

OP Mortgage Bank: Interim Report for January–March 2019

OP Mortgage Bank (OP MB) is part of OP Financial Group and its role is to raise, together with OP Corporate Bank plc, funding for OP from money and capital markets. OP MB is responsible for the Group's funding for the part of covered bond issuance.

Financial standing

The intermediary loans and loan portfolio of OP MB increased to EUR 14,439 million (13,771)*. OP MB issued a 1.25 billion-euro fixed-rate covered bond with a maturity of 10 years in international capital markets in February. Out of the proceeds of the bond, one billion euros were intermediated to OP cooperative banks in the form of intermediate loans. On 31 March 2019, 124 OP cooperative banks had a total of EUR 7,776 million (6,776) in intermediate loans from OP MB.

The company's financial standing remained stable throughout the reporting period. Operating profit for January–March amounted to EUR 4.2 (4.2) million.

*The comparatives for 2018 are given in brackets. For income statement and other aggregated figures, January–March 2018 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2018) serve as comparatives.

Collateralisation of bonds issued to the public

On 31 March 2019, loans as collateral in security of the covered bonds issued under the Euro Medium Term Covered Note programme worth EUR 20 billion established on 12 November 2010 under the Covered Bond Act (Laki kiinnityspank- kitoiminnasta (688/2010)) totalled EUR 14,452 million.

Capital adequacy

OP MB's Common Equity Tier 1 (CET1) ratio stood at 130.9% (136.4) on 31 March 2019. 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 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.

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 2019, OP Cooperative's member credit institutions comprised 155 OP 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 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 March 2019, 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	Vesa Aho	Chief Financial Officer, OP Cooperative
Members	Kaisu Christie Hanno Hirvinen	Director, Mortgages and Housing-related Services, OP Cooperative Head of Group Reasury, Op Corporate Bank plc

OP MB's Managing Director is Lauri Iloniemi, and his deputy is Sanna Eriksson.

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

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

Risk exposure

The most typical types of risks related to OP MB are credit risk, structural funding risk, liquidity risk and interest rate risk. The key credit risk indicators in use show that OP MB's credit risk exposure is stable and the limit for liquidity risk set by the Board of Directors has not been exceeded. The liquidity buffer for OP Financial Group, managed by OP Corporate Bank, is exploitable by OP MB. OP MB has used interest rate swaps to hedge against its interest rate risk. Interest rate swaps have been used to swap housing 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.

Outlook

On 25 April 2019, the ECB issued OP Financial Group with a decision on retail exposures as part of the TRIM project (Targeted Review of Internal Models). The decision, which took effect immediately, increases the risk weights of home loans applied in the capital adequacy measurement of OP Financial Group and its member credit institutions from their current level of 6% to approximately 12%. As a result of the increase in risk weights on home loans, the CET1 ratio of OP MB will decrease to approximately 60%. It is expected that OP MB's capital adequacy will still 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 for 1 January–30 March 2019 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 16 Leases adoption on 1 January 2019

OP MB adopted IFRS 16 Leases from 1 January 2019. The new standard changed the lessor's accounting and affected accounting for operating leases. As a result, all the lessor's leases were recognised in the balance sheet since operating leases and finance leases will no longer be separated from each other. OP MB applied a retrospective approach in the transition to a limited extent, which is why it did not restate comparatives for 2018. The adoption of the standard did not have any major effect on OP MB's balance sheet total.

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	Q1/2019	Q1/2018	Q1-4/2018
Net interest income	16,416	18,807	71,893
Interest income	10,410	14,805	52,587
Interest expenses	-6,006	-4,002	-19,306
Net commissions and fees	-10,627	-13,164	-49,193
Net investment income	1	1	1
Other operating income	0	2	3
Total income	5,790	5,647	22,704
Personnel costs	82	88	191
Depreciation/amortisation and impairment loss	53	209	783
Other operating expenses	1,348	1,211	5,099
Total expenses	1,483	1,507	6,073
Impairment loss on receivables	-98	56	-382
Earnings before tax	4,209	4,196	16,248
Income tax expense	842	839	3,249
Profit for the period	3,367	3,357	12,999

