OP MORTGAGE BANK
Stock exchange release 1 August 2018
Interim Report

OP Mortgage Bank: Interim Report for January–June 2018

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 intermediary loans and loan portfolio of OP MB were EUR 13,608 million (13,580)* in total during the reporting period. OP MB issued one fixed-rate covered bond with a maturity of 7.25 years in international capital markets in June. The proceeds of the bond were intermediated in its entirety to OP cooperative banks in the form of intermediary loans. On 30 June 2018, 116 OP cooperative banks had a total of EUR 5,776 million (4,776) in intermediary loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Operating profit for January–June amounted to EUR 7,6 (8,5) million.

*The comparatives for 2017 are given in brackets. For income statement and other aggregated figures, January–June 2017 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2017) serve as comparatives.

Collateralisation of bonds issued to the public

On 30 June 2018, 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 Covered Bond Act (Laki kiinnityspankkitoiminnasta (688/2010)) totalled EUR 13,410 million.

Capital adequacy

The Common Equity Tier 1 (CET1) ratio stood at 125.7 % (109.5) on 30 June 2018. 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 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 Financial Supervisory Authority has 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 30 June 2018, OP Cooperative's members comprised 157 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 30 June 2018, 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	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 his deputy was Hanno Hirvinen until 2 July 2018 and is Sanna Eriksson as of 3 July 2018.

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, intermediary 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 and it has been within the set limit.

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.

Accounting policies

The Interim Report for 1 January–30 June 2018 has been prepared in accordance with IAS 34 (Interim Financial Reporting).

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

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

OP MB's related parties include the parent company OP Cooperative and its subsidiaries, the OP Financial Group pension insurance companies OP Bank Group Pension Fund and OP Bank Group Pension Foundation, and the company's administrative personnel. Standard loan terms and conditions are applied to loans granted to the related parties. Loans are tied to generally used reference interest rates. The 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. The effects of transition to IFRS 9 on the classification and measurement of financial instruments have been presented in OP MB's Notes to the Financial Statements 2017 and Interim Report for 1 January–31 March 2018. OP MB has not adjusted comparatives for prior years.

Adoption of IFRS 15 on 1 January 2018

OP MB has applied IFRS 15, Revenue from Contracts with Customers, since 1 January 2018. In OP MB, IFRS 15 mainly applies to fees not included in the calculation of the effective interest rate.

Net commissions are presented in the notes to the Interim Report. Net commissions are divided into groups according to commission income and expenses recorded from customer agreements.
IFRS 15 did not change the revenue recognition time of the fees included in the scope of application of the standard in comparison with the previous practices. The adoption of IFRS 15 did not have any significant effect on OP MB’s financial result. OP MB started to apply IFRS 15 using the retrospective transition method.

Changes made to the specification of net commissions that previously were only presented in the Financial Statements are presented below:

- Commission expenses “From lending” have been named “From lending to OP cooperative banks”
- Commission expenses “Service charges to banks” have been named “Loan management fee to OP cooperative banks”
- Commission expenses from “Securities” have been named “Issue of bonds”

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	H1/2018	H1/2017	Q2/2018	Q2/2017	Q1–Q4/2017
Net interest income	36,338	36,258	17,531	18,102	74,984
Interest income	28,512	34,199	13,707	16,486	65,692
Interest expenses	-7,826	-2,059	-3,824	-1,615	-9,292
Net comissions and fees	-25,923	-24,892	-12,759	-12,499	-49,910
Net investment income	1	1	0	0	2
Other operating income	2	1	0	0	232
Total income	**10,419**	**11,368**	**4,772**	**5,603**	**25,309**
Personnel costs	185	169	97	76	328
Depreciation/amortisation and impairment loss	418	418	209	209	836
Other operating expenses	2,381	2,130	1,170	1,029	4,528
Total expenses	**2,983**	**2,718**	**1,476**	**1,314**	**5,692**
Impairment loss on receivables	168	-132	112	-212	-276
Earnings before tax	**7,604**	**8,519**	**3,408**	**4,077**	**19,341**
Income tax expense	1,520	1,703	682	815	3,868
Profit for the period	**6,083**	**6,815**	**2,726**	**3,262**	**15,473**

*Impairment losses on receivables have been calculated under IFRS 9 in 2018.

