measures to restrain the coronavirus pandemic threw the global economy into a recession during the first quarter. In the financial market, the funding costs of banks increased markedly. However, 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.

Accounting policies

The Interim Report 1 January–31 March 2020 has been prepared in accordance with IAS 34 (Interim Financial Reporting).

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

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

OP MB's related parties include the parent company OP Cooperative and its subsidiaries, the OP Financial Group pension insurance companies OP Bank Group Pension Fund and OP Bank Group Pension Foundation, and key management personnel and their close family members. Standard loan terms and conditions are applied to loans granted to 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

As part of OP Financial Group, OP MB adopted the European Banking Authority's (EBA) guidelines on the definition of default (Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013) in the first quarter. The Guidelines harmonise the definition of default applied by European banks on their customers. The new process in accordance with the Guidelines recognises defaulted customers earlier, for example, based on information in external credit registers. The new process extends the default to cover all exposures of an individual obligor. This change increased the number of observations of default and weakened the parameters of credit risk.

As part of OP Financial Group, OP MB applies a so-called Two-Step Approach. The first step involved the change of the definition of default during the first quarter of 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 increased the average risk weights of OP MB's loan portfolio in the first stage. Growth in the expected credit losses (ECL) in the income statement caused by the change in the definition of default has been taken into account in the effect on capital adequacy. OP MB applied the new definition of default to expected credit losses as a change in the accounting estimate. Consequently, impairment loss on receivables in the income statement increased by TEUR 637 in the first quarter of 2020.

Alternative Performance Measures

Key ratios	Q1/2020	Q1/2019	Q1-4/2019
Return on equity (ROE), %	1.6	3.6	3.2
Cost/income ratio, %	37	26	30

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

Primary statements

Income statement, TEUR	Q1/2020	Q1/2019	Q1-4/2019
Net interest income	12,787	16,416	61,521
Interest income	3,668	10,410	33,996
Interest expenses	-9,119	-6,006	-27,525
Net commissions and fees	-8,668	-10,627	-40,055
Net investment income	1	1	1
Other operating income	0	0	1
Total income	4,120	5,790	21,468
Personnel costs	110	82	399
Depreciation/amortisation and impairment loss	0	53	123
Other operating expenses	1,420	1,348	5,865
Total expenses	1,530	1,483	6,387
Impairment loss on receivables	-745	-98	-217
Earnings before tax	1,845	4,209	14,865
Income tax expense	369	842	2,973
Profit for the period	1,477	3,367	11,892

Statement of comprehensive income, TEUR	Q1/2020	Q1/2019	Q1-4/2019
Profit for the period	1,477	3,367	11,892
Items that will not be reclassified to profit or loss			
Gains/(losses) arising from remeasurement of defined benefit plans			3
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans			-1
Total comprehensive income	1,477	3,367	11,894

Balance sheet, TEUR	31 Mar. 2020	31 Mar. 2019	31 Dec. 2019
Receivables from credit institutions	10,018,842	8,181,373	9,144,571
Derivative contracts	357,197	223,450	291,146
Receivables from customers	5,326,462	6,663,249	5,628,716
Investments assets	40	40	40
Intangible assets	0	69	0
Property, plant and equipment	0	13	0
Other assets	20,901	31,794	31,605
Tax assets	1,346	125	908
Total assets	15,724,788	15,100,113	15,096,986
Liabilities to credit institutions	2,100,000	2,596,000	2,516,000
Derivative contracts	12,946	12,021	14,470
Debt securities issued to the public	13,198,593	12,062,664	12,135,974
Provisions and other liabilities	46,984	61,266	53,861
Tax liabilities	64	74	64
Total liabilities	15,358,586	14,732,024	14,720,370
Shareholders' equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	61,202	63,089	71,616
Total equity	366,202	368,089	376,616
Total liabilities and shareholders' equity	15,724,788	15,100,113	15,096,986

Off-balance-sheet commitments, TEUR	31 Mar. 2020	31 Mar. 2019	31 Dec. 2019
Irrevocable commitments given on behalf of customers	2	2	2

Statement of changes in equity, TEUR	Share capital	Other reserves	Retained earnings	Total equity
Shareholders' equity 1 Jan. 2019	60,000	245,000	72,720	377,720
Profit for the period			3,367	3,367
Other changes			-12,998	-12,998
Shareholders' equity 31 March 2019	60,000	245,000	63,089	368,089
Shareholders' equity 1 Jan. 2020	60,000	245,000	71,616	376,616
Profit for the period			1,477	1,477
Other changes			-11,891	-11,891
Shareholders' equity 31. March 2020	60,000	245,000	61,202	366,202

