OP MORTGAGE BANK
Stock exchange release 27 April 2017
Interim Report

OP Mortgage Bank: Interim Report for January–March 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 11,427 million (10,892)* during the reporting period. In March, OP MB issued a fixed-rate covered bond with a maturity of seven years in international capital markets. OP MB intermediated the bond with a nominal value of EUR 1,000 million in intermediate loans in its entirety to OP cooperative banks. On 31 March 2017, 95 OP cooperative banks had a total of EUR 2,853 million (1,853) 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 4.4 (5.4) million.

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 comparatives for 2016 are given in brackets. For income statement and other aggregated figures, January–March 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 March 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 10,991 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 112.2 % (109.5) on 31 March 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 increased capital conservation buffer.

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 45.5 million in March. Information on the Basel I floor and capital surplus can be found in note "Capital base and capital adequacy".

The Financial Supervisory Authority has decided to prepare a 15% minimum risk weight for home loans, in an effort, according to the Authority, to prepare for an intermediate-term systemic risk. OP MB's loan portfolio consists of low-risk home loans, on which the Authority's possible decision will relatively have the strongest impact. Based on an assessment, OP MB's capital adequacy will, however, remain solid even after the entry into force of the floor and be clearly above the minimum requirements set by the authorities; the minimum level of capital will continue to be determined according to the Basel I floor even after the setting of the floor. The Authority seeks to adopt the minimum risk weight at the beginning of 2018.

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 2017, OP Cooperative's members comprised 172 member cooperative banks as well as OP Corporate Bank plc, OP Mortgage Bank, OP Card Company Plc and 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 March 2017, OP MB had five employees. The Bank 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	Group Treasurer, 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. The interest rate risk of OP MB may be considered to be low.

Outlook

It is expected that the bank'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 2017.

Accounting policies

The Interim Report for 1 January–31 March 2017 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 financial year saw no major changes in related-party transactions.

The income statement layout grouping has been updated for the Interim Report 1 January–30 September 2016. Comparatives have been restated to correspond to the new grouping.

New standards and interpretations

IFRS 9 Financial Instruments

OP MB will for the first time apply IFRS 9 as of 1 January 2018.

The quantitative effect of the application of the standard on the 2018 financial statements cannot yet be assessed reliably since it will depend on the amount of the financial instruments held at that time, the financial position at that time and the choice of the calculation principles and management judgement. The new standard requires that OP MB analyse the calculation and monitoring processes for financial instruments, with the related changes being made are not yet completed. OP MB has made a preliminary assessment of the effects of the adoption of IFRS 9, as follows:

Classification and measurement

The classification of financial instruments under IFRS 9 is based on both the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial asset.

In case the objective of the debt instrument held within the portfolio business model is to hold assets in order to collect contractual cash flows or the objective is achieved by collecting contractual cash flows and selling financial assets, the classification is based on the contractual cash flow characteristics. In such a case, contractual cash flows that are solely payments of principal and interest on the principal amount outstanding are in line with a basic lending arrangement. Under IFRS 9, these financial assets are amortised cost or at fair value through other comprehensive income (FVOCI). The majority of OP MB’s financial assests under debt instruments are included in the abovementioned portfolios.

Impairment

The expected credit loss is calculated on all balance sheet items amortised at cost and those recognised at fair value through other comprehensive income (FVOCI) and on off-balance-sheet loan commitments.

OP MB’s credit risk models and the development of related systems are still underway. The expected credit loss is calculated using modelled risk parameters and formula PDxLGDxEAD for the majority of the portfolios. The expected credit loss is calculated for 12 months or lifetime, depending on whether the instrument’s credit risk on the reporting day has increased significantly from the original one. OP MB is planning to assess an increase in credit risk for lifetime through PD change. In addition, credit risk has increased significantly if payment is over 30 days past due. In the definition of default, OP MB uses a uniform definition in capital adequacy measurement.

OP MB will include forward-looking information and macroeconomic scenarios in the model. The macroeconomic scenarios are the same that OP MB uses otherwise in its financial annual planning.

