OP MORTGAGE BANK
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Financial Statements Bulletin

OP Mortgage Bank: Financial Statements Bulletin for 1 January–31 December 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 13,580 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. In November, OP MB issued a bond with a maturity of 5.25 years, of which EUR 913.4 million were intermediated to OP cooperative banks as intermediate loans. On 31 December 2017, 118 OP cooperative banks had a total of EUR 4 776 million (1,853) in intermediate loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Operating profit for January–December amounted to EUR 19.3 (22.6) million.

*The comparatives for 2016 are given in brackets. For income statement and other aggregated figures, January–December 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 31 December 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 13,266 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 109.5 % (109.5) on 31 December 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 11 million in December. 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. 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 31 December 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 31 December 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	Head of Group Treasury, 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 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 2018.

Proposal by the Board of Directors for the allocation of profit

OP Mortgage Bank's shareholders' equity capital on 31 December 2017:

+ Share capital	60,000,000.00
+ Reserve for invested non-restricted equity	245,000,000.00
+ Profit for the financial year	15,472,841.90
+ Retained earnings	59,584,633.65
Total	**380,057,475.55**

Distributable funds totalled 319,153,868.99 EUR.

As shown in the financial statements of 31 December 2017, the company's distributable funds, which include EUR 15,472,841.90 in profit for the financial year, totalled EUR 74,153,868.99. The Board of Directors proposes to the Annual General Meeting that a dividend of 202.01 EUR be distributed per share, totalling 15,472,349.92 EUR. Following dividend distribution, 59,585,125.63 EUR are entered in retained earnings. 303,681,519.07 EUR remain in the company's distributable equity.

The company’s financial position has not undergone any material changes since the end of the financial year 2017. 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 2017 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 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:

On 1 January 2018, OP MB adopted IFRS 9 Financial Instruments, published by the IASB in July 2014 and adopted by the EU in November 2016. For OP MB, the most significant change is that impairment losses are recognised on a more front-loaded basis, based on expected credit losses (ECL). IFRS 9 also entails changes to accounting policies, adjustments of receivables recognised earlier in the balance sheet and changes to classification of financial instruments. Adjustments made to carrying amounts were recognised in retained earnings in the opening balance sheet on the adoption date.

OP MB continues to apply hedge accounting under IAS 39 after adoption of IFRS 9. Comparatives for the financial statements included in the first opening balance sheet of 1 January 2018 were not adjusted. Changes in the notes to the financial statements arising from the application of IFRS 9 are only presented for the financial year 2018.

Since the amount of expected credit losses, EUR 0.8 million, was below the expected loss (EL) calculated in capital adequacy measurement, EUR 4 million, the ECL provision had no impact on OP MB's CET1 on 1 January 2018.

The allowance for expected credit losses under equity capital on 1 January 2018 totalled EUR 786 thousand. Impairment loss on receivables assessed individually and collectively on 31 December 2017, amounting to EUR 263 thousand, was reversed to retained earnings. In addition, total equity capital on 1 January 2018 was affected by a deferred tax change concerning these items.

ECL calculation includes many estimates which have significant impacts on the amount of the ECL provision, such as:

- Defining significant increases in credit risk (SICR)
- Various assumptions used in 12-month and lifetime ECL calculation
- Macroeconomic estimates used in the calculation.

Since the adoption of IFRS 9 occurs while Finland is enjoying a favourable economic outlook, the amount of expected credit loss was below impairment loss for loans under IAS 39. The expected credit loss is anticipated to be sensitive to changes in macroeconomic estimates, and it may increase significantly when the economic outlook deteriorates.

The effects presented in this report resulting from the adoption of IFRS 9 may still be specified further because OP MB will continue further developing ECL models and related IT systems and strengthening the control environment.
New accounting policies, assessment methods and items subject to management's judgment may change until OP MB publishes its first financial statements which include the opening balance sheet of 1 January 2018.

Classification and measurement

OP MB has classified its financial assets under IFRS 9, on the basis of how loans are managed to achieve their business objectives. Following the adoption of IFRS 9, OP MB's loans remained within the measurement category recognised at amortised cost.

Impairment

ECL is calculated on all balance sheet items amortised at cost and on off-balance-sheet loan commitments.

