ANNUAL REPORT 2012

Kommunalbanken Norway

Kommunalbanken Norway

Bjørnsund school camp Fræna municipality

Bjørnsund school camp is affiliated Norwegian School Camp Association. The main objective is to teach young people about coastal heritage. The school camp is newly renovated financed through KBN.

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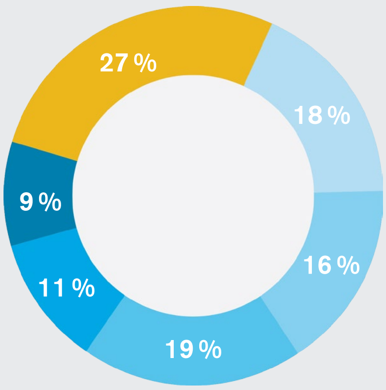
2012 in brief



New loans by sector *

- Infrastructure
- Social services
- Health services
- Kindergarten and education
- Water supply and waste disposal
- Other

** New loans by sector have been registered since June 2012. The graph shows new loans for the second half of 2012.*

KBN can look back on a year of…

- celebrating KBN's 85 years as provider of loans to the local government sector.
- increase in KBN's share capital by NOK 924 million from the Central Government enabling KBN to meet further growth in lending and ensuring that KBN meets target of minimum nine per cent Core Tier 1 capital.
- less turbulence in financial markets, stable interest rate margins on lending and liquidity portfolio.
- 550 loans granted to the local government sector, amounting to NOK 30.7 billion in total, representing a net lending growth of 5.6 per cent.
- profit for the year was NOK 1,876 million and return on equity after tax was 37.1 per cent.
- good and stable demand for KBN bonds in global financial markets.
- recertification of KBN's operations as environmentally sustainable by the Eco-Lighthouse Foundation (Miljøfyrtårn). One of five nominated as Oslo City's greenest business operations.
- continued "Green Lending Rate Scheme": Environment and climate friendly projects qualify for an improved interest rate. As of 31 December 2012 loans granted under green lending rate totaled close to seven billion Norwegian kroner.
- change of President & CEO: Mr. Petter Skouen retired in November followed by Mr. Martin Spillum as acting President & CEO until Ms. Kristine Falkgård began in her new position on 1 March 2013.

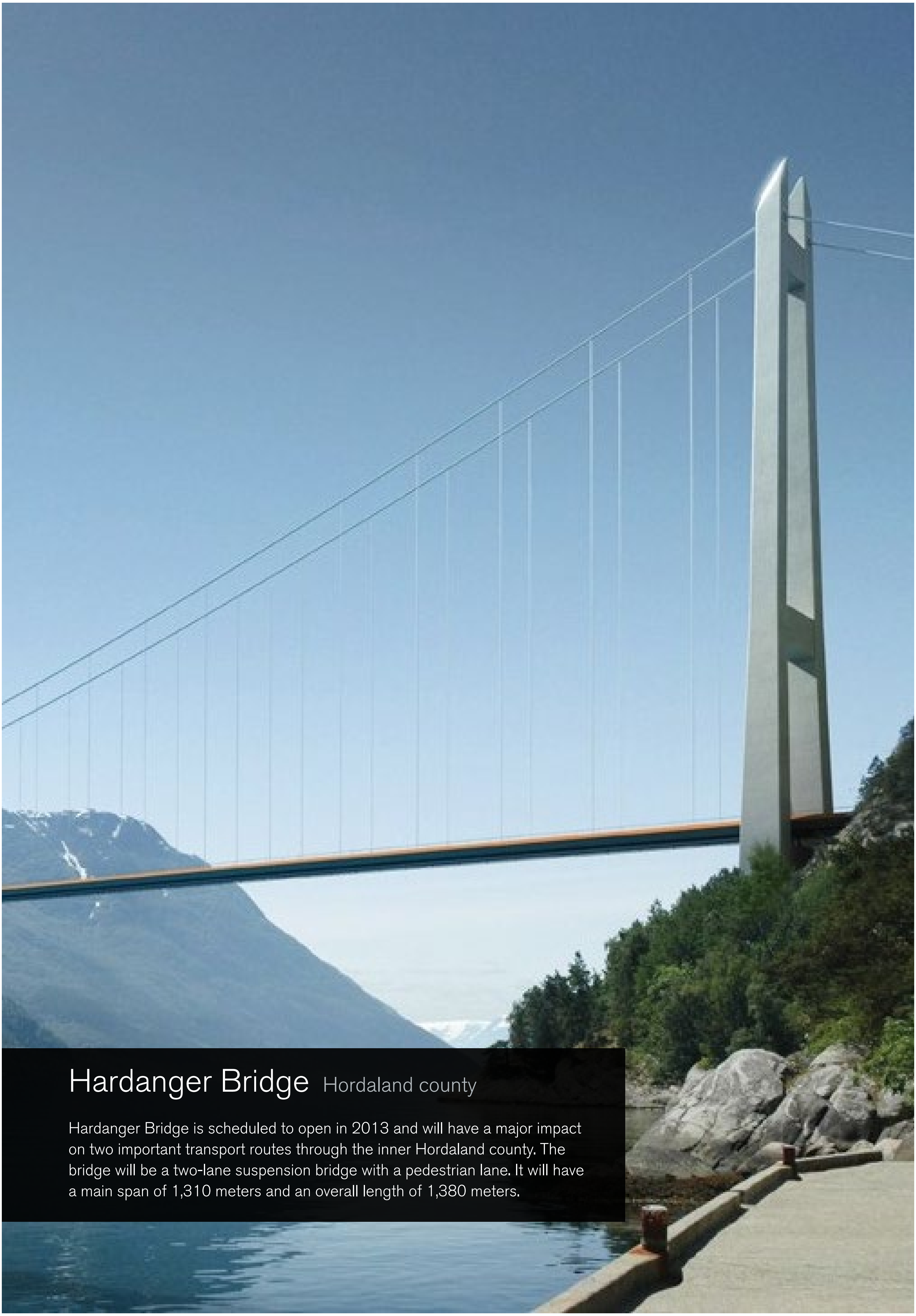
KBN celebrated 85 years of municipal lending in 2012

Key figures

(Amounts in NOK 1 000 000)

	2012	2011
RESULTS		
Net interest income	2 032	1 582
Core earnings [1]	1 393	1 138
Profit before tax	2 604	1 001
Profit for the year	1 876	724
Return on equity after tax [2]	37.10 %	18.33 %
Return on equity after tax (core earnings) [2]	27.55 %	28.80 %
Return on assets after tax [2]	0.51 %	0.22 %
Return on assets after tax (core earnings) [2]	0.38 %	0.34 %
LENDING		
New disbursements	30 677	46 921
Outstanding loans [3]	219 255	207 572
LIQUIDITY PORTFOLIO [3]	98 938	103 263
BORROWINGS		
New long-term borrowings	98 192	142 341
Repurchase of own debt	2 344	3 416
Redemptions	85 848	104 162
Total borrowings [3]	312 867	338 615
TOTAL ASSETS	348 953	366 901
EQUITY		
Equity	7 393	4 594
Core capital adequacy ratio	12.27 %	9.79%
Total capital adequacy ratio	14.97 %	13.22%

1 Profit after tax adjusted for unrealised gains/losses on financial instruments
2 Annualised return on equity and return on assets as percentage of average equity and average assets
3 Principal amounts



Hardanger Bridge Hordaland county

Hardanger Bridge is scheduled to open in 2013 and will have a major impact on two important transport routes through the inner Hordaland county. The bridge will be a two-lane suspension bridge with a pedestrian lane. It will have a main span of 1,310 meters and an overall length of 1,380 meters.

Good financial results do not happen by themselves

Another year of good economic performance is behind us. Even though 2012 was a more stable year in international financial markets, the challenges are still many. The European debt crisis means low prospects for growth and high unemployment figures in many countries around us. In the US the fiscal situation at the time of writing is still unresolved. How it will influence international financial markets in 2013, is too early to say.

In 2012 we celebrated 85 years providing low cost loans to the local government sector. When KBN was established in 1927 Norway was in a depression. Investments plummeted and unemployment was high. KBN was to guarantee municipalities stable access to credit. Our mandate has been the same since the establishment. Through several financial crises KBN has shown that it is a robust and efficient institution. We have had no loan losses in 85 years and are the leading provider of loans to the Norwegian local government sector.

In the revised National Budget for 2012, the Norwegian Parliament (Storting) approved an increase in KBN's capital of NOK 924 million to ensure that KBN fulfilled the Core Tier 1 capital requirements for financial institutions. KBN will continue to adapt to the new capital requirements. A capital base meeting the requirements is a prerequisite for KBN being capable of funding future local government investments. Further accumulation of equity must be obtained through operating profit.

Government reforms, population growth and demographic development lead to continued growth in local government investments. KBN has granted 550 loans during 2012, just over NOK 30 billion in total.

The turbulent last few years in global financial markets have only slightly influenced KBN's operations. Through our 85 years of existence we have proved our stability. The fact that we maintain highest possible credit rating (AAA/Aaa) is proof of this. The fact that we represent the public sector as well as being owned by the Norwegian state, have made us appear as a very safe haven for international investors wanting to invest in safe papers.

We have added a number of competent colleagues to our staff during last year. When vacancies are announced, I am pleased to register that KBN appear to be regarded as an attractive place of work.

KBN were among the five businesses nominated to the prize "Oslo City's greenest business". This is an inspiration to continue working even harder to achieve a conscious relationship to energy consumption as well as waste management. We also try to increase consciousness among suppliers and partners regarding ecology and climate and offer lower interest rates on loans on climate and environmental projects in the Norwegian local government sector.

We want KBN to be an important and trustworthy provider of loans to the local government sector.

Kristine Falkgård
President & CEO

The Norwegian local government sector

An asset class of exceptional quality
Norwegian local government rests on strong pillars. The high credit quality of the sector is largely derived from several factors; the economic and legislative framework that protect local authorities' status, responsibilities and finances, the strong equalisation system between municipalities that ensures minimum revenues, a high degree of central government transfers and a comprehensive system for meticulous central government supervision and control on the local government budgetary process.

The combined strengths of the system are fundamental to the low risk associated with Norwegian local governments as an asset class. Norwegian municipalities play a crucial role in providing vital services to the Norwegian public and a stable economic framework with access to low cost financing is considered important by the central government. The central government has a strong incentive to provide for a stable economic environment for local government financing, as volatility could lead to uncertainty, increase municipal borrowing expenses and prevent local governments delivering essential services to the population.

KBN's public mandate of offering the local government sector access to low cost financing contributes to protecting the stability of this system.

The Nordic model
The public sector in the Nordic region is effectively comprised of central and local governments. In Norway, Sweden and Denmark, the local government sector is made up of two tiers: counties and municipalities.

In Norway's case, the concept of municipal self-government is an important political principal, however in contrast to other Nordic and most European countries this self-government is not enshrined in the Norwegian constitution. The central government can at any time regulate the framework of municipal self-government and in principle this gives the national authorities great influence on the content of municipal activities.

The Norwegian local government sector has the responsibility for the provision of welfare state services. Municipalities' responsibilities cover education (primary schools), healthcare, care for the elderly, and the provision of drinking water and sewerage, while counties perform healthcare (county hospitals), secondary education, and some public transportation functions. The central government controls the transfer of funds through the public pension and social security system as well as controlling natural resources, defence, and the police.

Norway is divided into 19 counties and 429 municipalities, both having equal standing in terms of the formal framework for their responsibilities.

Supervision and control
Local governments hold an important position, being responsible for more than two thirds of public expenditure. The framework for the activities of the local government sector is laid down by Parliament through legislation and decisions regarding local government financing. Parliament determines the division of functions between the different levels of government, i.e. central government, counties and municipalities. The government can only assign new functions to local government by means of legislation or decisions made by Parliament.

Although the average population of a Norwegian local government is 11,600 (Norway's population is 5.0 million) and the difference in size of local governments is vast, there exists a comprehensive regional development policy which compensates for the economic disparities between local governments. It is an aim of the central government to offer citizens a high level of public services with equal standards, wherever they live in the country. Therefore there is a high degree of redistribution of income between municipalities and between counties. This is achieved through the General Purpose Grant Scheme. Redistribution of resources through the General Purpose Grant Scheme ensures both a fair distribution of income, and regional growth and development. This is essential to maintain an efficient and autonomous local government sector.

The local government sector relies on several sources of income, mainly taxes and central government transfers which account for 39 per cent and 48 per cent of revenues respectively. Municipalities collect most of their taxes from individual and corporate income and property tax. Counties on the other hand receive only income tax. The right of municipalities and counties to levy taxes is limited by maximum rates set annually by Parliament. Today, all municipalities and counties apply the maximum rate.

The legislative framework underlying the local government sector is laid out in the Local Government Act of 1992 which focuses on the key areas of monitoring and controlling local government budgets, regulating borrowing and the granting of guarantees, and provisions should a local government encounter financial difficulties.

Municipal budgets are regulated by the central government and each county or municipality's annual budget must be presented to the Ministry for Local Government and Regional Development.

Local government borrowing and granting of guarantees are regulated under the Local Government Act of September 1992 and municipalities are only permitted to raise debt for primary municipal investments, to convert existing debt and for temporary liquidity purposes.

Importantly, under the local government act, a local government cannot file for bankruptcy and cannot have bankruptcy proceedings filed against it.

If a local government does incur a budget deficit, the central government steps in to assure that the local government in question acts to provide a solution to correct its financial position. First, the local government is put on a publicly available 'watch-list'. The central government must then approve each of the local government's borrowings as well as a 'financial plan' for rectifying the problem within three years.

At all times the central government has the power to edit the budget and/or the 'financial plan' to ensure a timely recovery for the relevant municipality.

Should the extremely unlikely situation arise that a local government does experience financial difficulties the central government appoints a supervisory board for the relevant local government and the board then approves all payments and the order in which any claims shall be met. However, it is a testament to the high level of control and supervision of the municipal sector that this measure has never had to be implemented.

