

OP Mortgage Bank: Interim Report for January–September 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 13,178 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 their entirety to OP cooperative banks in the form of intermediary loans. On 30 September 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–September amounted to EUR 12,1 (13,2) million.

*The comparatives for 2017 are given in brackets. For income statement and other aggregated figures, January–September 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 September 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 12,976 million.

Capital adequacy

The Common Equity Tier 1 (CET1) ratio stood at 132,7 % (109.5) on 30 September 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 September 2018, OP Cooperative's members comprised 156 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 September 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.

On 31 October 2018, Harri Luhtala, Chair of the Board of Directors, resigned from membership of the Executive Board of OP Financial Group's central cooperative and, consequently, from membership of the Board of Directors of OP Mortgage Bank.

Vesa Aho was appointed to member of the Board of Directors to replace Harri Luhtala as of 1 November 2018. He was also appointed the Board's Chair.

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 the future.

Accounting policies

The Interim Report for 1 January–30 September 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	Q1– Q3/2018	Q1– Q3/2017	Q3/2018	Q3/2017	Q1– Q4/2017
Net interest income	54,615	54,735	18,276	18,477	74,984
Interest income	41,088	49,407	12,575	15,207	65,692
Interest expenses	-13,527	-5,328	-5,701	-3,270	-9,292
Net commissions and fees	-37,876	-37,080	-11,953	-12,189	-49,910
Net investment income	1	1	0	0	2
Other operating income	2	1	0	0	232
Total income	16,742	17,656	6,323	6,288	25,309
Personnel costs	260	241	76	72	328
Depreciation/amortisation and impairment loss	627	627	209	209	836
Other operating expenses	3,791	3,352	1,410	1,222	4,528
Total expenses	4,678	4,221	1,695	1,503	5,692
Impairment loss on receivables	35	-239	-133	-107	-276
Earnings before tax	12,098	13,197	4,494	4,678	19,341
Income tax expense	2,419	2,639	899	936	3,868
Profit for the period	9,679	10,558	3,596	3,742	15,473

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

Statement of comprehensive income, TEUR	Q1– Q3/2018	Q1– Q3/2017	Q3/2018	Q3/2017	Q1– Q4/2017
Profit for the period	9,679	10,558	3,596	3,742	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					0
Total comprehensive income	9,679	10,558	3,596	3,742	15,473

Key ratios	Q1– Q3/2018	Q1– Q3/2017	Q3/2018	Q3/2017	Q1– Q4/2017
Return on equity (ROE), %	3.4	3.8	3.9	5.3	4.1
Cost/income ratio, %	28	24	27	24	22

Cash flow from operating activities, TEUR	Q1–Q3/2018	Q1–Q3/2017
Profit for the financial year	9,679	10,558
Adjustments to profit for the financial year	9,017	9,011
Increase (-) or decrease (+) in operating assets	420,199	-1,005,353
Receivables from credit institutions	-1,000,000	-2,010,000
Receivables from the public and public-sector entities	1,403,677	989,451
Other assets	16,523	15,196
Increase (+) or decrease (-) in operating liabilities	-711,595	74,875
Liabilities to credit institutions and central banks	-692,000	90,000
Other liabilities	-19,595	-15,125
Income tax paid	-1,950	-3,032
Dividends received	1	1
A. Net cash from operating activities	-274,648	-913,939
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	-1,000,000	-1,350,000
Dividends paid and interest on cooperative capital	-15,472	-9,038
C. Net cash used in financing activities	-20,060	627,608
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)	-294,708	-286,332
Cash and cash equivalents at year-start	363,609	451,787
Cash and cash equivalents at year-end	69,527	166,082
Change in cash and cash equivalents	-294,081	-285,705
Interest received	56,436	65,156
Interest paid	4,339	9,919
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations	0	0
Impairment losses on receivables	-34	239
Price difference recognised on debt securities issued to the public	6,633	6,134
Other	2,418	2,638
Total adjustments	9,017	9,011
Cash and cash equivalents		
Receivables from credit institutions payable on demand	69,527	166,082
Total cash and cash equivalents	69,527	166,082