Statement of comprehensive income, TEUR	H1/2018	H1/2017	Q2/2018	Q2/2017	Q1–Q4/2017
Profit for the period	6,083	6,815	2,726	3,262	15,473
Items that will not be reclassified to profit or loss					
Gains/(losses) arising from remeasurement of defined benefit plans					1
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans					
Total comprehensive income	**6,083**	**6,815**	**2,726**	**3,262**	**15,473**

Key ratios	H1/2018	H1/2017	Q2/2018	Q2/2017	Q1–Q4/2017
Return on equity (ROE), %	3.2	3.7	3.0	3.5	4.1
Cost/income ratio, %	29	24	31	23	22

Cash flow from operating activities, TEUR	H1/2018	H1/2017
Profit for the financial year	6,083	6,815
Adjustments to profit for the financial year	5,893	6,046
Increase (-) or decrease (+) in operating assets	**-39,467**	**-1,467,167**
Receivables from credit institutions	-1,000,000	-2,000,000
Receivables from the public and public-sector entities	972,933	534,961
Other assets	-12,400	-2,128
Increase (+) or decrease (-) in operating liabilities	**-957,048**	**377,263**
Liabilities to credit institutions and central banks	-967,000	370,000
Other liabilities	9,952	7,263
Income tax paid	-1,392	-1,947
Dividends received	1	1
A. Net cash from operating activities	**-985,929**	**-1,078,988**
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	995,413	1,986,645
Decreases in debt securities issued to the public	0	-1,250,000
Dividends paid and interest on cooperative capital	-15,472	-9,038
C. Net cash used in financing activities	**979,940**	**727,608**
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)	**-5,989**	**-351,381**
Cash and cash equivalents at year-start	**363,609**	**451,787**
Cash and cash equivalents at year-end	**358,038**	**100,824**
Change in cash and cash equivalents	**-5,571**	**-350,963**
Interest received	18,412	32,310
Interest paid	-19,210	-8,945
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	-168	131
Price difference recognised on debt securities issued to the public	4,542	4,213
Other	1,519	1,702
Total adjustments	**5,893**	**6,046**
Cash and cash equivalents		
Receivables from credit institutions payable on demand	358,038	100,824
Total cash and cash equivalents	**358,038**	**100,824**

Balance sheet, TEUR	30 June 2018	30 June 2017	31 Dec. 2017
Receivables from credit institutions	6,134,207	3,953,593	5,139,778
Derivative contracts	124,424	151,770	129,810
Receivables from customers	7,832,253	8,504,785	8,803,822
Investments assets	40	40	40
Intangible assets	486	1,322	904
Other assets	61,786	58,340	49,386
Tax assets	554	703	705
Total assets	**14,153,750**	**12,670,553**	**14,124,444**
Liabilities to credit institutions	1,871,000	2,258,000	2,838,000
Derivative contracts	16,722	40,330	38,025
Debt securities issued to the public	11,813,060	9,916,185	10,796,102
Provisions and other liabilities	82,211	84,638	72,259
Tax liabilities			
Total liabilities	**13,782,993**	**12,299,153**	**13,744,387**
Shareholders’ equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	65,756	66,399	75,057
Total equity	370,756	371,399	380,057
Total liabilities and shareholders’ equity	**14,153,750**	**12,670,553**	**14,124,444**

Off-balance-sheet commitments, TEUR	30 June 2018	30 June 2017	31 Dec. 2017
Irrevocable commitments given on behalf of customers	2	8	3

Statement of changes in equity, TEUR	Share capital	Other reserves	Retained earnings	Total equity
Shareholders’ equity 1 Jan. 2017	**60,000**	**245,000**	**68,622**	**373,622**
Reserve for invested unrestricted equity				
Profit for the period			6,815	6,815
Other comprehensive income for the period				
Other changes			-9,038	-9,038
Shareholders’ equity 30 June 2017	**60,000**	**245,000**	**66,399**	**371,399**
Shareholders’ equity 31 Dec. 2017	**60,000**	**245,000**	**75,057**	**380,057**
Effect of IFRS 9 transition 1 Jan. 2018			**90**	**90**
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**	**65,756**	**370,756**