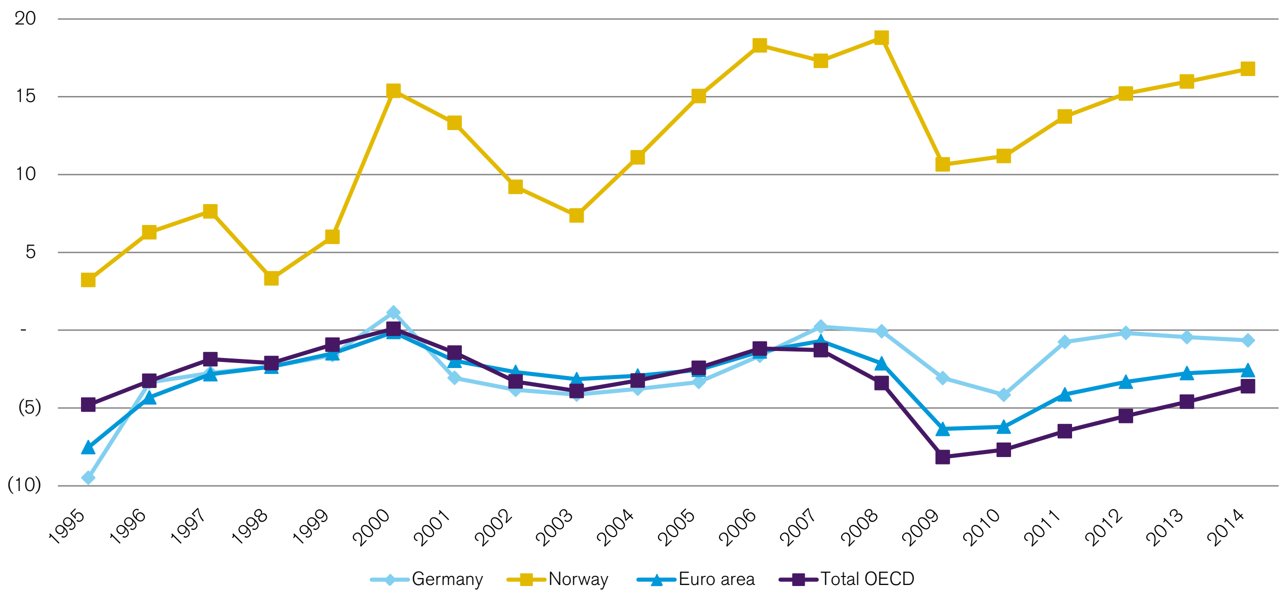
An update on the Norwegian economy

2012 has seen the continuation of the sovereign deficit problem in Europe and the uncertainty about the Eurozone as a whole. Although for now the risks surrounding a Greek exit from the Euro seems to have abated, there are still general imbalances and large budget deficits in advanced economies. European authorities have announced various strategies to deal with the crisis (ECB Outright Monetary Transactions and the proposed establishment of a single banking supervisory mechanism for example) and while these should help to strengthen the Economic and Monetary Union, unemployment rates are high and rising and there will be further challenges for Europe. Slow growth, coupled with fiscal tightening will continue to occupy policymakers and should see the continuation of low interest rates in the leading industrial countries for the short to medium term. Although the US has displayed some signs of a recovery, the GDP of Norway's peers in Europe continues to remain subdued. Norway is in a significantly better position however, than most countries to counteract the effects of a general economic slowdown. The current account balance and government finances are solid, and Norway is projected to post a surplus of approximately 15 per cent of GDP in 2012 and 16 per cent in 2013. Furthermore, the Norwegian banking system is not large, and the financial position of Norwegian banks is sound.

The Norwegian government is a net creditor with substantial foreign assets and large fiscal surpluses, primarily originating from the oil and gas sector. The government's total net cash flow from the extraction of petroleum is transferred to the Government Pension Fund – Global, Norway's Sovereign Wealth Fund. This Fund is fully integrated into the National Budget which means the Government will cover any non-oil budget deficit by transfers from the Fund according to the fiscal rule. In 2013 it is estimated that 3.3 per cent of the Fund will be used to balance the state budget.

As at end of 2012, the Government Pension Fund – Global reached NOK 3.750 trillion in size, approximately USD 675 billion or 140 per cent of GDP. The fund increased its target share of equity investments to 60 per cent from 40 per cent between the summers of 2007 and 2009, reducing fixed-income investments to 40 per cent. From March 2010, it also has a mandate to invest as much as 5 per cent of its assets in real estate through a corresponding decrease in fixed-income investments. According to Norges Bank, the Norwegian central bank, "the operational target of monetary policy in Norway is low and stable inflation, with annual consumer price inflation of close to 2.5 per cent over time". In the years before the global financial crisis, inflation moved slightly above this target level and as such

General government financial balances (% of GDP)



Source: OECD Economic Outlook, Volume 2012 Issue 2 - No. 92

the key policy rate was raised accordingly. However, following the onset of the financial crisis, Norges Bank reduced the key policy rate considerably, continuing to cut further in 2009 to 1.25 per cent. With a bounce back in the economy from the second half of 2009, rates were increased steadily to the 2.25 per cent level by mid-2011. Since then, the uncertainty surrounding the global economy and low domestic inflation has led Norges Bank into an easing bias and the key policy rate currently stands at 1.50 per cent. With solid domestic growth (projected to increase by 3 per cent in 2012 and 2.8-3 per cent in 2013) and strong annual wage growth of 4 per cent for 2012, the key policy rate is expected to be raised gradually towards a more normal level over 2014-2016. Economic activity remains weak in Europe however, and domestic inflation remains low and is estimated at between 1 per cent and 1½ per cent. Norges Bank must manage the strength of the kroner and lack of economic activity in Europe (and low interest rates in these countries), with the increase in domestic house prices and lending growth. As such, it is expected that the key policy rate will stay at today's level through 2013, followed by a gradual rise to a more normal level over 2014 to 2017.

Norway's economy has been resilient throughout the financial and sovereign debt crisis. Although Norway experienced two quarters of negative GDP growth in 2009, the economy rebounded in H2 2009 and according to the Ministry of Finance, the mainland economy showed only mild negative growth of 1.4 per cent for the whole of 2009.

In 2010 and 2011, the economy bounced back, with increased consumer confidence, low interest rates and low unemployment leading to higher private consumption. In 2011, GDP growth for mainland Norway reached 2.6 per cent. In 2012, despite a weak external environment and a sluggish European economy, Norway's GDP growth reached 3 per cent. This growth is being supported by continued activity in the petroleum industry, population growth and low interest rates. As such, mainland GDP growth is expected to be 2.8-3 per cent for 2013.

Unemployment in Norway has not risen as in other developed countries and remains at a low level. The Ministry of Finance point to an unemployment rate of 3.2 per cent in 2012, an decrease of 0.1 per cent compared with 2011. This is lower than the average of the past 20 years, approximately 4 per cent, and also low compared with other developed economies.

This is KBN

Kommunalbanken AS was established in 1999 by an act of Parliament as a direct continuation of the government administrative body, Norges Kommunalbank, which started its operations in 1927.

The Central Government, represented by the Ministry of Local Government and Regional Development, is the sole owner of KBN.

KBN maintains the highest rating, AAA/Aaa with a stable outlook, from the leading rating agencies Standard & Poor's and Moody's respectively.

KBN's main objective is to provide low-cost funding to local government sector's investments in local welfare services.

KBN is the main provider of loans to the local government sector with a market share of 47.3 per cent. KBN is one of the largest financial institutions in Norway.

Cost effective organisational structure and prudent management is conducive to maintaining low operating costs. KBN has 54 permanently employed. Operating costs as a percentage of total assets were 0.03 per cent in 2012.

KBN is regulated by the Norwegian FSA or Finanstilsynet.

KBN's operations are certified environmentally sustainable by the Eco-Lighthouse Foundation.

How KBN works

The main objective of the Central Government's ownership in KBN is to provide stable access to reasonable local government sector funding. This is KBN's sector policy function and the core of KBN's social responsibility, while simultaneously providing the state with a return on equity.

In order to meet its objective, KBN maintains cost effective operations and a highly competent staff within its special fields. KBN focuses on recruiting, developing and retaining employees with the right attitudes and expected ethical standards.

Highest credit rating combined with a diversified funding strategy and close dialogue with the investor market over time makes it possible for KBN to seek a diversity of capital markets as source of funding.

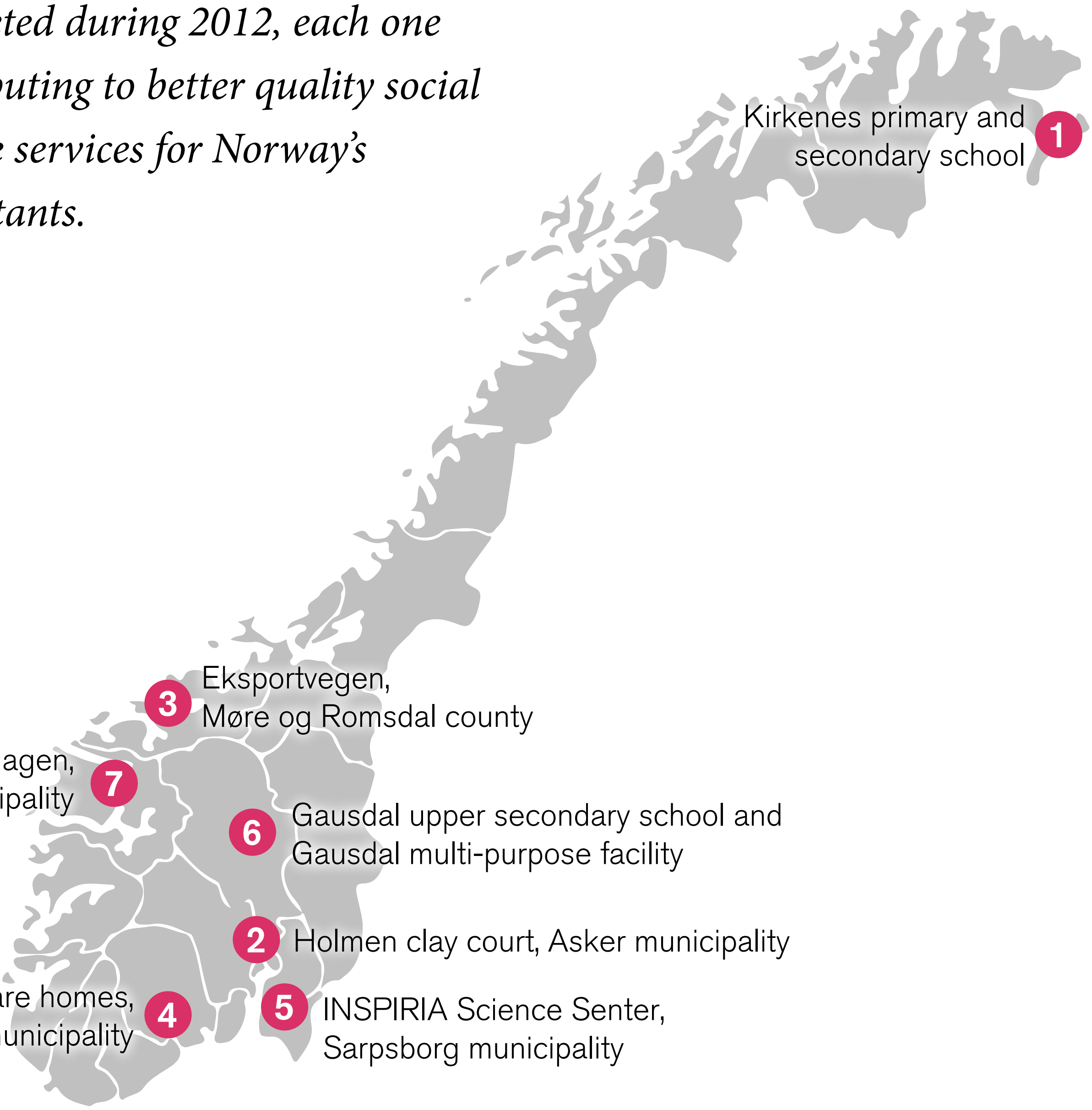
In accordance with KBN's main objective the institution is able to facilitate low loan costs for the local government sector owing to good access to reasonable funding and low operating costs.

KBN's liquidity portfolio is equivalent to 12 months' net capital requirements invested in liquid fixed income securities. The liquidity portfolio ensures that KBN is able to meet all obligations over the next 12 months without any borrowing.

No currency or interest rate risks are allowed. Borrowings in foreign currency are immediately hedged against interest rate and currency risk. KBN's Middle Office provides analysis, control and reports on liquidity, interest rate, currency and counterparty risk.

Municipal projects nationwide financed by KBN

Every year KBN finances hundreds of small and large municipal projects nationwide, making everyday life a little easier and better for Norway's inhabitants. All counties and 98 per cent of municipalities service loans in KBN. On the following pages KBN's lending department presents a few of the many projects completed during 2012, each one contributing to better quality social welfare services for Norway's inhabitants.



Kirkenes primary and secondary school

Holmen clay court (illustration)

We finance social welfare services

Anette Berg
Executive Vice President
Lending

The lending department consists of seven loan managers, three loan administration officers and head of lending, all with university degrees and all with varied job experience both from the public and private financial sector.

KBN targeted a lending growth of six per cent in 2012. Small and medium sized municipalities have been given priority. Municipal investments have been given preference to cases of debt refinancing.

KBN granted 550 loans amounting to NOK 30.7 billion during last year. Beginning of 2013 all counties and 421 of Norway's 428 municipalities have loans with KBN in addition to a number of municipal and inter-municipal companies. On the next few pages KBN's loan managers have chosen one project each from the geographic area they serve. It is only a handful of the many projects KBN has financed during 2012.

The projects show both the diversity in social welfare services provided by the local government sector as well as KBN's local involvement.

1 New primary and secondary school in Kirkenes

Lars M. Bekkelund
Loan Manager
Akershus, Finnmark, Hedmark

In the autumn of 2012, pupils and teachers in Kirkenes had the pleasure of starting the school year in new eco-friendly facilities.

For Kirkenes municipality, NOK 375 million represents a formidable investment, an investment in the next generation. Both pupils and teachers participated in the planning. The building process started in 2010. In the autumn of last year the mayor, Ms Cecilie Hansen, cut the ribbon declaring the building officially open.

The pupils have access to a building well suited for a number of activities. In addition to the primary and lower secondary schools, it houses the culture school, a gym and lockers. The Samovar Theatre in addition to Riksteatret (the Norwegian touring theatre) and Hålogaland Theatre use the stage when playing in Kirkenes. The area totals 12,500 m^2, enough space to really romp around in.

The school building meets low energy standards. Compared to the previous primary and lower secondary school, the municipality estimates energy savings of approx. two million kilowatt hours annually. The school is financed with a green floating rate loan from KBN, an interest rate lower than KBN's ordinary floating interest rate. This represents interest rate savings of more than NOK 7 million through the investment's life time.

Eksportvegen AS

2 Better sports facilities for children and youth

Jarle Byre
Loan Manager
Buskerud, Nordland

With low-cost financing in KBN and an unconditional guarantee of payment from Asker municipality, there will be artificial turf and new lighting at Holmen clay court. The facilities are run by Holmen sports club, a club with a membership of more than 750 football players and 550 cross country skiers. The sports club has grown considerably during the last few years and the requirements for training facilities have increased proportionately.

It is fairly unusual for a sports club to be financed by KBN. Following a unanimous vote in the municipal council in favour and the county officer affirming the plan, everything was formally in place. A NOK 5.2 million loan at 2.25 per cent interest rate. A rate considerably lower than what the sports club would be offered in a commercial bank. For a sports club with membership fees as its most important source of income, reasonable financing is important to be able to offer children and youth access to good training facilities without making membership too expensive.