Expected credit loss provisions under IFRS 9 are assessed to increase significantly from its current level based on IAS 39 and it varies by portfolio. The provisions will reduce equity capital on the date of transition. Based on preliminary assessments, the increase in expected credit loss provisions is not expected to have any significant effect on OP MB's CET1 ratio because the IFRS 9 compliant expected credit loss provisions are not expected to exceed the expected loss calculated in capital adequacy and the effect of used floors. Furthermore, the amendment to the Capital Requirements Regulation (CRR), proposed by the European Commission in November 2016, involves the possibility to gradually phase in the effects of impairment loss measurement under IFRS 9 in the calculation of the CET1 ratio.

Hedge accounting

For portfolio hedges, OP MB will continue to apply hedge accounting under IAS 39. OP MB has not yet made the decision to adopt IFRS 9 compliant hedge accounting.

Transitional provisions

OP MB will utilise the opportunity permitted by IFRS 9 not to restate comparative periods in classification and recognition (incl. impairment) in respect of the amendments. Retained earnings will be restated through the amendments as of 1 January 2018.

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	Q1/2017	Q1/2016	Q1–Q4/2016
Net interest income	18,156	18,866	76,171
Interest income	17,713	24,300	84,978
Interest expenses	-443	5,434	8,807
Net commissons and fees	-12,393	-12,156	-47,757
Net investment income	1	2	7
Other operating income	1	1	22
Total income	**5,765**	**6,713**	**28,443**
Personnel costs	93	89	321
Depreciation/amortisation and impairment loss	209	209	836
Other operating expenses	1,102	956	4,243
Total expenses	**1,404**	**1,254**	**5,400**
Impairment loss on receivables	80	-67	-400
Earnings before tax	**4,441**	**5,392**	**22,643**
Income tax expense	888	1,078	4,566
Profit for the period	**3,553**	**4,313**	**18,077**

Statement of comprehensive income, TEUR	Q1/2017	Q1/2016	Q1–Q4/2016
Profit for the period	3,553	4,313	18,077
Items that will not be reclassified to profit or loss			
Gains/(losses) arising from remeasurement of defined benefit plans			-138
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans			28
Total comprehensive income	**3,553**	**4,313**	**17,967**

Key ratios	Q1/2017	Q1/2016	Q1–Q4/2016
Return on equity (ROE), %	3.8	4.7	4.8
Cost/income ratio, %	24	19	19

Cash flow from operating activities, TEUR	Q1/2017	Q1/2016
Profit for the financial year	3,553	4,313
Adjustments to profit for the financial year	2,817	2,305
Increase (-) or decrease (+) in operating assets	**-548,394**	**16,088**
Receivables from credit institutions	-1,000,000	
Receivables from the public and public-sector entities	465,039	33,771
Other assets	-13,433	-17,683
Increase (+) or decrease (-) in operating liabilities	**-818,083**	**804,248**
Liabilities to credit institutions and central banks	-830,000	790,000
Other liabilities	11,917	14,248
Income tax paid	-1,251	-921
Dividends received	1	2
A. Net cash from operating activities	**-1,361,356**	**826,955**
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	992,263	
Dividends paid and interest on cooperative capital	-9,038	-16,282
C. Net cash used in financing activities	**983,225**	**-16,282**
D. Effect of foreign exchange rate changes on cash and cash equivalents		**0**
Net change in cash and cash equivalents (A+B+C+D)	**-378,132**	**810,673**
Cash and cash equivalents at year-start	**451,787**	**245,120**
Cash and cash equivalents at year-end	**73,864**	**1,056,002**
Change in cash and cash equivalents	**-377,923**	**810,882**
Interest received	9,089	6,564
Interest paid	-12,193	-8,966
Adjustments to profit for the financial year		
Non-cash items		
Unrealised net gains on foreign exchange operations		0
Impairment losses on receivables	-80	68
Other	2,898	2,237
Total adjustments	**2,817**	**2,305**
Cash and cash equivalents		
Receivables from credit institutions payable on demand	73,864	1,056,002
Total cash and cash equivalents	**73,864**	**1,056,002**