Balance sheet, TEUR	30 Sep. 2018	30 Sep. 2017	31 Dec. 2017
Receivables from credit institutions	5,845,696	4,028,851	5,139,778
Derivative contracts	94,713	148,566	129,810
Receivables from customers	7,401,537	8,050,192	8,803,822
Investments assets	40	40	40
Intangible assets	277	1,113	904
Other assets	32,863	41,016	49,386
Tax assets	213	852	705
Total assets	13,375,340	12,270,630	14,124,444
Liabilities to credit institutions	2,146,000	1,978,000	2,838,000
Derivative contracts	35,832	32,915	38,025
Debt securities issued to the public	10,766,493	9,822,322	10,796,102
Provisions and other liabilities	52,664	62,250	72,259
Tax liabilities	0	0	0
Total liabilities	13,000,988	11,895,488	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	69,352	70,142	75,057
Total equity	374,352	375,142	380,057
Total liabilities and shareholders' equity	13,375,340	12,270,630	14,124,444

Off-balance-sheet commitments, TEUR	30 Sep. 2018	30 Sep. 2017	31 Dec. 2017
Irrevocable commitments given on behalf of customers	2	3	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			10,558	10,558
Other comprehensive income for the period				
Other changes			-9,038	-9,038
Shareholders' equity 30 Sep. 2017	60,000	245,000	70,142	375,142
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			9,679	9,679
Other comprehensive income for the period				
Other changes			-15,474	-15,474
Shareholders' equity 30 Sep. 2018	60,000	245,000	69,352	374,352

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 Sep. 2018	31 Dec. 2017
Shareholders' equity	374,352	380,057
Common Equity Tier 1 (CET1) before deductions	374,352	380,057
Intangible assets	-277	-904
Excess funding of pension liability	-66	-65
Share of unaudited profits	-9,676	-15,473
Impairment loss – shortfall of expected losses	-2,447	-2,676
Common Equity Tier 1 (CET1)	361,883	360,940
Tier 1 capital (T1)	361,883	360,940
Total capital base	361,883	360,940
Total risk exposure amount		
Credit and counterparty risk	240,169	289,070
Operational risk	32,602	40,554
Total	272,772	329,623
Key ratios, %		
CET1 capital ratio	132.7	109.5
Tier 1 capital ratio	132.7	109.5
Capital adequacy ratio	132.7	109.5
Capital requirement		
Capital base	361,883	360,940
Capital requirement	28,641	34,610
Buffer for capital requirements	333,242	326,329

Net commissions and fees, TEUR	Q1- Q3/2018	Q1- Q3/2017	Q3/2018	Q3/2017	Q1- Q4/2017
Commission income					
Lending	4,561	4,925	1,454	1,435	6,465
Total	4,561	4,925	1,454	1,435	6,465
Commission expenses					
From lending to OP cooperative banks	4,430	4,803	1,407	1,387	6,336
Loan management fee to OP cooperative banks	37,959	37,110	11,989	12,168	49,936
Issue of bonds	38	83	8	67	92
Other	10	9	3	1	11
Total	42,437	42,005	13,407	13,624	56,375
Net commissions and fees	-37,876	-37,080	-11,953	-12,189	-49,910

Classification of financial assets and liabilities 30 Sep. 2018, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions	5,845,696			5,845,696
Derivative contracts		94,713		94,713
Receivables from customers	7,401,537			7,401,537
Shares and participations			40	40
Other receivables	32,863			32,863
Other assets	490			490
Total	13,280,587	94,713	40	13,375,340
Financial liabilities		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities to credit institutions			2,146,000	2,146,000
Derivative contracts		35,832		35,832
Debt securities issued to the public			10,766,493	10,766,493
Other liabilities			52,664	52,664
Total		35,832	12,965,157	13,000,988
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 Sep. 2018			89,940	89,940
Classification of financial assets and liabilities 31 Dec. 2017, TEUR				
	Loans and other receivables	Recognised at fair value through profit or loss	Available for sale	Total
Financial assets				
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 Sep. 2018, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,486,647	8,092,527	7,147,710	17,726,884
Total	2,486,647	8,092,527	7,147,710	17,726,884

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	94,713	35,832	276,675
Total	94,713	35,832	276,675

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 Sep. 2018	Fair value measurement at the end of reporting period		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	94,713		94,713
Total	94,713		94,713
Recurring fair value measurements of liabilities			
Derivate contracts	35,832		35,832
Total	35,832		35,832
Financial liabilities not measured at fair value			
Debt securities issued to the public	10,766,493	10,614,685	241,748
Total	10,766,493	10,614,685	241,748

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.

Schedule for Financial Statements Bulletin for 2018 and Interim Reports in 2019

Financial Statements Bulletin 2018	5 February 2019
Interim Report Q1/2019	7 May 2019
Interim Report H1/2019	30 July 2019
Interim Report Q1—3/2019	29 October 2019

Helsinki, 31 October 2018

OP Mortgage Bank
Board of Directors

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

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