Artificial turf on the clay court sports ground and upgraded lighting system will receive just over NOK 1.7 million in contribution from the state run lottery Norsk Tipping. The loan is to be financed through operations and income from increased activity in the facilities. Equity is just below NOK 2.7 million and the club operates with a profit.

Last year's result amounted to just over NOK 1.3 million.

3 Easier life behind the wheel

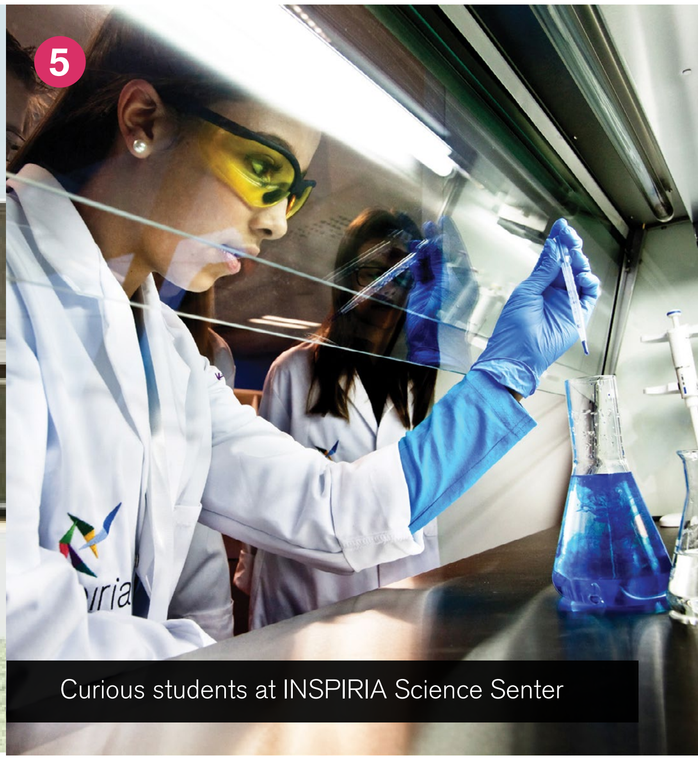
Marit Urmo Harstad
Loan Manager
Møre og Romsdal, Svalbard, Troms

Building roads, bridges and tunnels can be profitable to society. Some road projects however, are more profitable than others. Such as Tresfjord Bridge and Vågstrand Tunnel, reducing the driving time on the E 136 by at least 15 minutes between Ålesund, on the western coast of Norway and Oslo. The road is called the Export road through Møre og Romsdal county. KBN is a safe and solid lender to the company Eksportvegen AS.

Eksportvegen AS' main objective is to plan, build and operate the two projects: Tresfjord Bridge and Vågstrand Tunnel. Total costs: NOK 1.35 billion. The project offers faster and safer road connections within the borders of Rauma and Vestnes municipalities and on the main road E 136 between the eastern part of Norway and Sunnmøre in the west. Equally important is the fact that approx. 200 road exits along E136 disappear, thereby increasing road safety considerably. It is hoped that this will help to dramatically reduce the fatality rate in road accidents.

In May 2012, the company tendered for a loan of NOK 780 million. KBN was the only lender who responded. The amount is guaranteed by Møre og Romsdal county and is financed half through toll roads and half through state support. Loan requirements peaks in 2015 at the opening of the project and is to be repaid in 15 years, with a possible five year extension.

Care homes in Drangedal



Curious students at INSPIRIA Science Senter

4 Passive house care homes

Torger M. Jonasen
Loan Manager
Nord- og Sør-Trøndelag, Telemark

In the summer of 2012 Drangedal municipality started building 15 care homes for young people with disabilities. The homes is an important part of the municipality's commitment within the field of health and welfare and has been sorely missed for years.

Opening is scheduled for October 2013. The building is a community with 14 permanent apartments and one emergency apartment. 15 apartments, common use area for users and staff, storage room and a roofed eco-station covers 1,652 square metres in all. The building is mainly a one-floor wooden structure.

Planning has been carried out in close cooperation between architects, users and staff. It is a well suited building with a good ambience. The community is built according to passive house standards. This is an innovation in this type of building.

Total costs for the whole project is NOK 49.7 million. The building is financed through a loan in KBN and a grant from Husbanken – The Norwegian State Housing Bank. The project will make use of ENOVA grants both for planning and building of passive houses. The passive house standard reduces the energy consumption by 50 per cent.

5 INSPIRIA science center - center for curiosity and energy

Terje Christer Dalby
Loan Manager
Aust-Agder, Hordaland, Østfold

INSPIRIA science center is situated at Grålum in Sarpsborg municipality. In the summer of 2011 this public owned science center moved into its brand new 6,500 m2 building financed by KBN, guaranteed by Østfold county and Sarpsborg municipality.

INSPIRIA is a center for exploration and learning within the fields of mathematics, natural science and technology. Everywhere the building is filled with people of all ages eager to explore and experience phenomenons related to nature, environment, health and technology. The center offers curriculum related programs to primary as well as secondary schools in Østfold county. It is also meant to be a meeting place for business. The national newspaper VG gave the center its highest score when evaluating attractions along E6 road between Oslo and Gothenburg.

As one of eight Norwegian science centers, INSPIRIA reports to the Ministry of Education and Research and receives state support through The Research Council of Norway. The science centers have been established to motivate more children and youth to choose science. Research show that visits at a science center is of importance when making both academic as well as career choices.

KBN has supplied NOK 77.3 million in long term financing. Owing to the fact that the building has climate passive house standard, approximately half the borrowed loan amount has been given green floating interest rate. The rate is lower than ordinary interest rates in KBN and is offered to climate friendly projects.

Gausdal upper secondary school

Trivselshagen

6 Local and regional sector working hand in hand

Anita Hagebråten-Kvalvaag
Loan Manager
Oppland, Vest-Agder

A multi-purpose facility in Gausdal and Gausdal upper secondary school are good examples of a large and well completed cooperative project between Gausdal municipality and Oppland county. The flagship building was finished in December 2012 containing many functions for the benefit and enjoyment of both young and old in the municipality. Yet another example of projects KBN is proud to have financed.

The multi-purpose facility consists of two buildings. One building contains cultural activities, youth club, volunteer center and a school and public library in one. The second building houses Gausdal upper secondary school. The facilities form one continuous building. This is cost effective both as regards investments and operations.

Oppland county expands Gausdal upper secondary school with an addition containing class rooms, group rooms, teachers' working area, cantina and areas for mingling.

Gausdal municipality builds a sports hall connected to the Gausdalshallen. The municipality then has two adjacent halls with locker rooms in-between.

Total area when the addition and renovation is completed will cover approx. 11,000 square metres, making the project the largest in Gausdal so far. The price tag is NOK 140 million financed through KBN.

7 Trivselshagen – the new venue in Gloppen

Børge Daviknes
Loan Manager
Oslo, Rogaland, Sogn og Fjordane, Vestfold

Trivselshagen IKS is a cooperative effort between Gloppen municipality, Nordfjord, and Sogn og Fjordane county. The objective is to plan, build, own and run a common building complex to ensure Firda secondary school necessary facilities. The building complex will fulfil the requirements for culture and sports facilities for Gloppen's inhabitants in general.

The school and culture areas were the first to be completed. It consists of a theatre, facilitating both movies and theatre performances, as well as the library and a cafeteria. Then a gym hall and a swimming pool followed. The multipurpose halls are planned to be completed in 2013.

The whole project is budgeted at approx. NOK 290 million financed through loans in KBN amounting to NOK 125 million. The project is a good example of how a municipality and a county can cooperate to fulfil both entities' areas of responsibility in one common project.

Trivselshagen IKS covers approx. 13,000 square meters. The properties are localized in the town of Sandane.

Social responsibility

KBN's social responsibility role is described in the Ownership Report, No. 13 (2010-2011): "The bank's sector policy function as a reliable supplier of credit to local government with the best possible loan terms, is the core of the bank's social responsibility."

KBN shall contribute to sustainable development and long-term value creation through responsible business practices to protect the environment while furthering ethical and social issues.

With close to 50 per cent market share for loans to the local government sector, KBN is a significant player in society. KBN provides funds enabling municipalities, counties and municipal companies to achieve their social welfare goals.

Lower interest rate on eco-loans
In 2010 KBN decided to offer an interest rate product aimed at local climate-friendly investments. KBN's green floating rate is lower than the ordinary interest rate and are offered to projects rooted in the municipal climate action plan. These may be investments in the areas of energy efficiency, renewable energy, waste management, recycling, pedestrian and bicycle paths, water quality, environment-friendly means of transportation and facilities for outdoor recreation. As of 31 December 2012 close to 7 billion Norwegian kroner in loans with green floating interest rate had been disbursed.

Improving financial skills
KBN aims to help improve economic and financial expertise among municipal staff. KBN wishes to cooperate on a broad basis with organizations central in the local government sector. KBN contributes financially, offers expertise and technical assistance where events are concerned. Detailed annual agreements are entered into with major partners.

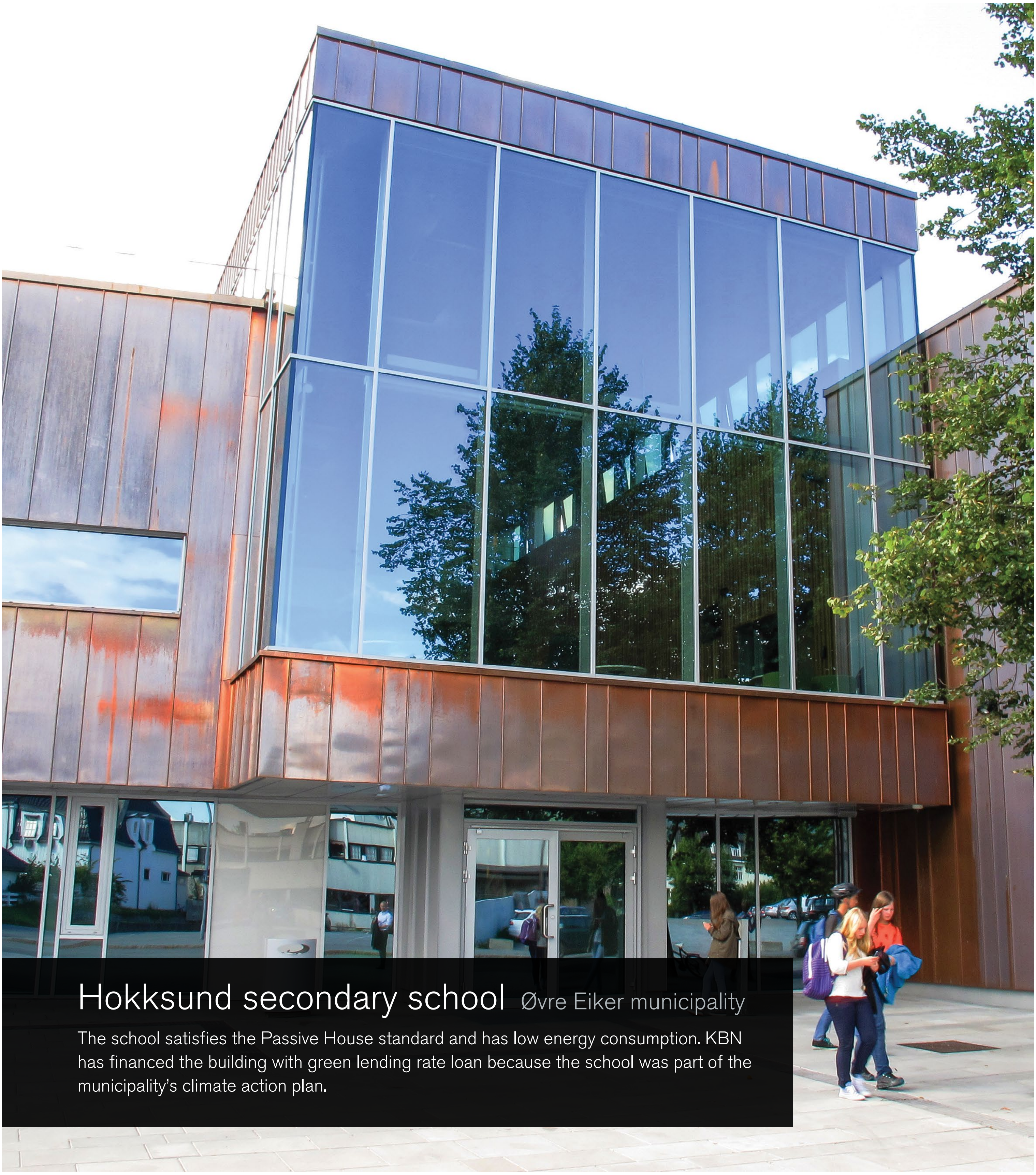
"As of 31 December 2012 close to 7 billion Norwegian kroner in loans with green floating interest rate had been disbursed"

In order to encourage and enhance skills, KBN has instituted the annual "Municipal Economist" prize as well as a student scholarship.

Eco-friendly operations in KBN
The facilities provide good opportunities for energy efficiency. Energy consumption is monitored by a network of sensors for power, cooling and heating. Detailed survey and monitoring of energy consumption provide a unique opportunity for controlling and reducing KBN's own consumption. Actions put into operation such as recycling, waste reduction and systems resulting in reduced energy consumption will be continued.

Due to the nature of its operations, KBN's direct effect on total greenhouse gas emissions and environmental impact are minimal. An annual environmental report is created, showing trends within the various criteria measured. The criteria are measured by a climate calculator for companies.

In 2012 the Eco-Lighthouse Foundation recertified KBN's operations as environmentally sustainable. KBN has a



Hokksund secondary school Øvre Eiker municipality

The school satisfies the Passive House standard and has low energy consumption. KBN has financed the building with green lending rate loan because the school was part of the municipality's climate action plan.

Grønn Punkt Norge (Green Dot Norway) membership. Green IT is implemented through the use of virtual servers. Work stations have been replaced by zero clients. KBN has eco-friendly guidelines for travel both to and from work and business travel.

Suppliers

Environmental criteria are set for purchases. Suppliers must be able to document eco-friendly operations. The number of eco-friendly products used by KBN has doubled since the survey began in 2009.

Kilden Performing Arts Centre Kristiansand county

Kilden is located at Odderøya in Kristiansand, and is home to Agder Regional Theatre, Kristiansand Symphony Orchestra and Opera Sør (the regional opera company). With a total area of 16,500 square meters it is surrounded by nature and with the sea as its closest neighbour. Kilden is partially funded by KBN.

The Board of Directors' Annual Report 2012

Kommunalbanken Norway (KBN) granted 550 loans during 2012, amounting to NOK 30.7 billion in total, representing a 48 per cent market share on loans to the Norwegian local government sector. Solid and stable operations over many years while maintaining the highest possible credit rating, AAA/Aaa, ensure access to favourable funding in international capital markets. Low borrowing costs combined with low operating expenses mean that KBN can maintain its role as an efficient public sector tool to provide local government sector access to loans at competitive terms.