Balance sheet, TEUR	31 Mar 2017	31 Mar 2016	31 Dec 2016
Receivables from credit institutions	2,926,634	1,799,372	2,304,556
Derivative contracts	181,599	273,010	220,461
Receivables from customers	8,574,074	9,576,120	9,039,563
Investments assets	40	40	40
Intangible assets	1,531	2,366	1,739
Other assets	69,644	96,506	56,212
Tax assets	823		460
Total assets	**11,754,344**	**11,747,413**	**11,623,031**
Liabilities to credit institutions	1,058,000	2,165,000	1,888,000
Derivative contracts	17,299	6,202	6,233
Debt securities issued to the public	10,221,615	9,092,027	9,277,801
Provisions and other liabilities	89,292	122,733	77,375
Tax liabilities	0	1,483	
Total liabilities	**11,386,207**	**11,387,445**	**11,249,409**
Shareholders’ equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	63,137	54,968	68,622
Total equity	368,137	359,968	373,622
Total liabilities and shareholders’ equity	**11,754,344**	**11,747,413**	**11,623,031**

Off-balance-sheet commitments, TEUR	31 Mar 2017	31 Mar 2016	31 Dec 2016
Irrevocable commitments given on behalf of customers	8	205	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			4,313	4,313
Total comprehensive income				
Other changes			-16,282	-16,282
Shareholders’ equity 31 Mar 2016	**60,000**	**245,000**	**54,968**	**359,968**
Shareholders’ equity 1 Jan 2017	**60,000**	**245,000**	**68,622**	**373,622**
Reserve for invested unrestricted equity				
Profit for the period			3,553	3,553
Total comprehensive income				
Other changes			-9,038	-9,038
Shareholders’ equity 31 Mar 2017	**60,000**	**245,000**	**63,137**	**368,137**

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 2017**	**31 Dec 2016**
Shareholders' equity	368,137	373,622
Common Equity Tier 1 (CET1) before deductions	**368,137**	**373,622**
Intangible assets	-1,531	-1,739
Excess funding of pension liability	-67	-67
Share of unaudited profits	-3,553	-18,077
Impairment loss – shortfall of expected losses	-2,883	-2,612
Common Equity Tier 1 (CET1)	**360,103**	**351,126**
Tier 1 capital (T1)	**360,103**	**351,126**
Total capital base	**360,103**	**351,126**
Total risk exposure amount		
Credit and counterparty risk	280,341	286,845
Operational risk	40,554	33,898
Total	**320,894**	**320,743**
Key ratios, %		
CET1 capital ratio	112.2	109.5
Tier 1 capital ratio	112.2	109.5
Capital adequacy ratio	112.2	109.5
Basel I floor		
Capital base	360,103	351,126
Basel I capital requirements floor	314,653	322,006
Capital buffer for Basel I floor	45,450	29,120

Classification of financial assets and liabilities 31 March 2017, TEUR				
Financial assets	**Loans and other receivables**	**Recognised at fair value through profit or loss**	**Available for sale**	**Total**
Receivables from credit institutions	2,926,634			2,926,634
Derivative contracts		181,599		181,599
Receivables from customers	8,574,074			8,574,074
Shares and participations			40	40
Other receivables	69,644			69,644
Other assets	2,353			2,353
Total	**11,572,705**	**181,599**	**40**	**11,754,344**
Financial liabilities		**Recognised at fair value through profit or loss**	**Other liabilities**	**Total**
Liabilities to credit institutions			1,058,000	1,058,000
Derivative contracts		17,299		17,299
Debt securities issued to the public			10,221,615	10,221,615
Other liabilities			89,293	89,293
Total		**17,299**	**11,368,908**	**11,386,207**
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 March 2017			237,788	**237,788**

Classification of financial assets 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 Mar 2017, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1–5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,756,837	8,216,977	7,124,058	18,097,871
Total	**2,756,837**	**8,216,977**	**7,124,058**	**18,097,871**

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	181,599	17,299	394,236
Total	**181,599**	**17,299**	**394,236**

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 Mar 2017	**Fair value measurement at year end**		
	Balance sheet value	**Level 1**	**Level 2**
Recurring fair value measurements of assets			
Derivate contracts	181,599		181,599
Total	**181,599**		**181,599**
Recurring fair value measurements of liabilities			
Derivate contracts	17,299		17,299
Total	**17,299**		**17,299**
Financial liabilities not measured at fair value			
Debt securities issued to the public	10,221,615	10,095,600	363,804
Total	**10,221,615**	**10,095,600**	**363,804**

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**

Financial reporting 2017

Schedule for Interim Reports in 2017:

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Helsinki, 27 April 2017

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