

OP Mortgage Bank: Interim Report 1 January–30 September 2020

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 totalled EUR 15,056 million (14,335)* on 30 September 2020. OP MB issued a 1 billion-euro fixed-rate covered bond with a maturity of 8.25 years in international capital markets in January. Out of the proceeds of the bond, EUR 984 million were intermediated to 77 OP cooperative banks in the form of intermediary loans in April. In February, a new extension of an intermediary loan model was performed on a bond issued in February 2019 that will mature in 2029. As part of this extension, seven OP cooperative banks applied for an intermediary loan from OP MB at a total amount of EUR 185 million.

In April, OP MB issued a 500 million-euro retained covered bond with a maturity of two years. Out of the proceeds of the bond, EUR 100 million was intermediated to an OP cooperative bank in the form of an intermediary loan in June. In April, OP MB also issued a 300 million-euro retained covered bond with a maturity of eight years. The proceeds of the bond were intermediated in full to five OP cooperative banks in the form of intermediary loans. The bond issues in April were performed as internal issues within OP Financial Group.

On 30 September 2020, 120 OP cooperative banks had a total of EUR 10,255 million (8,706) in intermediate loans from OP MB.

Impairment loss on receivables increased to EUR 1.3 million (0.0). As a result of the coronavirus crisis, customers have actively applied for repayment holidays on their loans. Combined with the changes in macroeconomic parameters applied in the calculation of expected credit losses, this increased the amount of expected credit losses. The new definition of default adopted in March also increased the amount of expected credit losses.

The company's financial standing remained stable throughout the reporting period. Earnings before tax amounted to EUR 6.3 million (11.8).

*The comparatives for 2019 are given in brackets. For income statement and other aggregated figures, January–September 2019 figures serve as comparatives. For balance-sheet and other cross-sectional figures, figures at the end of the previous financial year (31 December 2019) serve as comparatives.

Collateralisation of bonds issued to the public

On 30 September 2020, 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 Act on Mortgage Credit Banks (Laki kiinnityspankkitoiminnasta (688/2010)) totalled EUR 15,392 million.

Capital adequacy and capital base

OP MB's Common Equity Tier 1 (CET1) ratio stood at 61.0% (69.8) on 30 September 2020. The lower ratio was affected in particular by the rise in risk weights caused by the adoption of the new definition of default. The minimum 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.

OP MB has presented its capital base and capital adequacy in accordance with the EU Capital Requirements Regulation (EU 575/2013).

Capital base and capital adequacy, TEUR	30 Sep 2020	31 Dec 2019
Shareholders' equity	369,781	376,616
Common Equity Tier 1 (CET1) before deductions	369,781	376,616
Excess funding of pension liability	-69	-69
Share of unaudited profits	-5,055	-11,892
Shortfall of ECL minus expected losses	-3,815	-5,589
Common Equity Tier 1 (CET1)	360,841	359,066
Tier 1 capital (T1)	360,841	359,066
Tier 2 Capital (T2)		
Total capital base	360,841	359,066
Total risk exposure amount		
Credit and counterparty risk	556,575	476,138
Operational risk	34,748	38,237
Total	591,323	514,375
Key ratios, %		
CET1 capital ratio	61.0	69.8
Tier 1 capital ratio	61.0	69.8
Capital adequacy ratio	61.0	69.8
Capital requirement		
Capital base	360,841	359,066
Capital requirement	62,089	54,012
Buffer for capital requirements	298,751	305,055

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 2020, OP Cooperative's member credit institutions comprised 138 OP cooperative banks as well as OP Corporate Bank plc, OP MB and OP Card Company Plc.

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 Act on Mortgage Credit Banks, 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 receivables without this being prevented by OP MB's liquidation or bankruptcy.

Personnel

On 30 September 2020, OP MB had six 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.

Management

The Board composition is as follows:

Chair	Vesa Aho	Chief Financial Officer, OP Cooperative
Members	Kaisu Christie	Director, Retail Customer Financing and Housing-related Services, OP Cooperative
	Lauri Iloniemi	Head of Group Treasury and Asset and Liability Management, OP Corporate Bank plc

OP MB's Managing Director is Sanna Eriksson. Until 30 June 2020, the deputy Managing Director was Pekka Moisio, Head of Funding and Liquidity Management. As of 1 July 2020, the deputy Managing Director is Tuomas Ruotsalainen, Senior Covered Bonds Manager at OP MB.