KBN lending grew by 5.6 per cent in 2012. Population growth and demographic changes have caused considerable demand for investments in the local government sector. A majority of projects financed by KBN in 2012 are related to building and refurbishment of schools, kindergartens and care homes as well as upgrading of infrastructure, water systems, sanitation as well as IT.

Profit for the year was NOK 1,876 million as against NOK 724 million in 2011. Return on equity after tax was 37.1 per cent as against 18.3 per cent in 2011. Financial results are influenced by positive changes in fair value of hedging instruments as well as stable margins on KBN's lending products and liquidity portfolio.

As of 30 June 2012, Core Tier 1 capital requirements for financial institutions were increased to a minimum of nine per cent. In the revised National Budget for 2012, the Norwegian Parliament (Storting) approved an increase in KBN's capital of NOK 924 million to ensure that KBN fulfilled the requirements. Due to expected increase in equity requirements through Basel III and CRD IV, KBN targeted a lending growth of six per cent in 2012.

KBN's total assets at year-end were NOK 349 billion. Loans to Norwegian municipalities and counties amounted to NOK 219.3 billion. KBN's liquidity portfolio amounted at year-end to NOK 98.9 billion.

The Central Government, represented by the Ministry of Local Government and Regional Development, is sole owner of KBN. KBN's registered office is in Oslo.

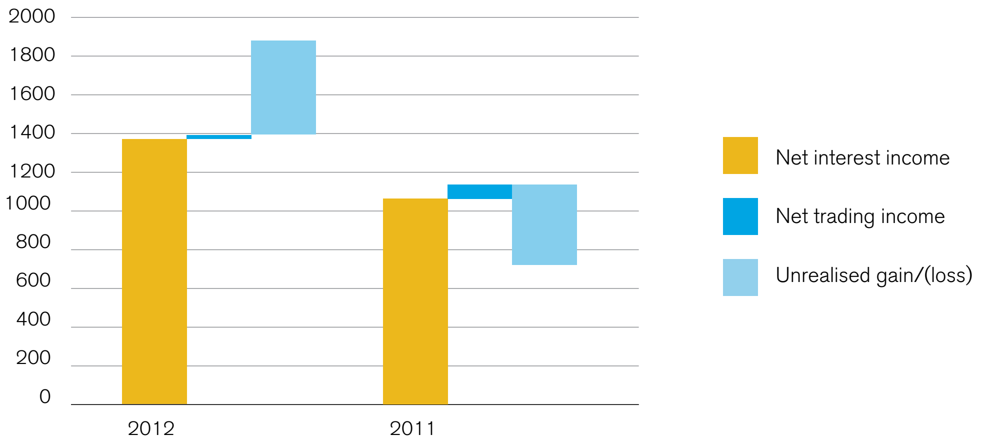
Annual accounts

The Board of Directors confirms, in accordance with the Norwegian Accounting Act § 3-3a, that KBN's ability to continue as a going concern remains unchanged, and the financial statements of 2012 are prepared on a going concern basis. The Board of Directors considers that the financial statements for 2012 provide an adequate description of KBN's financial position at year-end. The annual accounts have been prepared in accordance with International Financial Reporting Standards, IFRS, as adopted by EU.

Profit for the year 2012 was NOK 1,876 million, an increase of NOK 1,151 million compared to 2011. NOK 897 million of the increase in profit is a rever-

Profit after tax

(amounts in NOK mill)



sal of earlier recognised negative value changes on financial instruments. KBN's financial results adjusted for unrealised gains/losses on financial instruments, are presented in the key figures as core earnings, with correspondingly adjusted figures for return on equity and return on assets.

Net interest income in 2012 after fees and commission expenses amounted to NOK 2,011 million as against NOK 1,561 million in 2011. Favourable margins on hedging instruments contributed to reduced borrowing costs in Norwegian kroner and were the main reason for increased interest rate margins on lending and liquidity portfolio.

Net trading income from repurchase of own debt and sale of securities in the liquidity portfolio in 2012 totaled NOK 29 million, down from NOK 109 million in 2011.

Net unrealised gain on financial instruments was NOK 671 million in 2012, against a loss of NOK 575 million in 2011. Price volatility in the derivative markets in 2011 resulted in considerable unrealised fair value changes in the derivative (hedging) portfolio. As pricing levels in the derivative markets normalised in 2012, the previously recognised losses were reversed in the income statement.

Total operating expenses were NOK 107 million in 2012, an increase from NOK 96 million in 2011.

Total operating expenses amount to 0.03 per cent of total assets.

An appreciation of Norwegian kroner and a reduction in the liquidity portfolio both contributed to a reduction in the total assets. Total assets as of 31 December 2012 amounted to NOK 349.0 billion, compared to NOK 366.9 billion at previous year-end.

KBN's total eligible capital as of 31 December 2012 amounted to NOK 8.6 billion, of which NOK 7.1 billion was Core Tier 1 capital. In 2012 KBN's share capital was increased with NOK 924 million through a new share issuance. NOK 502 million of the paid in capital was used for repurchase of all outstanding Hybrid Tier 1 capital instruments. KBN's core capital following the repurchase consists of share capital and retained earnings.

Core Tier 1 capital ratio at year end was 12.27 per cent while total capital ratio was 14.97 per cent.

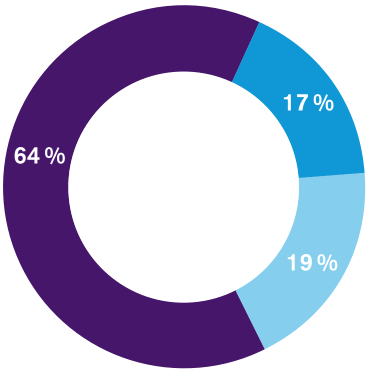
Lending

KBN granted a total of 550 new loans and cases of debt refinancing, a total of NOK 30.7 billion. By year-end KBN's loan portfolio amounted to NOK 219.3 billion, an annual increase of 5.6 per cent.

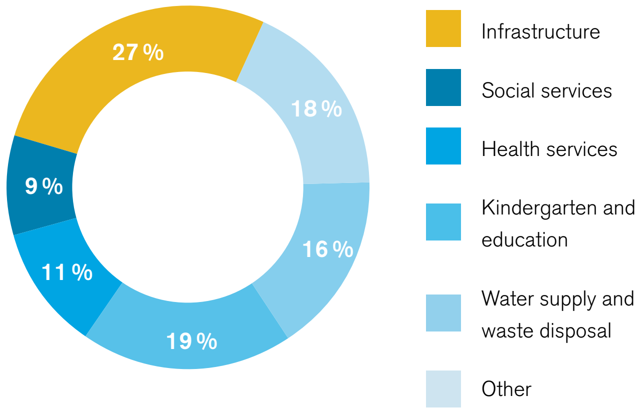
Beginning of 2013 all counties, 421 of 428 municipalities as well as Longyearbyen Local Council serviced loans in KBN, in addition to municipally owned companies. Loans to limited liability companies require municipal or county guarantee, primarily through the issuance of an unconditional guarantee of payment.

Population growth and demographic changes have resulted in substantial investment requirements in the

Loan volume in 2012 by borrower



New loans by sector *



** New loans by sector have been registered since June 2012. The graph shows new loans for the second half of 2012.*

local government sector. The government administration reform of 2010 transferred responsibility for a large part of the Norwegian road network from state to municipal and county level. KBN has become a major contributor to Norwegian infrastructure funding. 27 per cent of new loans disbursed in 2012, were loans to infrastructure projects. At year-end 2012 KBN had disbursed loans to roads amounting to NOK 23.8 billion, an increase of 48 per cent since the reform of government administration came into effect in 2010. A major share of new loans has been transferred to water supply and sanitary projects as well as kindergarten and school projects.

The municipal sector is characterised by strong competition particularly from the domestic bond market. The fact that KBN offers all municipalities the same interest rate, guarantees lowest possible funding costs even for municipalities without access to capital markets. In 2012 KBN chose to introduce limits on loans with commercial paper terms owing to new and stricter capital adequacy requirements. The effect has been that some municipalities, particularly the larger ones, have to a greater degree sought the capital market as a source of funding in 2012, while small and medium sized municipalities have funded their projects through KBN.

KBN continued its increased emphasis on building customer relationships through activities such as customer meetings and regional conferences with current topics relevant to the sector. KBN offers real-time financial information and access to the municipality's own loan portfolio via KBN's web site. In 2012 KBN relaunched a loan administration tool aimed at facilitating municipalities on the liability side.

According to law of public procurement municipalities are supposed to tender banking agreements. As a neutral part KBN offers to assist municipalities when asking for offers for payment services, and carried through 12 such negotiations in 2012.

To contribute to municipalities reducing energy consumption and greenhouse gas emissions, KBN offers a Green Lending Rate Scheme. The rate is 0.1 per cent lower than the ordinary rate. The loan must be used to finance projects included in the municipal environment and climate plans.

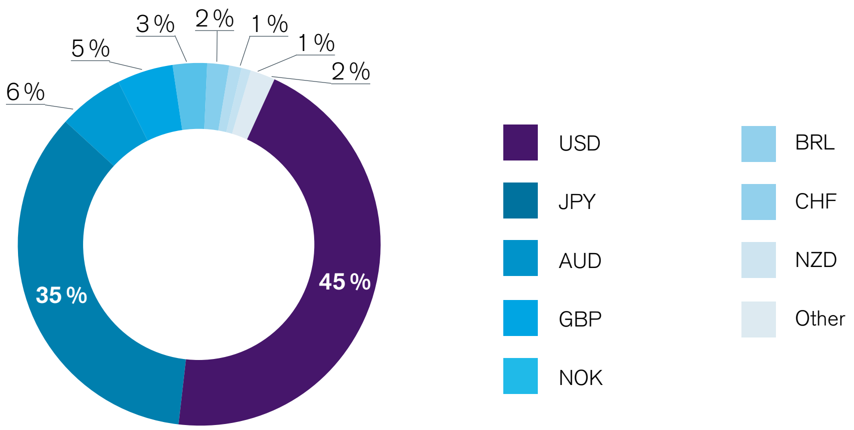
KBN has had no loan losses in 2012. No defaults or payment problems among customers underpin expectations of no losses in 2013.

Funding

KBN maintains its AAA/Aaa rating and its bonds are regarded as attractive investments. This is related to Norway's solid fiscal position, KBN's ownership, assets and public policy mandate to provide low cost funding to the Norwegian local government sector. Investors globally have shown increasing interest in holding to the agency's bonds giving KBN good market access.

KBN has established a funding strategy based on four building blocks/key segments: Benchmark funding, issuance in institutional niche markets, private placements to institutional investors and retail issues. Focusing on a variety of funding markets, KBN has established stable access to funding markets on favourable terms and through a well diversified investor base. Japanese markets/investors continue to be KBN's main source of

Debt portfolio 2012



funding. KBN does however see growth in markets such as the US, South America, Europe and the Middle East/ Africa. Total funding volume for 2012 amounted to NOK 98.2 billion.

Uridashi loans are primarily aimed at smaller private investors in Japan, where the Japanese authorities have conferred KBN sovereign status. 2012 saw a reduction in issuance in Japan as KBN sought somewhat longer maturity than the Uridashi market traditionally offers for parts of the portfolio. All in all KBN executed 323 trades in the Uridashi market, a total equivalent of NOK 37 billion or 38 per cent of total borrowing in 2012.

To finance the green lending rate, KBN has established a green funding program in the Japanese retail market earmarked municipal climate and environmental related projects.

KBN has established a diversified funding strategy and bond issues were done in 13 currencies in 2012. KBN issued three USD benchmark loans throughout the year. The loans were well received in the market with particularly strong presence of US accounts. All loans were oversubscribed and a total of four billion US dollars were sold in USD benchmark loans throughout the year. In addition a record 2.7 billion US dollars were placed in floating rate notes primarily aimed at central banks and other institutional investors.

KBN's total volume of bonds, commercial papers and other funding instruments decreased in 2012 from NOK 338.6 billion to NOK 312.9 billion due to a strong exchange rate and a minor reduction in the liquidity portfolio.

KBN's (international) lending program «Programme for the Issuance of Debt Instruments» is mainly aimed at international borrowing. This is a standardized loan documentation that simplifies and secures the loan processing for both lender and borrower. Since 2011 the program is without an upper limit.

Liquidity

In line with KBN's financial policies the liquidity level should be, over time, equivalent to 12 months' net capital requirements, including lending growth. In any given situation KBN is able to meet all obligations over the next 12 months without any new borrowing. Surplus liquidity is managed with a low-risk investment strategy, both in terms of credit and market risk. The liquidity portfolio is invested in liquid fixed income securities issued by governments, states, regional governments, multilateral development banks and financial institutions, with high credit ratings. Average maturity is 12 months, of which about half is due within 12 months. There is no interest rate or currency risk and the maturity profile is reconciled against the underlying borrowings.

Risk management

Risk management and risk exposure within KBN shall ensure KBN's credit rating and access to the most attractive financial markets. Credit and liquidity risk is overall low. KBN has no position-related exposure to interest rate and currency risk. All risk limits and trading of new financial instruments are approved by the Board of Directors. The financial policies and guidelines for lending to municipalities are considered by the Board of Directors annually.

Credit risk represents KBN's single largest risk. Consequently the control and monitoring of KBN's credit exposure is given great focus and is done so on a continual basis.

Credit risk in the lending portfolio is confined/limited to payment deferment as payment obligations cannot be eliminated. The provisions of the Local Government Act do not permit local and regional authorities to file for bankruptcy. The Local Government Act also provides the procedures to be followed if payment deferral must be implemented. The state, through the Ministry for Local Government and Regional Development takes over the management of a municipality if the municipality fails to fulfil its payment obligations. This gives loan providers protection against any loss of accumulated debt and accrued interest.

Credit risk arising from KBN's liquidity management and (related) hedging operations is low due to strict policies on entering into financial agreements. The framework for liquidity management approved by the Board of Directors, requires rating of at least A2 / A from the rating institutes Moody's and Standard and Poor's, maturity, instrument type, type of counterparty and the counterparty's home country.

Trading in derivatives is subject to standard ISDA agreements and the establishment of collateral agreements, including cash collateral with derivative counterparties.

Procedures and processing for managing credit risk are established. All counterparties are reviewed regularly and the Board of Directors is kept informed about KBN's counterparty risk. An extended market update is given quarterly.

Market risk consists primarily of interest rate and currency risk. KBN's financial policies allow minimal exposure to interest rate and currency fluctuations. Interest rate and currency risk is managed by ensuring that KBN's assets and liabilities are balanced at any time.

Liquidity risk is minimized by the fact that the liquidity portfolio over time will equal to 12-month net capital requirements. The portfolio, moreover, is invested in liquid securities of high credit quality and short duration.