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 2018**	**31 Dec. 2017**
Shareholders' equity	370,756	380,057
Common Equity Tier 1 (CET1) before deductions	**370,756**	**380,057**
Intangible assets	-486	-904
Excess funding of pension liability	-66	-65
Share of unaudited profits	-6,083	-15,473
Impairment loss – shortfall of expected losses	-2,641	-2,676
Common Equity Tier 1 (CET1)	**361,481**	**360,940**
Tier 1 capital (T1)	**361,481**	**360,940**
Total capital base	**361,481**	**360,940**
Total risk exposure amount		
Credit and counterparty risk	255,023	289,070
Operational risk	32,602	40,554
Total	**287,626**	**329,623**
Key ratios, %		
CET1 capital ratio	125.7	109.5
Tier 1 capital ratio	125.7	109.5
Capital adequacy ratio	125.7	109.5
Capital requirement		
Capital base	361,481	360,940
Capital requirement	30,201	34,610
Buffer for capital requirements	331,280	326,329

Net commissions and fees, TEUR	H1/2018	H1/2017	Q2/2018	Q2/2017	Q1–Q4/2017
Commission income					
Lending	3,107	3,489	1,556	1,660	6,465
Total	**3,107**	**3,489**	**1,556**	**1,660**	**6,465**
Commission expenses					
From lending to OP cooperative banks	3,023	3,416	1,511	1,625	6,336
Loan management fee to OP cooperative banks	25,970	24,941	12,771	12,514	49,936
Issue of bonds	30	16	27	15	92
Other	7	7	6	5	11
Total	**29,030**	**28,381**	**14,315**	**14,158**	**56,375**
Net commissions and fees	**-25,923**	**-24,892**	**-12,759**	**-12,499**	**-49,910**

Classification of financial assets and liabilities 30 June 2018, TEUR				
Financial assets	**Amortised cost**	**Recognised at fair value through profit or loss**	**Fair value through other comprehensive income**	**Total**
Receivables from credit institutions	6,134,207			6,134,207
Derivative contracts		124,424		124,424
Receivables from customers	7,832,253			7,832,253
Shares and participations			40	40
Other receivables	61,786			61,786
Other assets	1,040			1,040
Total	**14,029,285**	**124,424**	**40**	**14,153,750**
Financial liabilities		**Recognised at fair value through profit or loss**	**Amortised cost**	**Total**
Liabilities to credit institutions			1,871,000	1,871,000
Derivative contracts		16,722		16,722
Debt securities issued to the public			11,813,060	11,813,060
Other liabilities			82,211	82,211
Total		**16,722**	**13,766,271**	**13,782,993**
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 June 2018			140,453	**140,453**

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**

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 2018, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	4,556,703	8,092,527	6,453,674	19,102,904
Total	**4,556,703**	**8,092,527**	**6,453,674**	**19,102,904**

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	124,424	16,722	317,485
Total	**124,424**	**16,722**	**317,485**

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**

Financial instruments classification, grouped by valuation technique, TEUR			
30 June 2018	**Fair value measurement at year end**		
	Balance sheet value	**Level 1**	**Level 2**
Recurring fair value measurements of assets			
Derivate contracts	124,424		124,424
Total	**124,424**		**124,424**
Recurring fair value measurements of liabilities			
Derivate contracts	16,722		16,722
Total	**16,722**		**16,722**
Financial liabilities not measured at fair value			
Debt securities issued to the public	11,813,060	11,711,042	242,471
Total	**11,813,060**	**11,711,042**	**242,471**

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**

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 Q1–3/2018	31 October 2018

Helsinki, 1 August 2018

OP Mortgage Bank
Board of Directors

For more information, please contact: Lauri Iloniemi, Managing Director, tel. +358 (0)10 252 3541

DISTRIBUTION
LSE London Stock Exchange
Euronext Dublin (Irish Stock Exchange)
OAM (Officially Appointed Mechanism)
Major media
op.fi