Risk exposure

When entering 2020, OP MB had a strong capital base, capital buffers and risk-bearing capacity. The coronavirus pandemic that spread widely in early 2020 had a global effect on societies, which has further affected economic development and operating conditions in the financial sector. This is the case in Finland too.

The pandemic may especially affect risks associated with lending, liquidity maintenance and business processes. OP MB's capital base is sufficient to secure business continuity.

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 home 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 towards the year end

During the third quarter, the world economy began to recover from the collapse experienced in spring. However, the recovery was uneven with GDP clearly below last year's level almost everywhere in the world. In autumn, the number of COVID-19 infections rebounded but so far the consequences have been less severe than in spring. The financial market has remained calm, partly due to major support from central banks. Interest rates are exceptionally low throughout.

A gradual recovery of the economy is expected to continue if the COVID-19 pandemic remains reasonably under control. However, the outlook is still uncertain both in the domestic and the export market. A sudden worsening of the pandemic would affect OP Financial Group in three ways: economic uncertainty and uncertainty in the financial and capital market would increase, a rise in financial difficulties among customers would increase credit risk and decrease the demand for services, and a worsening disease situation could make it more difficult for OP Financial Group to run its operations efficiently.

It is expected that OP MB's capital adequacy will remain extremely strong and the overall quality of the loan portfolio good. This will make it possible to issue a new covered bond at the end of the year.

Alternative Performance Measures

Key ratios	Q1-3/2020	Q1-3/2019	Q3/2020	Q3/2019	Q1-4/2019
Return on equity (ROE), %	1.8	3.3	2.0	3.0	3.2
Cost/income ratio, %	38	28	43	36	30

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

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Primary statements

Income statement, TEUR	Q1-3/2020	Q1-3/2019	Q3/2020	Q3/2019	Q1-4/2019
Net interest income	37,324	47,248	11,969	15,169	61,521
Interest income	13,453	28,593	5,001	8,234	33,996
Interest expenses	-23,871	-18,656	-6,968	-6,935	-27,525
Net commissions and fees	-24,954	-30,854	-7,878	-9,954	-40,055
Net investment income	1	1	0	0	1
Other operating income	0	0	0	0	1
Total income	12,372	16,395	4,091	5,215	21,468
Personnel costs	343	282	111	113	399
Depreciation/amortisation and impairment loss	0	123	0	18	123
Other operating expenses	4,404	4,226	1,664	1,726	5,865
Total expenses	4,747	4,631	1,774	1,857	6,387
Impairment loss on receivables	-1,306	42	22	97	-217
Earnings before tax	6,319	11,806	2,338	3,456	14,865
Income tax expense	1,264	2,361	468	691	2,973
Profit for the period	5,055	9,445	1,871	2,765	11,892

Statement of comprehensive income, TEUR	Q1-3/2020	Q1-3/2019	Q3/2020	Q3/2019	Q1-4/2019
Profit for the period	5,055	9,445	1,871	2,765	11,892
Gains/(losses) arising from remeasurement of defined benefit plans					3
Income tax on gains/(losses) on arising from remeasurement of defined benefit plans					-1
Total comprehensive income	5,055	9,445	1,871	2,765	11,894

Balance sheet, TEUR	30 Sep 2020	30 Sep 2019	31 Dec 2019
Receivables from credit institutions	10,647,667	8,228,916	9,144,571
Derivative contracts	401,934	436,776	291,146
Receivables from customers	4,801,069	5,947,913	5,628,716
Investments assets	40	40	40
Other assets	29,022	32,160	31,605
Tax assets	1,514	538	908
Total assets	15,881,246	14,646,343	15,096,986
Liabilities to credit institutions	1,400,000	2,916,000	2,516,000
Derivative contracts	15,621	16,770	14,470
Debt securities issued to the public	14,042,773	11,280,226	12,135,974
Provisions and other liabilities	53,008	59,107	53,861
Tax liabilities	64	74	64
Total liabilities	15,511,466	14,272,176	14,720,370
Shareholders' equity			
Share capital	60,000	60,000	60,000
Reserve for invested unrestricted equity	245,000	245,000	245,000
Retained earnings	64,781	69,167	71,616
Total equity	369,781	374,167	376,616
Total liabilities and shareholders' equity	15,881,246	14,646,343	15,096,986

Off-balance-sheet commitments, TEUR	30 Sep 2020	30 Sep 2019	31 Dec 2019
Irrevocable commitments given on behalf of customers	0	2	2