Operational risk is present in all areas of KBN's operations. KBN minimizes operational risk through a continuous effort to ensure good internal controls and the good ethical behaviour and skills among its staff. The Board of Directors is regularly informed about KBN's operational risk.

Corporate communication

With the state as sole owner, represented by the Ministry of Local Government and Regional Development, KBN maintains a good dialogue with the owner. The Board of Directors attaches great importance to good relations with the central government and important public bodies to communicate the importance of KBN's socially beneficial function through the funding of public welfare services.

KBN cooperates with many organizations in the municipal sector. The institution has been an important partner where important financial questions are being discussed.

To reach out to target groups, KBN has increased its presence on social media during 2012.

Corporate governance

KBN complies with Norwegian recommendations for corporate governance in relevant areas, taking into account KBN's organizational and ownership structure. The purpose of the recommendations is to ensure that companies practice corporate governance clarifying the distribution of roles between shareholders, the Board of Directors and the management, in addition to that which is specified in the applicable legislation. The recommendations are intended to strengthen confidence in companies and contribute the greatest possible wealth creation over time, to the benefit of the shareholders, customers, employees and other interested parties.

KBN's central bodies are organized in accordance with the provisions of the Companies Act. KBN's bodies are: The General Assembly, the Supervisory Board, the Board of Directors, the Control Committee, internal and external auditors and the chief executive officer. KBN is made up of three operating areas with staff and support functions.

KBN's internal audits are intended to ensure that risk analysis and risk monitoring is carried out, and that operations are conducted in accordance with approved policies and guidelines. Internal audits are an integral part of KBN's management and planning process. Status and risk in the audit process is monitored at departmental level and reported to the President & CEO and the Board of Directors. Internal audits on financial reports ensure reliable accounting information in the monthly, quarterly and annual reports. Internal control systems and risk analysis is evaluated ongoing by the company's accountant, audit committee and Board of Directors.

The Board of Directors is elected by the General Assembly in accordance with the Articles of Association § 16, cf. § 8. The Board shall consist of five to nine members. Two of the Board members must be elected by and from among the employees. For these members personal deputies must be elected to attend and speak on the Board of Directors. The other members are elected for two year terms, so that a minimum of two are up for election each year, with a maximum of three of the elected members.

The Articles of Association's §§ 6 and 7 state that the acquisition of shares is conditional on the consent of the Board of Directors. Consent can only be withheld if there are grounds of fact. The pre-emption rights given to shareholders under section 4-19 of the (Norwegian) Companies Act can also be applied to shares that have changed hands.

Board members Frode Berge, Nanna Egidius and Martha Takvam were reelected at the general meeting.

The employees elected Trine Tafjord as their new employee representative. Jarle Byre and Marit Urmo Harstad were chosen as employee alternates.

Henceforth the Board of Directors consists of the following members: Else Bugge Fougner (Chairman), Nils R. Sandal (Vice Chairman), Frode Berge, Nanna Egidius, Åmund T. Lunde, Rune Sollie, Martha Takvam, Roald Fischer (employee representative, with Jarle Byre as personal deputy) and Trine Tafjord (employee representative, with Marit Urmo Harstad as personal deputy).

The Board of Directors has established two sub-committees, the Audit Committee and the Compensation Committee.

Organization and competence development
KBN's HR strategy and personnel policies are founded on KBN's core business challenges and framework and shall support KBN's objectives and values. A professional skills development scheme is to ensure KBN sufficient manpower with the right professional skills.

By year-end 2012 KBN had 54 permanently employed, occupying 51.9 full time equivalent positions, compared with 50 permanently employed, occupying 48.5 full time equivalent positions the previous year. The increase in staff is a consequence of KBN's growth both in size and complexity, new government reporting requirements and the need to strengthen expertise in strategically important areas within the organization.

KBN is working continuously with measures to maintain low sickness absence, motivational corporate culture and a healthy working environment. Sick leave was 2.08 per cent in 2012, compared to 2.16 per cent in 2011.

Ethics and social responsibility
Work has systematically taken place to ensure that each employee has knowledge and awareness of the ethical guidelines. The guidelines are to communicate wished for attitudes and expected ethical standards. It is every employee's responsibility to follow the guidelines.

KBN shall act with social responsibility and be climate conscious. In 2012 KBN was recertified as an eco-business. KBN carries through regular risk analysis and has set up environmental goals and a Health, Environment and Safety (HES) action plan.

Diversity and equal opportunities
KBN aims to maintain an even distribution of women and men among employees as well as among management, as well as diversity in age, background and experience. This supplies KBN with professional skills and attitudes important in many of KBN's tasks.

Of KBN's workforce of 54, 27 are women and 27 are men. The proportion of women on the Board of Directors is 44.4 per cent. The Chairman of the Board of Directors is a woman.

Management team consists of 50/50 females/males. President& CEO, Petter Skouen, retired as of 30 November 2012. Kristine Falkgård succeeded Skouen as of 1 March 2013.

Four employees, three women and one man are of non-nordic origin. They are represented in the management and among specialists. Five parents have made use of maternity leave during the year, three women and two men.

Application of profits
The Board of Directors proposes the following distribution of the profit for the fiscal year 2012: NOK 252.8 million is to be paid out as ordinary dividend to the owner and NOK 1,623 million is to be transferred to retained earnings.

Retained earnings are thus NOK 4,996 million, and total equity amounts to NOK 7,140 million.

Future prospects
Norway experiences a continued surplus in its state budget, giving Norway larger possibilities to choose its financial policy going forward than many other countries. Economic activity in Norway is maintained by strong demand from households and high activity in the offshore industry. With this scenario in mind, continued growth is still foreseen in local government revenues.

The demographic development in Norway, characterized by population growth and increase in life expectancy, results in continued growth in local government investments. Population growth will result in investments in infrastructure, housing, kindergartens and schools, while the increased life expectancy long-term will demand investments in the care of the elderly. A continuation of developments in health care services owing to the central government health coordination reform is expected.

Going forward KBN will provide low cost loans for municipal investments. It will require of KBN a continuation of its diversified funding strategy ensuring access to cost effective funding. In 2013 Japanese and American capital markets will go on being KBN's most important markets for funding. The issuance of strategic benchmark loans will be continued.

KBN will continue to adapt the institution to the new capital requirements. A capital base meeting the requirements is a prerequisite for KBN being capable of funding future local government investments. Further accumulation of equity must be obtained through operating profit. Long-term increased equity will lead to a percentagewise decrease in return on equity. At the same time KBN are to maintain its low risk profile and continue to be a trustworthy provider of credit to the local government sector offering its customers the best possible loan terms.

The accounts for 2012 show satisfactory results and KBN is well positioned for sustainable financing of local government social services in the years ahead.

The Board of Directors would like to thank KBN's employees for a job well done.

Else Bugge Fougner
Chairman

Nils R. Sandal
Vice Chairman

Frode Berge
Board Member

Nanna Egidius
Board Member

Roald Fischer
Board Member

Åmund T. Lunde
Board Member

Trine Tafjord
Board Member

Rune Sollie
Board Member

Martha Takvam
Board Member

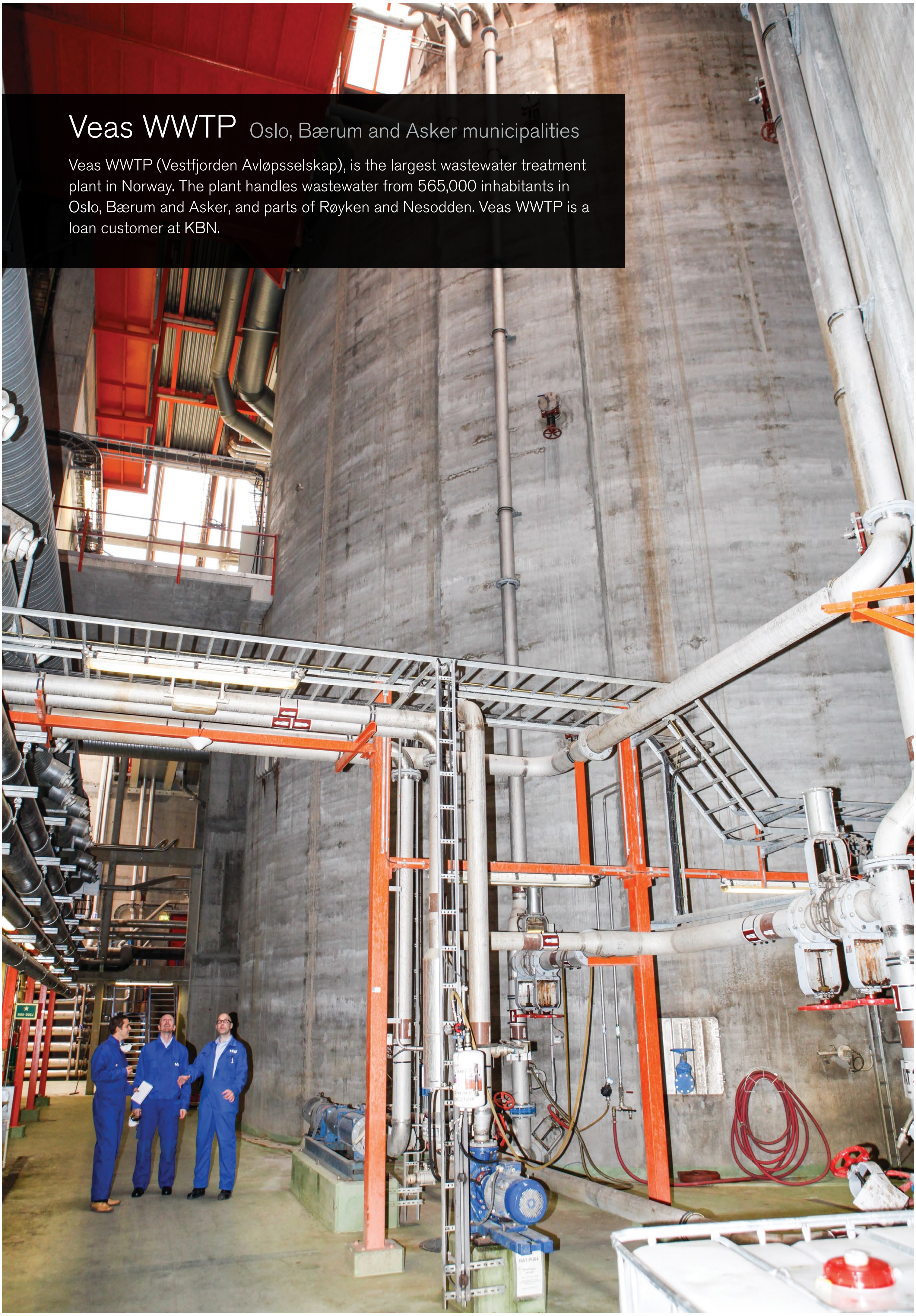
Kristine Falkgård
President & CEO

The Board of Directors

Standing, from left: Frode Berge, Nanna Egidius, Else Bugge Fougner, Rune Sollie and Nils R. Sandal.
Seated, from left: Trine Tafjord, Åmund T. Lunde, Martha Takvam and Roald Fischer.

Veas WWTP Oslo, Bærum and Asker municipalities

Veas WWTP (Vestfjorden Avløpsselskap), is the largest wastewater treatment plant in Norway. The plant handles wastewater from 565,000 inhabitants in Oslo, Bærum and Asker, and parts of Røyken and Nesodden. Veas WWTP is a loan customer at KBN.



Financial statements 2012

Notes to the financial statements

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	2012	2011
Interest income		6 871	6 730
Interest expense		4 839	5 148
NET INTEREST INCOME	**1**	**2 032**	**1 582**
Fees and commission expenses	**2**	21	19
Net unrealised gain/(loss) on financial instruments	**3**	671	(575)
Net trading income	**4**	29	109
TOTAL OTHER OPERATING INCOME		**679**	**(485)**
Salaries and administrative expenses	**5,6,7**	84	77
Depreciation on fixed assets		4	4
Other expenses	**9**	19	15
TOTAL OPERATING EXPENSES		**107**	**96**
PROFIT BEFORE TAX		**2 604**	**1 001**
Income tax	**8**	728	276
PROFIT FOR THE YEAR		**1 876**	**724**

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	2012	2011
Profit for the year		1 876	724
Other comprehensive income		0	0
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		**1 876**	**724**

STATEMENT OF FINANCIAL POSITION			
(Amounts in NOK 1 000 000)	**Note**	**2012**	**2011**
ASSETS			
Deposits with credit institutions	**10,12,14,21**	5 940	3 151
Instalment loans	**10,11,12,15**	221 996	210 189
Notes, bonds and other interest-bearing securities	**10,11,12,13,16**	102 223	116 657
Financial derivatives	**10,12,20**	18 780	36 889
Other assets	**17**	15	15
TOTAL ASSETS		**348 953**	**366 901**
LIABILITIES AND EQUITY			
Loans from credit institutions	**10,12,18,21**	6 041	11 915
Commercial paper	**10,12**	363	0
Senior securities issued	**10,11,12,13,19**	317 108	336 942
Financial derivatives	**10,12,20**	15 568	10 165
Other liabilities		33	53
Current tax liabilities	**8**	576	445
Deferred tax liabilities	**8**	167	14
Pension liabilities	**7**	35	30
Subordinated debt	**10,12,22**	1 670	2 080
Hybrid Tier 1 capital instruments	**10,12,22**	0	663
TOTAL LIABILITIES		**341 560**	**362 307**
Share capital	**23**	2 145	1 221
Retained earnings		5 249	3 373
TOTAL EQUITY		**7 393**	**4 594**
TOTAL LIABILITIES AND EQUITY		**348 953**	**366 901**

STATEMENT OF CHANGES IN EQUITY

		2012		
(Amounts in NOK 1 000 000)	**Note**	**Share capital**	**Retained earnings**	**Total equity**
Equity as of 1 January 2012		1 221	3 373	4 594
Total comprehensive income for the year		0	1 876	1 876
Issue of share capital		924	0	924
Dividends		0	0	0
Equity as of 31 December 2012	**23**	**2 145**	**5 249**	**7 393**

		2011		
(Amounts in NOK 1 000 000)	**Note**	**Share capital**	**Retained earnings**	**Total equity**
Equity as of 1 January 2011		1 221	2 814	4 034
Total comprehensive income for the year		0	724	724
Issue of share capital		0	0	0
Dividends		0	(165)	(165)
Equity as of 31 December 2011	**23**	**1 221**	**3 373**	**4 594**

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	Note	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Interest received		7 158	6 396
Interest paid		(5 051)	(5 091)
Fees and commissions paid		(21)	(21)
Receipts from repurchase of issued securities		29	111
Cash payments to employees and suppliers		(103)	(92)
Income taxes paid		(442)	(260)
		1 570	**1 044**
Net disbursement of loans to customers		(11 666)	(23 734)
Net (increase)/decrease in deposits with credit institutions		(8 928)	8 835
Net (increase)/decrease in notes, bonds and other interest-bearing securities		8 974	(21 489)
Net (increase)/decrease in other assets		0	0
Net increase/(decrease) in other liabilities		(17)	21
NET CASH FLOWS FROM OPERATING ACTIVITIES		**(10 067)**	**(35 324)**
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of property and equipment		(4)	(2)
NET CASH FLOWS FROM INVESTING ACTIVITIES		**(4)**	**(2)**
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of commercial paper		362	14 417
Repayment of commercial paper		0	(14 385)
Proceeds from issuance of debt securities		98 195	142 374
Repayment of debt securities		(87 783)	(107 659)
Proceeds from other borrowed funds		0	0
Repayment of other borrowed funds		(478)	(487)
Proceeds from issuance of subordinated debt		0	1 565
Repayment of subordinated debt		(944)	0
Dividends paid		0	(165)
Paid in share capital		924	0
NET CASH FLOWS FROM FINANCING ACTIVITIES		**10 277**	**35 661**
NET CHANGE IN CASH AND CASH EQUIVALENTS		**206**	**335**
Effects of foreign exchange differences		(362)	(264)
Cash and cash equivalents at 1 January		150	78
Net change in cash and cash equivalents		(156)	72
Cash and cash equivalents at 31 December		**(6)**	**150**
Deposits with credit institutions without agreed period of notice	**14**	*0*	*150*
Loans from credit institutions without agreed period of notice	**18**	*(6)*	*0*

ACCOUNTING POLICIES

REPORTING ENTITY

Kommunalbanken AS (“the Company” or “KBN”) is a limited company providing loans to counties, municipalities, intermunicipal companies and other companies that carry out tasks at a municipal level. KBN’s registered office is in Haakon VIIs gate 5B, Oslo. The financial statements for the year ended 31 December 2012 were approved by the Board of Directors on 18 March 2013.