Cash flow from operating activities, TEUR	Q1/2020	Q1/2019
Profit for the financial year	1,477	3,367
Adjustments to profit for the financial year	3,376	3,138
Increase (-) or decrease (+) in operating assets	-623,577	-664,355
Receivables from credit institutions	-935,000	-1,000,000
Receivables from the public and public-sector entities	300,719	334,928
Other assets	10,704	717
Increase (+) or decrease (-) in operating liabilities	-422,878	-290,359
Liabilities to credit institutions and central banks	-416,000	-300,000
Other liabilities	-6,878	9,641
Income tax paid	-808	-966
Dividends received	1	1
A. Net cash from operating activities	-1,042,409	-949,174
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	993,570	1,233,863
Dividends paid and interest on cooperative capital	-11,891	-12,998
C. Net cash used in financing activities	981,679	1,220,864
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)	-60,730	271,690
Cash and cash equivalents at year-start	438,702	133,460
Cash and cash equivalents at period-end	377,972	405,203
Change in cash and cash equivalents	-60,730	271,743
Interest received	14,941	10,683
Interest paid	-2,583	-16,333
Adjustments to profit for the financial year		
Impairment losses on receivables	746	99
Price difference recognised on debt securities issued to the public	2,262	2,198
Other	367	840
Total adjustments	3,376	3,138
Cash and cash equivalents		
Receivables from credit institutions payable on demand	377,972	405,203
Total cash and cash equivalents	377,972	405,203

Notes

Net commissions and fees, TEUR	Q1/2020	Q1/2019	Q1-4/2019
Commission income			
Lending	1,121	1,208	4,891
Total	1,121	1,208	4,891
Commission expenses			
From lending to OP cooperative banks	1,072	1,168	4,703
Loan management fee to OP cooperative banks	8,653	10,586	40,018
Issue of bonds	62	80	220
Other	1	1	6
Total	9,788	11,835	44,946
Net commissions and fees	-8,668	-10,627	-40,055

Classification of financial assets and liabilities 31 March 2020, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	10,018,842			10,018,842
Derivative contracts		357,197		357,197
Receivables from customers	5,326,462			5,326,462
Investment assets			40	40
Other receivables	20,814			20,814
Other assets	0			0
Financial assets	15,366,117	357,197	40	15,723,354
Other than financial assets				1 434
Total	15,366,117	357,197	40	15,724,788
		Recognised at fair value through profit or loss	Amortised cost	Total
Financial liabilities				
Liabilities to credit institutions			2,100,000	2,100,000
Derivative contracts		12,946		12,946
Debt securities issued to the public			13,198,593	13,198,593
Other liabilities			43,684	43,684
Financial liabilities		12,946	15,342,277	15,355,222
Other than financial liabilities				3,364
Total		12,946	15,342,277	15,358,586
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 March 2020			298,668	298,668

Classification of financial assets and liabilities 31 Dec. 2019, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	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 receivables	31,340			31,340
Other assets	0			0
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

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 March 2020, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	4,304,629	8,358,723	5,410,800	18,074,152
Total	4,304,629	8,358,723	5,410,800	18,074,152

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	357,197	12,946	511,344
Total	357,197	12,946	511,344

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	10,518,873	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

Financial instruments classification, grouped by valuation technique, TEUR				
31 March 2020				
	Fair value measurement at year end			
	Balance sheet value	Level 1	Level 2	Level 3
Recurring fair value measurements of assets				
Derivate contracts	357,197		357,197	
Total	357,197	0	357,197	0
Recurring fair value measurements of liabilities				
Derivate contracts	12,946		12,946	
Total	12,946	0	12,946	0
Financial liabilities not measured at fair value				
Debt securities issued to the public	13,198,593	11,313,708	1,032,261	1,151,419
Total	13,198,593	11,313,708	1,032,261	1,151,419

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

Valuation techniques whose input parameters involve uncertainty (Level3)

Opening balance 1 January 2019	140,290
Transfers to level 3	1,011,129
Transfers from level 3	
Other change	
Closing balance 31 March 2020	1,151,419

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.

Schedule for Interim Reports in 2020

Half-year Financial Report H1/2020	21 July 2020
Interim Report Q1–3/2020	22 October 2020

Helsinki, 28 April 2020

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Board of Directors

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