Statement of changes in equity, TEUR	Share capital	Other reserves	Retained earnings	Total equity
Shareholders' equity 1 Jan 2020	60,000	245,000	71,616	376,616
Profit for the period			5,055	5,055
Other changes			-11,891	-11,891
Shareholders' equity 30 Sep 2020	60,000	245,000	64,781	369,781
Shareholders' equity 1 Jan 2019	60,000	245,000	72,720	377,720
Profit for the period			9,445	9,445
Other changes			-12,998	-12,998
Shareholders' equity 30 Sep 2019	60,000	245,000	69,167	374,167

Cash flow from operating activities, TEUR	Q1-3/2020	Q1-3/2019
Profit for the financial year	5,055	9,445
Adjustments to profit for the financial year	7,622	8,987
Increase (-) or decrease (+) in operating assets	-723,358	55,286
Receivables from credit institutions	-1,553,668	-1,000,000
Receivables from the public and public-sector entities	827,727	1,054,921
Other assets	2,583	365
Increase (+) or decrease (-) in operating liabilities	-1,116,854	27,479
Liabilities to credit institutions and central banks	-1,116,000	20,000
Other liabilities	-854	7,479
Income tax paid	-1,870	-2,899
Dividends received	1	1
A. Net cash from operating activities	-1,829,403	98,299
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	1,810,722	1,233,863
Decreases in debt securities issued to the public	-20,000	-1,000,000
Dividends paid and interest on cooperative capital	-11,891	-12,998
C. Net cash used in financing activities	1,778,831	220,864
D. Effect of foreign exchange rate changes on cash and cash equivalents		
Net change in cash and cash equivalents (A+B+C+D)	-50,572	319,163
Cash and cash equivalents at year-start	438,702	133,460
Cash and cash equivalents at year-end	388,130	452,747
Change in cash and cash equivalents	-50,572	319,286
Interest received	16,433	28,435
Interest paid	-23,841	-26,642
Adjustments to profit for the financial year		
Impairment losses on receivables	1,308	-39
Price difference recognised on debt securities issued to the public	5,058	6,666
Other	1,256	2,360
Total adjustments	7,622	8,987
Cash and cash equivalents		
Receivables from credit institutions payable on demand	388,130	452,747
Total cash and cash equivalents	388,130	452,747

Accounting policies

The Interim Report 1 January–30 September 2020 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 and 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 key management personnel and their close family members. Standard loan terms and conditions are applied to loans granted to 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

As part of OP Financial Group, OP MB adopted the European Banking Authority's (EBA) guidelines on the definition of default (Guidelines on the application of the definition of default under Article 178 of Regulation (EU) No 575/2013) in the first quarter. The Guidelines harmonise the definition of default applied by European banks on their customers. The new process in accordance with the Guidelines recognises defaulted customers earlier, for example, based on information in external credit registers. As regards retail customers, the new process extends the default to cover all exposures of an individual obligor. This change increased the number of observations of default and weakened the parameters of credit risk.

As part of OP Financial Group, OP MB applies a so-called Two-Step Approach. The first step involved the change of the definition of default during the first quarter of 2020. The second step to be taken later involves the calibration of credit risk parameters. The supervisory obligation related to the adoption of the new definition of default increased the average risk weights of OP MB's loan portfolio at the first step. Growth in expected credit losses (ECL) in the income statement caused by the change in the definition of default has been taken into account in the effect on capital adequacy. OP MB applied the new definition of default to expected credit losses as a change in the accounting estimate. Consequently, impairment loss on receivables in the income statement increased by TEUR 637 in the first quarter.

Notes

Net commissions and fees, TEUR	Q1-3/2020	Q1-3/2019	Q3/2020	Q3/2019	Q1-4/2019
Commission income					
Lending	2,983	3,733	893	1,241	4,891
Total	2,983	3,733	893	1,241	4,891
Commission expenses					
From lending to OP cooperative banks	2,853	3,593	852	1,191	4,703
Loan management fee to OP cooperative banks	24,947	30,789	7,896	9,896	40,018
Issue of bonds	133	201	22	106	220
Other	5	4	2	1	6
Total	27,937	34,587	8,771	11,195	44,946
Net commissions and fees	-24,954	-30,854	-7,878	-9,954	-40,055