BASIS OF PREPARATION

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by EU. The financial statements are presented on a historical cost basis, except for:

- Financial instruments held for trading
- Financial instruments at fair value through profit or loss
- Financial instruments classified as Loans and Receivables or Other liabilities that are hedged items and the carrying value is adjusted for fair value changes attributable to the risks that are being hedged.

FOREIGN CURRENCY TRANSLATION

The Company’s functional and presentational currency is the Norwegian kroner (NOK). Assets and liabilities denominated in a foreign currency are translated into NOK at the exchange rate on the reporting date. Revenues and expenses denominated in a foreign currency are translated into NOK at the exchange rate at the transaction date. The financial statements are presented in NOK and rounded to the nearest million kroner, except when otherwise indicated.

SIGNIFICANT ESTIMATES AND ACCOUNTING JUDGEMENTS

The preparation of financial statements in accordance with IFRS requires management to make judgements and use estimates when value of assets and liabilities cannot be measured reliably at the reporting date. Those estimates and accounting judgements can affect carrying values of assets and liabilities, and revenues and expenses. Assumptions made about future development may change due to market changes, and actual results may deviate from the estimates. The most significant judgements and estimates used in the preparation of the financial accounts are:

Fair value measurement
The fair value of financial instruments that are not traded in an active market, or do not have available quoted prices at the reporting date, is determined using valuation techniques. The valuation requires the management to make assumptions and use estimates when considering credit risk and liquidity risk. Even if the assumptions and estimates are based to the greatest possible extent on actual market conditions prevailing at the reporting date, they involve judgement and may add to the degree of uncertainty in valuations. Assumptions and judgements may apply to the classification of financial instruments measured at fair value in the IFRS 7 hierarchy.

Pension liabilities
The value of pension liabilities is determined using actuarial valuation, which involves assumptions about variables, i.e. discount rates, expected return on plan assets, inflation, expected salary growth and mortality rates. Changes in actuarial estimates affect the defined benefit obligation and pension costs. The Company complies with the actuarial and economic estimates prepared and updated by the Norwegian Accounting Standards Board (Norsk Regnskapsstiftelse).

FINANCIAL INSTRUMENTS

Recognition and derecognition

Financial assets and liabilities are recognised in the statement of financial position when KBN becomes a party to the contractual provisions of the instrument. On initial recognition all financial assets and liabilities are measured at fair value. For financial assets that are not carried at fair value through profit or loss, the value at initial recognition includes transaction costs that are directly attributable to acquisition. For regular way purchase of financial assets the value changes of the asset are recognised from the trade date.

Financial assets are derecognised when the contractual rights to the cash flows expire or are transferred. Financial liabilities are derecognised when the contractual obligation has been discharged, cancelled or expired. Repurchases of issued debt securities result in derecognition of financial liabilities. Any difference between settlement amount and carrying value of the liability is recognised in the income statement as gain or loss at the date of transaction.

Designation and measurement

Classification of financial instruments takes place at initial recognition and determines the subsequent measurement according to IAS 39. The designation of financial instruments is determined by the character of the instruments and the management’s intention at acquisition.

Financial assets held for trading
Included in this category are bonds and notes in the trading portfolio. Financial assets held for trading are measured at fair value through profit or loss.

Financial assets designated at fair value through profit or loss (FVO)
Financial assets classified in this category include selected bonds and notes in the liquidity portfolio, fixed rate loans and NIBOR-indexed loans to customers, which are hedged with interest rate and/or cross-currency derivatives. Application of the Fair Value Option to these assets helps to achieve consistent treatment with associated derivatives or financial liabilities which are measured at fair value through profit or loss.

Financial assets held to maturity
Financial assets in this category are primarily investments in senior bond debt, and asset-backed securities, that have been acquired with the intention to hold to maturity, and selected securities that became illiquid as a result of the financial crisis in 2008 and have been reclassified from “Held for trading” to “Held to maturity”-category as of 1 July 2008. Financial assets held to maturity are measured at amortised cost using the effective interest rate method.

Loans and Receivables
Included in this category are loans and advances to customers, and bonds and notes not quoted in an active market. Financial assets designated as Loans and Receivables are measured at amortised cost using the effective interest rate method.

Hedge accounting may apply to bonds and notes classified as Loans and Receivables. When the criteria for fair value hedge are met, the change in the fair value that is attributable to the risk hedged is recorded as a part of carrying value under “Notes, bonds and other interest-bearing securities”, and is also recognised in the income statement as “Net unrealised gain/(loss) on financial instruments”.

Financial liabilities designated at fair value through profit or loss (FVO)
Fair Value Option is applied to the majority of issued debt securities, where market risk exposure is hedged with derivative contracts. The financial liabilities and corresponding derivative contracts are evaluated on a fair value basis and managed in accordance with the Company’s risk management policy that allows only limited exposure to interest rate and FX-risk in liabilities.

Financial liabilities at amortised cost
Financial liabilities measured at amortised cost are public benchmark loans that are designated as hedged items and meet criteria for fair value hedges. Changes in fair value of these loans that are attributable to the risk hedged are recorded as a part of the carrying value under “Senior securities issued” and are recognised in the income statement as “Net unrealised gain/(loss) on financial instruments”.

Financial derivatives
Financial derivatives are classified as Held for trading, with the exception of contracts designated as hedging instruments in fair value hedges. All financial derivatives are measured at fair value through profit or loss and are presented as assets when the value is positive, and as liabilities—when the value is negative.

Fair value of financial instruments

Level 1
Securities traded in an active market with frequent market observations are recorded at quoted prices in active markets at the reporting date. Quoted prices are provided by international vendors (Reuters/Bloomberg). Quoted prices provided by vendors are classified as Level 1-inputs when they represent actual market transactions. Currency basis on USD-NOK and EUR-USD basis swaps, that are quoted in an active market are classified as Level 1-inputs.

Level 2
Level 2 includes financial instruments that are not traded in an active market and where fair value can be determined using quoted prices on identical or similar instruments, or using valuation techniques where significant inputs are based on observable market data. Level 2-inputs might include:

- Observable interest rate yield curves, FX-rates, equity indices and commodity indices
- Quoted prices and credit spreads at the reporting date for similar instruments issued by the same issuer but with a different tenor, so that an adjustment for maturity is necessary
- Quoted prices and credit spreads at the reporting date for similar instruments issued by the same issuer but denominated in a different currency, so that an adjustment for currency is necessary
- Actual market transactions in identical instruments before or after reporting date, so that an adjustment for events between the date of transaction and the reporting date is necessary
- More liquid instruments issued by the same issuer with identical maturity, but an adjustment for liquidity risk is necessary
- Prices on potential new issues in similar instruments from the same issuer

Level 3

Level 3 includes financial instruments that are not traded in an active market. Fair value of these instruments is determined using valuation techniques where significant inputs are not based on observable market data. Financial instruments classified as Level 3 include notes and bonds with low liquidity, fixed-rate loans to customers, issued debt securities not traded in an active market and most OTC-derivatives.

The same input might be used to determine fair value of notes and bonds classified as Level 2 and Level 3. In these cases presentation depends on whether adjustments that are done to the observable market data are considered to be significant (Level 3) or not (Level 2). Other inputs used in determination of fair value might include:

- Indicative prices and estimates for similar instruments provided by other market participants
- Market indices, both bonds and credit default swap indices, for similar instruments
- Non-binding price quotes from different sources
- Historical or implied volatilities

Offsetting of financial assets and liabilities

Financial assets and financial liabilities are offset and the net amount is presented in the Statement of Financial Position when the Company has a legally enforceable right to offset these items and intends to realise the asset and settle the liability simultaneously. Standard master netting agreements do not qualify for offsetting, therefore, the related assets and liabilities are presented gross in the Statement of Financial Position. Cash collateral received or pledged as additional security for derivative exposure is subject to ISDA-agreements that give right to offsetting of assets and liabilities in event of default, but do not qualify for offsetting under IAS 32. Cash collateral is presented gross in the Statement of Financial Position.

Impairment of financial assets

Financial instruments classified as Loans and Receivables or Held to maturity are measured in accordance with IAS 39. When there is objective evidence of value loss, the assets are impaired.

Individual impairments
When there is objective evidence that a loss has been incurred, the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows. The loss is recognised in the income statement. When commitments are assessed for individual impairments, the following loss events may be taken into consideration:

- Significant financial difficulty of the issuer or obligor
- Payment default or breach of contract
- Delinquency in interest or principal payments or renegotiation of loan terms as a result of debtors' financial distress

Group impairments
Financial assets are tested for impairment at a group level, based on the division of the assets into groups with similar risk characteristics. Assets are impaired if the observable data indicates a reduction in future cash flows from the group as a result of negative changes to debtors' creditworthiness and/or changes in economic environment that correlate with defaults in the group. Loans to customers are assessed as a uniform group, based on the provisions of the Local Government Act that rates all Norwegian municipalities equally with regard to risk to the lender. Securities carried at amortised cost are split into groups according to the issuer's risk, underlying exposure and geographical spread. The impairment loss is calculated per risk group, based on expectations to the macroeconomic conditions that can impact on the counterparty's ability to pay, and the loss history for the various risk groups. Under current legislation limiting the municipalities' possibility of going bankrupt, the Company does not expect any impairments on its instalment loans.

Hedge Accounting

Interest rate swaps and cross currency swaps are used to manage market risk in the portfolio of notes and bonds classified as Loans and Receivables and senior securities issued classified as Other liabilities. Hedge relationship between a bond and a swap is treated as fair value hedge. Hedge relationship is established and documented at a transaction level, and hedge effectiveness is measured on an on-going basis using Dollar-offset method. Ineffective part of hedge is recognised in the income statement. Hedging instruments are measured at fair value through profit or loss, and carrying amounts are adjusted accordingly. The change in fair value on the hedged items, that is attributable to the risk hedged, is recorded as a part of carrying value of the item and is recognised in the income statement as "Net unrealised gain/(loss) on financial instruments".

STATEMENT OF CASH FLOWS

Statement of Cash Flows is prepared using the direct method and presents cash flows classified by activity. Cash and cash equivalents include cash on hand, demand deposits and short-term deposits with credit institutions without agreed period of notice.

RECOGNITION OF INCOME AND EXPENSES

Interest and commissions are recognised in the income statement as they are earned or accrued. Interest income for assets and liabilities carried at amortised cost is recognised in the income statement using the effective interest method. Unrealised gains and losses on financial instruments at fair value and value changes on hedged items under hedge accounting are recognised in income statement under "Net unrealised gain/(loss) on financial instruments". Commission expenses on government guaranteed funding are accrued over the lifetime of the transaction. Other commission expenses and charges are recognised as expenses in the period when the service is provided.

FIXED ASSETS

Fixed assets are carried at cost with the deduction of accumulated depreciation and write-downs. Ordinary depreciation, based on cost price, is calculated using a straight line method over the estimated useful life, and the disposal value of the assets is assumed to be zero.

INTANGIBLE ASSETS

A domain name is classified as an intangible asset with an indefinite useful life and is not depreciated. Assets are tested for impairment annually. If there is an indication that the assets are impaired, the value of the assets is written down, and the difference between the carrying amount and the recoverable amount is recognised in profit or loss.

PENSIONS

The Company has an employee pension scheme. The pension scheme is treated as a defined benefit plan. A standard profile of benefits earned and expected final salary are used to determine entitlements. The net pension cost for the period is included in "Salaries and administrative expenses" and consists of the sum of the period's service costs, interest costs on the calculated liability and expected return on the pension assets. Value of net pension liabilities is calculated based on economic and actuarial assumptions. Actuarial gains and losses in excess of 10 % of the higher of gross pension liabilities and gross pension assets at the beginning of the year (the corridor) are recorded in the income statement.

The discount rate used for calculation of pension liabilities as of 31 December 2012 is determined by reference to the market yields on high quality domestic covered bond. The management concluded that the domestic covered bond market satisfied IAS 19-requirements to high quality corporate bonds with a "deep market". The discount rate used as of 31 December 2011 was determined by reference to the market yields on government bonds. The change in pension liabilities attributable to the change in the discount rate is recognised as actuarial gain and does not represent a change in accounting principles.

LEASES

A lease that does not transfer substantially all the risks and rewards incidental to ownership of the asset is classified as an operating lease. Leases that are not operating are classified as finance leases.

Lease payments under an operating lease are recognised on a straight-line basis over the lease term. Under finance leases, assets and liabilities are recognised in the statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payment.

TAXES

Taxes are recognised as they accrue, i.e. the income tax is based on the profit before tax. It is adjusted for temporary and permanent differences before the year's tax base for current taxes is calculated. Deferred tax liabilities and deferred tax assets are calculated on the basis of temporary differences between the accounting and tax values at the financial year end. The nominal tax rate is used for this calculation. Tax increasing and tax-reducing differences within the same period are offset. Income tax consists of current taxes (tax on the taxable profit or loss for the year), changes in net deferred tax and adjustment to taxes payable in respect of previous years.

EQUITY

The Company's equity consists of share capital and retained earnings. Dividends are classified as equity until approved by the Annual General Meeting.