ECL is calculated using modelled risk parameters and formula PDxLGDxEAD for the majority of the portfolios. ECL is calculated for each contract for 12 months or lifetime, depending on whether the instrument’s credit risk on the reporting day has increased significantly from the original one. Both qualitative and quantitative criteria are used to assess whether the credit risk has increased significantly. 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 the lifetime PD used for assessing the quantitative change. In addition, credit risk has increased significantly if payment is over 30 days past due. Contracts are classified into three stages. Stage 1 includes contracts whose credit risk has not increased significantly from the original level and for which a 12-month ECL is calculated. Stage 2 includes contracts whose credit risk has increased significantly from the original level and for which a lifetime ECL is calculated. Stage 3 includes defaulted contracts for which a lifetime ECL is also calculated.

In the definition of default, OP MB uses the same definition as used in capital adequacy measurement.

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

IFRS 15 Revenue from Contracts with Customers

OP MB has applied IFRS 15 as of 1 January 2018. This standard has replaced 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 had no effect on the revenue recognition of financial instruments. IFRS 15 lead to added information presented in the notes to the financial statements for 2018. The grouping of commission income and expenses is specified in the notes. 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. The adoption of IFRS 15 therefore had no financial effect on OP MB's result. OP MB applies 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	**Q4/2017**	**Q4/2016**	**Q1–Q4/2017**	**Q1–Q4/2016**
Net interest income	20,249	19,570	74,984	76,171
Interest income	16,286	19,539	65,692	84,978
Interest expenses	-3,964	-31	-9,292	8,807
Net commissions and fees	-12,830	-11,647	-49,910	-47,757
Net investment income	1	5	2	7
Other operating income	232	0	232	22
Total income	**7,652**	**7,929**	**25,309**	**28,443**
Personnel costs	87	78	328	321
Depreciation/amortisation and impairment loss	209	209	836	836
Other operating expenses	1,175	801	4,528	4,243
Total expenses	**1,471**	**1,088**	**5,692**	**5,400**
Impairment loss on receivables	-38	-221	-276	-400
Earnings before tax	**6,144**	**6,621**	**19,341**	**22,643**
Income tax expense	1,229	1,323	3,868	4,566
Profit for the period	**4,915**	**5,297**	**15,473**	**18,077**

Statement of comprehensive income, TEUR	**Q4/2017**	**Q4/2016**	**Q1–Q4/2017**	**Q1–Q4/2016**
Profit for the period	4,915	5,297	15,473	18,077
Items that will not be reclassified to profit or loss				
Gains/(losses) arising from remeasurement of defined benefit plans	1	-138	1	-138
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans	0	28	0	28
Total comprehensive income	**4,916**	**5,187**	**15,473**	**17,967**

Key ratios	**Q4/2017**	**Q4/2016**	**Q1–Q4/2017**	**Q1–Q4/2016**
Return on equity (ROE), %	5.2	5.7	4.1	4.8
Cost/income ratio, %	19	14	22	19

Cash flow from operating activities, TEUR	**Q1–Q4/2017**	**Q1–Q4/2016**
Profit for the financial year	15,473	18,077
Adjustments to profit for the financial year	12,335	12,649
Increase (-) or decrease (+) in operating assets	**-2,681,266**	**-517,538**

Receivables from credit institutions	-2,923,400	-1,109,400
Receivables from the public and public-sector entities	235,309	569,251
Other assets	6,826	22,611
Increase (+) or decrease (-) in operating liabilities	**944,884**	**481,863**
Liabilities to credit institutions and central banks	950,000	513,000
Other liabilities	-5,116	-31,137
Income tax paid	-4,113	-6,323
Dividends received	2	7
A. Net cash from operating activities	**-1,712,685**	**-11,264**
Cash flow from investing activities		
B. Net cash used in investing activities		
Cash flow from financing activities		
Increases in debt securities issued to the public	2,982,709	1,243,488
Decreases in debt securities issued to the public	-1,350,000	-1,010,000
Dividends paid and interest on cooperative capital	-9,037	-16,392
C. Net cash used in financing activities	**1,623,671**	**217,095**
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)	**-89,014**	**205,831**
Cash and cash equivalents at year-start	**451,787**	**245,120**
Cash and cash equivalents at year-end	**363,609**	**451,787**
Change in cash and cash equivalents	**-88,178**	**206,667**
Interest received	73,705	107,476
Interest paid	-2,469	39,919
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	277	405
Price difference recognised on debt securities issued to the public	8,192	7,685
Other	3,866	4,559
Total adjustments	**12,335**	**12,649**
Cash and cash equivalents		
Receivables from credit institutions payable on demand	363,609	451,787
Total cash and cash equivalents	**363,609**	**451,787**