Classification of financial assets and liabilities 30 Sep 2020, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Recognised at fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	10,647,667			10,647,667
Derivative contracts		401,934		401,934
Receivables from customers	4,801,069			4,801,069
Investment assets			40	40
Other receivables	28,935			28,935
Financial assets	15,477,672	401,934	40	15,879,645
Other than financial assets				1,601
Total	15,477,672	401,934	40	15,881,246
		Recognised at fair value through profit or loss	Amortised cost	Total
Financial liabilities				
Liabilities to credit institutions			1,400,000	1,400,000
Derivative contracts		15,621		15,621
Debt securities issued to the public			14,042,773	14,042,773
Other liabilities			50,033	50,033
Financial liabilities		15,621	15,492,806	15,508,427
Other than financial liabilities				3,039
Total		15,621	15,492,806	15,511,466
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 30 Sep 2020			476,982	476,982

Classification of financial assets and liabilities 31 Dec 2019, TEUR				
	Amortised cost	Recognised at fair value through profit or loss	Recognised at fair value through other comprehensive income	Total
Financial assets				
Receivables from credit institutions and central banks	9,144,571			9,144,571
Derivative contracts		291,146		291,146
Receivables from customers	5,628,716			5,628,716
Investment assets			40	40
Other receivables	31,340			31,340
Financial assets	14,804,627	291,146	40	15,095,813
Other than financial assets				1,173
Total	14,804,627	291,146	40	15,096,986
		Recognised at fair value through profit or loss	Amortised cost	Total
Financial liabilities				
Liabilities to credit institutions			2,516,000	2,516,000
Derivative contracts		14,470		14,470
Debt securities issued to the public			12,135,974	12,135,974
Other liabilities			50,295	50,295
Financial liabilities		14,470	14,702,269	14,716,739
Other than financial liabilities				3,631
Total		14,470	14,702,269	14,720,370
Valuation difference of debt securities issued to the public (difference between fair value and carrying amount) 31 Dec 2019			297,338	297,338

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 30 Sep 2020, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	4,122,544	9,030,183	4,972,250	18,124,977
Total	4,122,544	9,030,183	4,972,250	18,124,977

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	401,934	15,621	559,124
Total	401,934	15,621	559,124

Derivative contracts 31 Dec 2019, TEUR	Nominal values/residual term to maturity			
	Less than 1 year	1-5 years	More than 5 years	Total
Interest rate derivatives				
Hedging	2,314,788	10,518,873	4,410,800	17,244,461
Total	2,314,788	10,518,873	4,410,800	17,244,461

	Fair values		Credit equivalent
	Assets	Liabilities	
Interest rate derivatives			
Hedging	291,146	14,470	449,628
Total	291,146	14,470	449,628

Financial instruments classification, grouped by valuation technique, TEUR				
30 Sep 2020	Fair value measurement at year end			
	Balance sheet value	Level 1	Level 2	Level 3
Recurring fair value measurements of assets				
Derivate contracts	401,934		401,934	
Total	401,934		401,934	
Recurring fair value measurements of liabilities				
Derivate contracts	15,621		15,621	
Total	15,621		15,621	
Financial liabilities not measured at fair value				
Debt securities issued to the public	14,042,773	13,557,950		962,144
Total	14,042,773	13,557,950		962,144

31 Dec 2019	Fair value measurement at year end			
	Balance sheet value	Level 1	Level 2	Level 3
Recurring fair value measurements of assets				
Derivate contracts	291,146		291,146	
Total	291,146		291,146	
Recurring fair value measurements of liabilities				
Derivate contracts	14,470		14,470	
Total	14,470		14,470	
Financial liabilities not measured at fair value				
Debt securities issued to the public	12,135,974	9,744,711	2,548,311	140,290
Total	12,135,974	9,744,711	2,548,311	140,290

Valuation techniques whose input parameters involve uncertainty (Level3)

Opening balance 1 January 2020	140,290
Transfers to level 3	
Transfers from level 3	
Other change	821,854
Closing balance 30 Sep 2020	962,144

The line Other change includes bonds on hierarchy level 3 issued by OP MB during the reporting period.

Time of publication of 2020 reports

Report by the Board of Directors and Financial Statements 2020	Week 10
Corporate Governance Statement 2020	Week 10

Schedule for Financial Statements Bulletin 2020 and Interim Reports in 2021

Financial Statements Bulletin 1 January–31 December 2020	10 February 2021
Interim Report 1 January–31 March 2021	28 April 2021
Half-year Financial Report 1 January–30 June 2021	28 July 2021
Interim Report 1 January–30 September 2021	27 October 2021

Helsinki, 22 October 2020

OP Mortgage Bank
Board of Directors

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