SEGMENT INFORMATION

The Company has one operating segment: lending to the Norwegian municipalities and municipal companies. The Company does not provide separate segment reporting other than disclosures on the lending portfolio and the business as a whole.

CHANGES IN ACCOUNTING POLICIES

Accounting policies applied to the financial statements are consistent with those used in the previous year. In 2012 IASB has not implemented any changes in accounting standards that could have significant impact on KBN's financial statements.

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

IAS 19—Employee benefits

The amendments to IAS 19 Employee Benefits eliminate the option to defer recognition of gains and losses, known as “corridor method”. Furthermore, the standard introduces a new method of disaggregating defined benefit cost: the net interest approach. The amended standard is effective from 1 January 2013. The adoption of the amendments will require KBN to recognise all changes in the value of defined benefit plan in profit or loss and other comprehensive income. The estimated effect of adopting the revised IAS 19 amount to NOK 2.2 million.

IAS 32—Financial instruments: Presentation

The amendments clarify the meaning of “currently has a legally enforceable right to set-off” (IAS 32.42 a), and that some gross settlement systems may be considered equivalent to net settlement. The amendments are effective for annual periods beginning on or after 1 January 2014 and are required to be applied retrospectively. The amendments are not expected to have any material effect on the Company's financial statements.

IFRS 7—Financial instruments: Disclosures

The amendments require KBN to disclose information about rights to set-off and related arrangements (e.g. collateral agreements). The disclosures will provide users with information that is useful in evaluating the effect of netting arrangements on the Company's financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with *IAS 32 Financial instruments: Presentation*. The disclosures also apply to recognised financial instruments that are subject to enforceable master netting arrangement or similar agreements, irrespective of whether they are set off in accordance with IAS 32. The amendments will not impact KBN's financial position or performance and will become effective for annual periods beginning on or after 1 January 2013.

IFRS 9—Financial instruments

IFRS 9, as issued, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after1 January 2013, but the amendments issued in December 2011 moved the mandatory effective date to 1 January 2015. In subsequent phases impairment and hedge accounting is going to be assessed. KBN is valuating the effect of the adoption of IFRS 9 and will present a comprehensive picture when the final standard is issued.

IFRS 13—Fair Value Measurement

The standard provides guidance on how to measure fair value of financial and non-financial assets and liabilities when required or permitted by IFRS. IFRS 13 becomes effective for annual periods beginning on or after 1 January 2013. Adoption of the standard is not expected to have any material impact for KBN.

NOTE 1 NET INTEREST INCOME

(Amounts in NOK 1 000 000)

2012	Total	At fair value through profit or loss FVO	Held for trading	Fair value hedge	Held to maturity	Loans and Receivables	Other liabilities
Deposits with credit institutions	**38**	37	0	0	0	1	0
Instalment loans	**6 244**	3 830	95	0	0	2 319	0
Notes, bonds and other interest-bearing securities	**2 460**	1 810	55	0	148	447	0
Financial derivatives	**(1 870)**	0	(1 584)	(286)	0	0	0
Total interest income	**6 871**	**5 677**	**(1 435)**	**(286)**	**148**	**2 767**	**0**
Loans from credit institutions	**4**	4	0	0	0	0	0
Senior securities issued	**9 326**	7 867	0	0	0	0	1 459
Financial derivatives	**(4 530)**	0	(3 577)	(953)	0	0	0
Subordinated debt and Hybrid Tier 1 capital instruments	**39**	39	0	0	0	0	0
Total interest expenses	**4 839**	**7 910**	**(3 577)**	**(953)**	**0**	**0**	**1 459**
Net interest income	**2 032**	**(2 234)**	**2 142**	**668**	**148**	**2 767**	**(1 459)**

2011	Total	At fair value through profit or loss FVO	Held for trading	Fair value hedge	Held to maturity	Loans and Receivables	Other liabilities
Deposits with credit institutions	**45**	45	0	0	0	0	0
Instalment loans	**6 271**	3 718	310	0	0	2 243	0
Notes, bonds and other interest-bearing securities	**2 588**	1 508	288	0	147	645	0
Financial derivatives	**(2 173)**	0	(1 596)	(578)	0	0	0
Total interest income	**6 730**	**5 271**	**(998)**	**(578)**	**147**	**2 889**	**0**
Loans from credit institutions	**12**	12	0	0	0	0	0
Senior securities issued	**10 049**	8 796	0	0	0	0	1 254
Financial derivatives	**(4 960)**	0	(3 970)	(990)	0	0	0
Subordinated debt and Hybrid Tier 1 capital instruments	**48**	48	0	0	0	0	0
Total interest expenses	**5 148**	**8 855**	**(3 970)**	**(990)**	**0**	**0**	**1 254**
Net interest income	**1 582**	**(3 584)**	**2 972**	**412**	**147**	**2 889**	**(1 254)**

NOTE 2 FEES AND COMMISSION EXPENSES

(Amounts in NOK 1 000 000)

	2012	2011
Expenses of banking services	12	12
Other transaction costs	9	9
Other income	0	2
Total fees and commission expenses	**21**	**19**

NOTE 3 NET UNREALISED GAIN/(LOSS) ON FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

	2012					
	Total	**At fair value through profit or loss**			**Loans and**	**Other**
		FVO	**Held for trading**	**Fair value hedge**	**Receivables**	**liabilities**
Instalment loans	**395**	401	(5)	0	0	0
Notes, bonds and other interest-bearing securities	**181**	158	1	0	21	0
Financial derivatives	**6 762**	0	6 679	83	0	0
Loans from credit institutions	**4**	4	0	0	0	0
Senior securities issued	**(6 701)**	(6 690)	0	0	0	(10)
Subordinated debt and Hybrid Tier 1 capital instruments	**29**	29	0	0	0	0
Net unrealised gain/(loss) on financial instruments	**671**	**(6 098)**	**6 675**	**83**	**21**	**(10)**

	2011					
	Total	**At fair value through profit or loss**			**Loans and**	**Other**
		FVO	**Held for trading**	**Fair value hedge**	**Receivables**	**liabilities**
Instalment loans	**525**	522	3	0	0	0
Notes, bonds and other interest-bearing securities	**(168)**	(85)	16	0	(98)	0
Financial derivatives	**(252)**	0	(1 656)	1 404	0	0
Loans from credit institutions	**(3)**	(3)	0	0	0	0
Senior securities issued	**(544)**	855	0	0	0	(1 399)
Subordinated debt and Hybrid Tier 1 capital instruments	**(132)**	(132)	0	0	0	0
Net unrealised gain/(loss) on financial instruments	**(575)**	**1 156**	**(1 637)**	**1 404**	**(98)**	**(1 399)**

Unrealised gain/(loss) on financial instruments include value changes on financial instruments classified as at fair value through profit or loss, as well as fair value adjustments on financial instruments in fair value hedges.

Changes in fair value are the result of changes in underlying market parameters and risk factors, such as interest rates, FX-rates, credit spreads and basis swap spreads. Changes in fair value are recorded as part of the carrying values of financial instruments and in the income statement. Unrealised gains/(losses) are reversed over contracts' remaining lifetime when the instruments are held to maturity and are settled at contract terms. If the instruments are redeemed before maturity and any gain or loss is realised, the amount is reclassified to "Net trading income".

Financial derivatives in fair value hedges are measured at fair value through profit or loss. The hedged items include NOK 14.9 billion in "Notes, bonds and other interest-bearing securities" and NOK 71.5 billion in "Senior securities issued", that are classified as Loans and Receivables and Other liabilities and are measured at amortised cost. Changes in fair value attributable to the hedged risk are recorded as part of the carrying value of the hedged item and are also recognised in the income statement as "Net unrealised gain/(loss) on financial instruments".

NOTE 4 NET TRADING INCOME

(Amounts in NOK 1 000 000)

	2012	**2011**
Gain/(loss) from repurchase of securities issued	74	121
Gain/(loss) from sale of notes and bonds	(45)	(12)
Net trading income	**29**	**109**

NOTE 5 SALARIES AND ADMINISTRATIVE EXPENSES

(Amounts in NOK 1 000 000)

	2012	**2011**
Salaries	46	40
Employer contributions	7	6
Pension costs	11	9
Other personnel benefits	1	3
Administrative expenses	19	18
Total salaries and administrative expenses	**84**	**77**
Average number of employees	*50.3*	*47.7*

NOTE 6 REMUNERATION

(Amounts in NOK 1 000)

The Company's remuneration policy is designed in accordance with the Regulation on remuneration in the financial service industry, and State's guidelines on remuneration for senior executives in state-owned companies. The remuneration policy aims at attracting, motivating and retaining talented professionals. The remuneration policy aligns the Company's values and low risk tolerance with individual performance goals.

The Board of Directors evaluates and approves remuneration policy annually. The Board in KBN has established a compensation committee, that prepares matters concerning remuneration for the Board's consideration.

Total remuneration consists of fixed salary, variable salary, pension benefit plans and other benefits. KBN has no share-based or option-based programs for the employees.

KBN maintains competitive remuneration level in accordance with the Company's requirements for professional knowledge and experience. Fixed salary constitutes the main part of the total remuneration package.

The variable salary is based on a profit-sharing scheme and requires the achievement of the Company's overall financial targets in 2012. The profit-sharing scheme applies to all employees and can be at a maximum of 1.5 of the base month salary. The executives are subject to the same remuneration policy with regard to variable salary. The total amount of variable salary in 2012 was NOK 4.8 million including employer contributions.

The pension plan is a defined benefit plan with a service period of 30 years and a retirement pension of 66 per cent of base salary and a supplemental retirement plan covering salaries over 12xBase amount. The defined benefit plan covering salaries over 12xBase amount has been closed as of 1 April 2011.

	2012			
Remuneration to senior executives	**Fixed salary**	**Variable salary**	**Other benefits**	**Pension costs**
Petter Skouen (President & CEO)[1]	2 066	274	181	602
Martin Spillum (Acting President & CEO)[2]	1 956	249	20	789
Siv F. Galligani (Deputy CEO)	1 655	225	110	576
Anette Berg (Head of Lending)	1 347	133	78	304
Karina Folvik (Head of Accounting and Financial Reporting)	1 463	178	22	435
Tor Ole Steinsland (Head of Corporate Communication) (from 01.01.12)	950	0	15	122
Total remuneration to senior executives	**9 437**	**1 058**	**426**	**2 827**
Total remuneration to employees whose professional activities affect the risk positions of the institution	**17 147**	**1 880**	**541**	**2 803**
Total remuneration to the employees in the independent control functions	**5 000**	**475**	**188**	**688**

[1] The President & CEO Petter Skouen retired as of 30 November 2012. Kristine Falkgård is appointed as a President & CEO as of 1 March 2013.
[2]Martin Spillum (CFO) was an acting President & CEO in the period 1 December 2012—28 February 2013.

	2011			
Remuneration to senior executives	**Fixed salary**	**Variable salary**	**Other benefits**	**Pension costs**
Petter Skouen (President & CEO)	1 968	461	175	729
Siv F. Galligani (Deputy CEO)	1 589	399	98	462
Martin Spillum (CFO)	1 764	937	17	430
Anette Berg (Head of Lending)	1 181	0	11	345
Karina Folvik (Head of Accounting and Financial Reporting)	1 287	741	19	295
Total remuneration to senior executives	**7 789**	**2 538**	**320**	**2 261**
Total remuneration to employees whose professional activities affect the risk positions of the institution	**17 423**	**3 388**	**455**	**2 468**
Total remuneration to the employees in the independent control functions	**5 480**	**1 733**	**150**	**702**

The senior executives have a period of notice of three months and no termination benefit following termination. The acting President & CEO has the same pension plan as the other employees with a benefit level of 66 per cent of base salary. The pension costs include incurred expenses of the defined benefit plan and provisions for contributions covering salary over 12xBase amount.

Lending to employees has the same terms for senior executives as for the other employees. As of 31 December 2012 the acting President & CEO had a mortgage loan of NOK 2.4 million at 3.15 per cent and a repayment period of 30 years.

Remuneration to Board of Directors	2012	2011
Chairman Else Bugge Fougner[1]	226	215
Vice-chairman Kristin Marie Sørheim[1] (until 22.06.11)	0	58
Vice-chairman Nils R Sandal[1] (from 22.06.11)	126	60
Board member Frode Berge	100	98
Board member Svein Blix (until 22.06.11)	0	48
Board member Nanna Egidius[2]	150	147
Board member Åmund T. Lunde[1,2]	216	205
Board member Martha Takvam[2]	150	147
Board member Rune Sollie[2] (from 22.06.11)	150	75
Board member employees' representative Ellen Eskedal Scavenius (until 21.06.12)	50	98
Board member employees' representative Trine Tafjord (from 21.06.12)	50	0
Board member employees' representative Roald Fischer (from 22.06.11)	100	50
Total remuneration to Board of Directors	**1 317**	**1 198**

[1]Member of compensation committee

[2]Member of audit committee

Remuneration to Control Committee	2012	2011
Chairman Britt Lund	53	51
Committee member Kjell Inge Skaldebø	33	32
Committee member Anne-Ma Tostrup Smith	33	32
Committee alternate member Roy Jevard[1]	10	7
Total remuneration to Control Committee	**128**	**122**

[1]Remuneration to the alternate member is NOK 3 500 per meeting

Remuneration to Supervisory Board	2012	2011
Chairman Elin Eidsvik	21	21
Board members	59	55
Total remuneration to Supervisory Board	**80**	**75**

Fees to the statutory auditor	2012	2011
Statutory audit fees	829	791
Other financial audit and attestation services	935	837
Tax services	0	0
Other services not related to audit	21	29
Total fees excl. VAT	**1 785**	**1 657**

NOTE 7 PENSIONS

(Amounts in NOK 1 000)

KBN has a defined benefit plan that covers all employees and is administered through Kommunal Landspensjonskasse (KLP). The pension benefits cover retirement benefits, disability and death and survivor pensions. Pension benefits complement benefits from the National Insurance Scheme. The defined benefit plan is compliant with the requirements of the Norwegian Mandatory Service Pension Act.

Full pension benefit requires a service period of 30 years and gives the right to a retirement pension of 66 per cent of base salary including the National Insurance Scheme. KBN also has a contractual pension plan (AFP). The plan is included in the calculation of pension liabilities. The defined benefit plan covering salaries over 12xBase amount has been closed as of 1 April 2011.

The employer contributions to the defined benefit plan are recognised as expense.

The defined benefit plan is administrated through a public sector occupational pension scheme and asset composition cannot be specified.

Economic estimates used in calculation of pension costs and defined benefit obligation

	31 December 2012	31 December 2011
Discount rate	3.90%	2.60%
Estimated wage growth	3.50%	3.50%
Expected growth in Base amount	3.25%	3.25%
Expected growth in benefit levels	2.48%	2.48%
Expected return on assets	3.90%	4.10%

The discount rate used for calculation of pension liabilities as of 31 December 2012 is determined by reference to the market yields on high quality domestic covered bond. The discount rate used as of 31 December 2011 was determined by reference to the market yields on government bonds. The management concluded that the domestic covered bond market in 2012 satisfied IAS 19-requirements. The change in pension liabilities attributable to the change in the discount rate is recognised as actuarial gain in 2012.