Statement of comprehensive income, TEUR	Q1/2019	Q1/2018	Q1-4/2018
Profit for the period	3,367	3,357	12,999
Items that will not be reclassified to profit or loss			
Gains/(losses) arising from remeasurement of defined benefit plans			60
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans			-12
Total comprehensive income	3,367	3,357	13,047

Key ratios	Q1/2019	Q1/2018	Q1-4/2018
Return on equity (ROE), %	3.4	3.6	3.4
Cost/income ratio, %	26	27	27

Cash flow from operating activities, TEUR	Q1/2019	Q1/2018
Profit for the financial year	3,367	3,357
Adjustments to profit for the financial year	3,138	2,986
Increase (-) or decrease (+) in operating assets	-664,355	512,251
Receivables from credit institutions	-1,000,000	0
Receivables from the public and public-sector entities	334,928	519,106
Other assets	717	-6,855
Increase (+) or decrease (-) in operating liabilities	-290,359	-498,854
Liabilities to credit institutions and central banks	-300,000	-500,000
Other liabilities	9,641	1,146
Income tax paid	-966	-1,140
Dividends received	1	1
A. Net cash from operating activities	-949,174	18,601
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	1,233,863	0
Dividends paid and interest on cooperative capital	-12,998	-15,472
C. Net cash used in financing activities	1,220,864	-15,472
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)	271,690	3,129
Cash and cash equivalents at year-start	133,460	363,609
Cash and cash equivalents at year-end	405,203	366,947
Change in cash and cash equivalents	271,743	3,338
Interest received	10,683	10,121
Interest paid	-16,333	-6,733
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations		
Impairment losses on receivables	99	-56
Price difference recognised on debt securities issued to the public	2,198	2,205
Other	840	837
Total adjustments	3,138	2,986
Cash and cash equivalents		
Receivables from credit institutions payable on demand	405,203	366,947
Total cash and cash equivalents	405,203	366,947

Balance sheet, TEUR	31 Mar. 2019	31 Mar. 2018	31 Dec. 2018
Receivables from credit institutions	8,181,373	5,143,116	6,909,630
Derivative contracts	223,450	113,306	139,668
Receivables from customers	6,663,249	8,284,697	6,994,873
Investments assets	40	40	40
Intangible assets	69	695	120
Other assets	31,807	56,241	32,525
Tax assets	125	995	0
Total assets	15,100,113	13,599,088	14,076,856
Liabilities to credit institutions	2,596,000	2,338,000	2,896,000
Derivative contracts	12,021	43,072	8,597
Debt securities issued to the public	12,062,664	10,776,570	10,742,840
Provisions and other liabilities	61,266	73,405	51,625
Tax liabilities	74	11	74
Total liabilities	14,732,024	13,231,059	13,699,135
Shareholders' equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	63,089	63,030	72,720
Total equity	368,089	368,030	377,720
Total liabilities and shareholders' equity	15,100,113	13,599,088	14,076,856

Off-balance-sheet commitments, TEUR	31 Mar. 2019	31 Mar. 2018	31 Dec. 2018
Irrevocable commitments given on behalf of customers	2	2	2

Statement of changes in equity, TEUR	Share capital	Other funds	Retained earnings	Total shareholders' equity
Shareholders' equity 1 Jan. 2018	60,000	245,000	75,147	380,147
Reserve for invested unrestricted equity				
Profit for the period			3,357	3,357
Other comprehensive income for the period			0	0
Other changes			-15,474	-15,474
Shareholders' equity 31 Mar. 2018	60,000	245,000	63,030	368,030

Shareholders' equity 1 Jan. 2019	60,000	245,000	72,720	377,720
Reserve for invested unrestricted equity				
Profit for the period			3,367	3,367
Other comprehensive income for the period				
Other changes			-12,998	-12,998
Shareholders' equity 31 Mar. 2019	60,000	245,000	63,089	368,089