Balance sheet, TEUR	31 Dec. 2017	31 Dec. 2016
Receivables from credit institutions	5,139,778	2,304,556
Derivative contracts	129,810	220,461
Receivables from customers	8,803,822	9,039,563
Investments assets	40	40
Intangible assets	904	1,739
Other assets	49,386	56,212
Tax assets	705	460
Total assets	**14,124,444**	**11,623,031**
Liabilities to credit institutions	2,838,000	1,888,000
Derivative contracts	38,025	6,233
Debt securities issued to the public	10,796,102	9,277,801
Provisions and other liabilities	72,259	77,375
Total liabilities	**13,744,387**	**11,249,409**
Shareholders' equity		
Share capital	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000
Retained earnings	75,057	68,622
Total equity	380,057	373,622
Total liabilities and shareholders' equity	**14,124,444**	**11,623,031**

Off-balance-sheet commitments, TEUR	31 Dec. 2017	31 Dec. 2016
Irrevocable commitments given on behalf of customers	3	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			18,077	18,077
Other comprehensive income for the period			-110	-110
Other changes			-16,282	-16,282
Shareholders' equity 31 Dec. 2016	**60,000**	**245,000**	**68,622**	**373,622**
Shareholders' equity 1 Jan. 2017	**60,000**	**245,000**	**68,622**	**373,622**
Reserve for invested unrestricted equity				
Profit for the period			15,473	15,473
Other comprehensive income for the period			1	1
Other changes			-9,038	-9,038
Shareholders' equity 31 Dec. 2017	**60,000**	**245,000**	**75,057**	**380,057**

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	31 Dec. 2017	31 Dec. 2016
Shareholders' equity	380,057	373,622
Common Equity Tier 1 (CET1) before deductions	**380,057**	**373,622**
Intangible assets	-904	-1,739
Excess funding of pension liability	-65	-67
Share of unaudited profits	-15,473	-18,077

Impairment loss – shortfall of expected losses	-2,676	-2,612
Common Equity Tier 1 (CET1)	**360,940**	**351,126**
Tier 1 capital (T1)	**360,940**	**351,126**
Total capital base	**360,940**	**351,126**
Total risk exposure amount		
Credit and counterparty risk	289,070	286,845
Operational risk	40,554	33,898
Total	**329,623**	**320,743**
Key ratios, %		
CET1 capital ratio	109.5	109.5
Tier 1 capital ratio	109.5	109.5
Capital adequacy ratio	109.5	109.5
Basel I floor		
Capital base	360,940	351,126
Basel I capital requirements floor	349,700	322,006
Capital buffer for Basel I floor	11,240	29,120

Classification of financial assets and liabilities 31 Dec. 2017, TEUR				
Financial assets	**Loans and other receivables**	**Recognised at fair value through profit or loss**	**Available for sale**	**Total**
Receivables from credit institutions	5,139,778			5,139,778
Derivative contracts		129,810		129,810
Receivables from customers	8,803,822			8,803,822
Shares and participations			40	40
Other receivables	49,386			49,386
Other assets	1,609			1,609
Total	**13,994,594**	**129,810**	**40**	**14,124,444**
Financial liabilities		**Recognised at fair value through profit or loss**	**Other liabilities**	**Total**
Liabilities to credit institutions			2,838,000	2,838,000
Derivative contracts		38,025		38,025
Debt securities issued to the public			10,796,102	10,796,102
Other liabilities			72,259	72,259
Total		**38,025**	**13,706,362**	**13,744,387**
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec. 2017			158,358	**158,358**

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 31 Dec. 2017, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,648,299	7,824,977	8,561,488	19,034,765
Total	**2,648,299**	**7,824,977**	**8,561,488**	**19,034,765**

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	129,810	38,025	334,303
Total	**129,810**	**38,025**	**334,303**

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			
31 Dec. 2017	**Fair value measurement at year end**		
	Balance sheet value	**Level 1**	**Level 2**
Recurring fair value measurements of assets			
Derivate contracts	129,810		129,810
Total	**129,810**		**129,810**

Recurring fair value measurements of liabilities			
Derivate contracts	38,025		38,025
Total	**38,025**		**38,025**
Financial liabilities not measured at fair value			
Debt securities issued to the public	10,796,102	10,710,871	243,589
Total	**10,796,102**	**10,710,871**	**243,589**

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 Interim Reports in 2018:

Interim Report Q1/2018	3 May 2018
Interim Report H1/2018	1 August 2018
Interim Report Q1—3/2018	31 October 2018

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OP Mortgage Bank
Board of Directors

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