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 Mar. 2019	31 Dec. 2018
Shareholders' equity	368,089	377,720
Common Equity Tier 1 (CET1) before deductions	368,089	377,720
Intangible assets	-69	-120
Excess funding of pension liability	-66	-66
Share of unaudited profits	-3,367	-12,999
Shortfall of ECL minus expected losses	-2,092	-1,962
Common Equity Tier 1 (CET1)	362,495	362,573
Tier 1 capital (T1)	362,495	362,573
Excess of ECL minus expected losses	18	38
Tier 2 Capital (T2)	18	38
Total capital base	362,513	362,611
Total risk exposure amount		
Credit and counterparty risk	238,649	223,980
Operational risk	38,237	41,893
Total	276,886	265,873
Key ratios, %		
CET1 ratio	130.9	136.4
Tier 1 capital ratio	130.9	136.4
Capital adequacy ratio	130.9	136.4
Capital requirement		
Capital base	362,513	362,611
Capital requirement	29,084	27,924
Buffer for capital requirements	333,429	334,687

Net commissions and fees, TEUR	Q1/2019	Q1/2018	Q1-4/2018
Commission income			
Lending	1,208	1,552	5,972
Total	1,208	1,552	5,972
Commission expenses			
From lending to OP cooperative banks	1,168	1,511	5,783
Loan management fee to OP cooperative banks	10,586	13,199	49,297
Issue of bonds	80	3	72
Other	1	2	13
Total	11,835	14,715	55,165
Net commissions and fees	-10,627	-13,164	-49,193

Classification of financial assets and liabilities 31 March 2019, TEUR				
Assets	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Receivables from credit institutions and central banks	8,181,373			8,181,373
Derivative contracts		223,450		223,450
Receivables from customers	6,663,249			6,663,249
Shares and participations			40	40
Other receivables	31,807			31,807
Other assets	193			193
Total	14,876,622	223,450	40	15,100,113
Liabilities		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities to credit institutions			2,596,000	2,596,000
Derivative contracts		12,021		12,021
Debt securities issued to the public			12,062,664	12,062,664
Other liabilities			61,339	61,339
Total		12,021	14,720,003	14,732,024
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 March 2019			244,733	244,733

Classification of financial assets liabilities 31 Dec. 2018, TEUR				
Assets	Amortised cost	Recognised at fair value through profit or loss	Fair value through other comprehensive income	Total
Receivables from credit institutions and central banks	6,909,630			6,909,630
Derivative contracts		139,668		139,668
Receivables from customers	6,994,873			6,994,873
Shares and participations			40	40
Other receivables	32,525			32,525
Other assets	120			120
Total	13,937,148	139,668	40	14,076,856
Liabilities		Recognised at fair value through profit or loss	Amortised cost	Total
Liabilities to credit institutions			2,896,000	2,896,000
Derivative contracts		8,597		8,597
Debt securities issued to the public			10,742,840	10,742,840
Other liabilities			51,698	51,698
Total		8,597	13,690,539	13,699,135
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec. 2018			140,345	140,345

Debt securities issued to the public are carried at amortised cost. The fair value of these debt instruments has been measured using information available in markets and employing commonly used valuation techniques. The difference between the fair value and carrying amount is presented as valuation difference in the "Classification of financial assets and liabilities" table.

Derivative contracts 31 Mar. 2019, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,480,662	8,843,827	6,989,731	18,314,220
Total	2,480,662	8,843,827	6,989,731	18,314,220

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	223,450	12,021	408,907
Total	223,450	12,021	408,907

Derivative contracts 31 Dec. 2018, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,450,856	8,092,527	6,849,439	17,392,822
Total	2,450,856	8,092,527	6,849,439	17,392,822

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	139,668	8,597	319,910
Total	139,668	8,597	319,910

Financial instruments classification, grouped by valuation technique, TEUR			
31 Mar. 2019	Fair value measurement at year end		
	Balance sheet value	Level 1	Level 2
Recurring fair value measurements of assets			
Derivate contracts	223,450		223,450
Total	223,450		223,450
Recurring fair value measurements of liabilities			
Derivate contracts	12,021		12,021
Total	12,021		12,021
Financial liabilities not measured at fair value			
Debt securities issued to the public	12,062,664	12,160,209	147,188
Total	12,062,664	12,160,209	147,188

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

OP MB does not hold any transfers between the levels of fair value valuation.

Schedule for Interim Reports in 2019:

Interim Report H1/2019	30 July 2019
Interim Report Q1–3/2019	29 October 2019

Helsinki, 7 May 2019

OP Mortgage Bank Board of Directors

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