Pension costs	**Funded plan**		**Unfunded plan**	
	2012	**2011**	**2012**	**2011**
Net periodic pension cost	7 180	6 100	1 742	1 348
Interest cost	1 778	2 102	324	411
Expected return on plan assets	(1 452)	(1 627)	0	0
Service cost	240	225	0	0
Actuarial (gain)/loss recognised in profit or loss	342	0	190	212
Employer contributions	1 092	959	291	248
Net pension costs	**9 182**	**7 758**	**2 548**	**2 219**

Pension liabilities	**Funded plan**		**Unfunded plan**	
	2012	**2011**	**2012**	**2011**
Defined benefit obligation	59 295	61 278	10 660	10 748
Plan assets	(42 252)	(32 643)	0	0
Unrecognised actuarial gain/(loss)	3 853	(9 873)	(1 162)	(3 444)
Employer contributions	2 946	2 645	1 339	1 030
Net pension liabilities	**23 842**	**21 407**	**10 838**	**8 334**

Movement in pension liabilities	**Funded plan**		**Unfunded plan**	
	2012	**2011**	**2012**	**2011**
Net pension liabilities as of 1 January	21 407	18 581	8 334	6 115
Net pension costs	9 182	7 758	2 548	2 219
Contribution to the pension scheme	(6 747)	(4 932)	(44)	0
Net pension liabilities as of 31 December	**23 842**	**21 407**	**10 838**	**8 334**

Movement in the fair value of plan assets	**Funded plan**	
	2012	**2011**
Fair value of plan assets as of 1 January	32 643	28 242
Expected return on plan assets	1 452	1 627
Actuarial gain/(loss)	2 625	(1 002)
Service cost	(240)	(225)
Contribution to the pension scheme incl. employer contributions	5 913	4 323
Benefits paid	(140)	(322)
Fair value of plan assets as of 31 December	**42 252**	**32 643**

NOTE 8 TAX

(Amounts in NOK 1 000 000)

	2012	2011
Current taxes	576	445
Changes in deferred taxes	154	(169)
Total income tax	**729**	**276**

Current taxes	**2012**	**2011**
Current tax payable	576	445
Adjustments to previous years	0	0
Total current taxes	**576**	**445**

Reconciliation of effective income tax rate	**2012**	**2011**
Profit before tax	2 604	1 001
Calculated income tax (28 %)	729	280
Non-deductible expenses	0	0
Non-taxable revenue	0	(4)
Tax expense	**729**	**276**
Effective income tax rate	28.0%	27.6%

Deferred tax liability/(asset)	**2012**	**2011**
Deferred tax liability/(asset) as of 1 January	14	182
Changes in deferred tax	153	(169)
Deferred tax liability/(asset) as of 31 December	**167**	**14**

Temporary differences	**2012**	**2011**
Fixed assets	(1)	0
Pension liabilities	(35)	(30)
Provisions	(7)	(1)
Financial derivatives	392	503
Fair value changes	248	(423)
Total temporary differences	**598**	**49**
Deferred tax liability/(asset) (28 %)	**167**	**14**

NOTE 9 LEASES

(Amounts in NOK 1 000 000)

Future minimum lease payments	**2012**	**2011**
Under 1 year	6	6
Between 1 and 5 years	24	25
Over 5 years	17	23
Total future minimum lease payments	**48**	**54**

Lease payments recognised as an expense in the period	**6**	**6**

Property rental in Haakon VIIs gate in Oslo comprise the main part of the operating leases where KBN is a lessee.

NOTE 10 DESIGNATION OF FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

	2012						
	Total	At fair value through profit or loss			Held to	Loans and	Other
		FVO	Held for trading	Fair value hedge	maturity	Receivables	liabilities
Deposits with credit institutions	**5 940**	1 030	0	0	0	4 910	0
Instalment loans	**221 996**	123 776	0	0	0	98 220	0
Notes, bonds and other interest-bearing securities	**102 223**	82 819	74	0	4 388	14 942	0
Financial derivatives	**18 780**	0	16 129	2 651	0	0	0
Total financial assets	**348 939**	**207 625**	**16 203**	**2 651**	**4 388**	**118 072**	**0**
Loans from credit institutions	**6 041**	391	0	0	0	0	5 650
Commercial paper	**363**	363	0	0	0	0	0
Senior securities issued	**317 108**	245 594	0	0	0	0	71 514
Financial derivatives	**15 568**	0	14 336	1 232	0	0	0
Subordinated debt	**1 670**	1 670	0	0	0	0	0
Hybrid Tier 1 capital instruments	**0**	0	0	0	0	0	0
Total financial liabilities	**340 749**	**248 017**	**14 336**	**1 232**	**0**	**0**	**77 164**

	2011						
	Total	At fair value through profit or loss			Held to	Loans and	Other
		FVO	Held for trading	Fair value hedge	maturity	Receivables	liabilities
Deposits with credit institutions	**3 151**	2 350	0	0	0	801	0
Instalment loans	**210 189**	115 635	11 910	0	0	82 643	0
Notes, bonds and other interest-bearing securities	**116 657**	84 801	13 679	0	4 532	13 645	0
Financial derivatives	**36 889**	0	34 283	2 606	0	0	0
Total financial assets	**366 885**	**202 786**	**59 872**	**2 606**	**4 532**	**97 089**	**0**
Loans from credit institutions	**11 915**	510	0	0	0	0	11 405
Commercial paper	**0**	0	0	0	0	0	0
Senior securities issued	**336 942**	278 251	0	0	0	0	58 692
Financial derivatives	**10 165**	0	9 047	1 118	0	0	0
Subordinated debt	**2 080**	2 080	0	0	0	0	0
Hybrid Tier 1 capital instruments	**663**	663	0	0	0	0	0
Total financial liabilities	**361 766**	**281 504**	**9 047**	**1 118**	**0**	**0**	**70 097**

NOTE 11 FINANCIAL INSTRUMENTS MEASURED AT AMORTISED COST

(Amounts in NOK 1 000 000)

	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Instalment loans	98 220	98 170	82 643	82 689
Notes, bonds and other interest-bearing securities classified as Loans and Receivables	14 942	15 081	13 645	13 669
Notes, bonds and other interest-bearing securities classified as Held to maturity	4 388	4 410	4 532	4 564
Total financial assets measured at amortised cost	**117 551**	**117 661**	**100 820**	**100 922**
Senior securities issued	71 514	71 642	58 692	58 037
Total financial liabilities measured at amortised cost	**71 514**	**71 642**	**58 692**	**58 037**

NOTE 12 FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

(Amounts in NOK 1 000 000)

	2012			
	Level 1	**Level 2**	**Level 3**	**Total**
Deposits with credit institutions	0	1 030	0	**1 030**
Instalment loans	0	72 224	51 552	**123 776**
Notes, bonds and other interest-bearing securities	41 703	39 574	1 616	**82 892**
Financial derivatives	171	14 473	4 135	**18 780**
Total financial assets at fair value	**41 874**	**127 301**	**57 303**	**226 478**
Loans from credit institutions	0	391	0	**391**
Commercial paper	0	363	0	**363**
Senior securities issued	0	0	245 594	**245 594**
Financial derivatives	2 446	9 732	3 390	**15 568**
Subordinated debt	0	0	1 670	**1 670**
Hybrid Tier 1 capital instruments	0	0	0	**0**
Total financial liabilities at fair value	**2 446**	**10 485**	**250 653**	**263 585**

	2011			
	Level 1	**Level 2**	**Level 3**	**Total**
Deposits with credit institutions	0	2 350	0	**2 350**
Instalment loans	0	79 036	48 510	**127 545**
Notes, bonds and other interest-bearing securities	24 492	56 859	17 129	**98 480**
Financial derivatives	5 713	24 629	6 548	**36 889**
Total financial assets at fair value	**30 205**	**162 873**	**72 187**	**265 264**
Loans from credit institutions	0	510	0	**510**
Commercial paper	0	0	0	**0**
Senior securities issued	0	0	278 251	**278 251**
Financial derivatives	384	5 094	4 686	**10 165**
Subordinated debt	0	0	2 080	**2 080**
Hybrid Tier 1 capital instruments	0	0	663	**663**
Total financial liabilities at fair value	**384**	**5 604**	**285 680**	**291 670**

Reconciliation of movements in Level 3

	2011	**Purchase**	**Redemption**	**Gain/(loss)[2]**	**Transfers**	**2012**
Instalment loans	48 510	7 887	(5 024)	439	(259)	51 552
Notes, bonds and other interest-bearing securities[1]	17 129	281	(9 334)	(59)	(6 400)	1 616
Financial derivatives	6 548	209	(1 929)	(690)	(3)	4 135
Total financial assets at fair value in Level 3	**72 187**	**8 377**	**(16 287)**	**(311)**	**(6 662)**	**57 303**
Senior securities issued	278 251	66 987	(86 868)	(12 776)	0	245 594
Financial derivatives	4 686	764	(340)	(1 863)	144	3 390
Subordinated debt	2 080	0	(313)	(97)	0	1 670
Hybrid Tier 1 capital instruments	663	0	(657)	(6)	0	0
Total financial liabilities at fair value in Level 3	**285 680**	**67 751**	**(88 179)**	**(14 742)**	**144**	**250 653**

[1]Notes and bonds for NOK 6.4 billion have been transferred from Level 3 to Level 2, and NOK 0.8 billion from Level 3 to Level 1 as a result of increased liquidity in bond markets in 2012.

[2]All gains/(losses) on financial instruments in Level 3 are recognised in the income statement under "Net interest income", "Net unrealised gain/(loss) on financial instruments" or "Net trading income".

	2010	**Purchase**	**Redemption**	**Gain/(loss)**	**Transfers**	**2011**
Instalment loans	41 564	12 969	(4 349)	(921)	(754)	48 510
Notes, bonds and other interest-bearing securities	16 126	9 903	(10 460)	66	1 495	17 129
Financial derivatives	6 056	1 660	(2 955)	1 968	(181)	6 548
Total financial assets at fair value in Level 3	**63 746**	**24 531**	**(17 764)**	**1 113**	**560**	**72 187**
Senior securities issued	228 177	131 463	(94 903)	7 222	6 292	278 251
Financial derivatives	2 566	3 569	(378)	(1 069)	(3)	4 686
Subordinated debt	306	1 565	0	209	0	2 080
Hybrid Tier 1 capital instruments	672	0	0	(9)	0	663
Total financial liabilities at fair value in Level 3	**231 722**	**136 597**	**(95 281)**	**6 353**	**6 289**	**285 680**

Impact of changes in key assumptions	2012		2011	
	Carrying amount	Effect of changes in key assumptions	Carrying amount	Effect of changes in key assumptions
Instalment loans	51 552	(140)	48 510	(156)
Notes, bonds and other interest-bearing securities	1 616	(1)	17 129	(2)
Financial derivatives	745	13	1 862	(419)
Senior securities issued	245 594	101	278 251	369
Subordinated debt	1 670	5	2 080	7
Hybrid Tier 1 capital instruments	0	0	663	0
Total	**301 177**	**(23)**	**348 495**	**(201)**

The changes in key assumptions are defined as a 10 bp change in the unobservable inputs that are material for determining fair value of assets and liabilities.

Fair value of financial instruments

The fair value hierarchy applied to determination of fair value of financial instruments has three levels:

Level 1—Quoted prices in active markets for identical assets and liabilities

Level 2—Observable inputs other than quoted prices

Level 3—Other inputs that are not based on observable market data.

Valuation techniques used for determination of fair value of financial instruments in Level 2 and 3 include discounted cash flows and option pricing models with inputs from observable market data and unobservable inputs. All changes in fair value of financial instruments are recorded as part of the carrying value of assets and liabilities, and recognised in the income statement as “Net unrealised gain/(loss) on financial instruments” or “Net trading income”.

Deposits with credit institutions

Deposits with credit institutions that are carried at fair value include cash time deposits with other credit institutions. Because of their short-term nature the fair value of these instruments is approximately equal to the notional amount.

Instalment loans

Level 2 includes short-term debt certificates issued by municipalities and loans with floating Nibor-indexed interest rate. The customers have more flexibility in refinancing these types of loans with other lenders when market conditions change. As a result, these types of loans are subject to greater competition from lenders and have observable prices that can be used as Level 2 input when the fair value is determined.

Level 3 includes fixed rate loans to customers that are not traded in an active market and do not have observable market prices after initial recognition. A significant valuation input for fixed rate loans is credit value adjustment, that is estimated at each reporting date. Credit risk is considered to be the same for all municipalities. As observable market data for credit risk is not available, the management has to make assumptions and estimate relevant adjustments for credit risk based on current lending levels and any additional loan security.

Notes and bonds

The best estimate of fair value is price quotations in an active market with many willing buyers and sellers at the reporting date. Level 1 inputs for notes and bonds include quoted prices provided by international vendors (Reuters/Bloomberg). The price quotes used in valuation represent actual transactions in an active market.

Fair value of notes and bonds that do not have available market quotes at the reporting date is calculated using the discounted cash flow method, where discount rates are derived from current interest rate yield curves. Discount rates are adjusted for credit risk and liquidity risk of the issuer, based on observable market data. When applying credit/liquidity value adjustments to discount rates, the assets are grouped based on the issuer’s credit rating, currency, time to maturity, underlying exposure and geographic position. For more detailed description of inputs in fair value determination, see “Accounting policies.”

Senior securities issued

The funding portfolio is split into four main groups, based on the funding product and loan documentation used. The four main categories are benchmark loans, loans in public niche markets, private placements and retail loans. The two first groups are characterised by public syndicated loans in various currencies, where the size of the loan forms the primary difference between the two groups. Fair value of these loans is based on quoted prices of existing issues, prices on new issues and price information obtained from different sources. When those prices represent actual market transactions sufficiently close to the reporting date, they will be classified as Level 1 input in fair value hierarchy.

Group three is private placements and is characterised by non-public loans where the loan terms are specially adapted for a single investor. The final main group is retail loans, i.e. loans sold to retail investors. These loans are normally not traded in the secondary market and do not have available price quotes. The portfolio is therefore classified as Level 3 in fair value hierarchy. The choice of valuation models and input depends on the structure of each loan. The fair value of the bonds without embedded options is determined using the discounted cash flow method with inputs based on current interest rate yield curves and credit spreads estimated from prices on new issues. The fair value of structured bonds with option elements is calculated using option pricing models that use both interest rates, FX-rates and historical volatilities as parameters.

Financial derivatives

All financial derivatives are OTC-contracts used only in financial hedges. Basis swaps (USD-NOK, USD-EUR and EUR-NOK) are recorded at market prices quoted in an active market. The fair value of plain vanilla interest rate and cross currency swaps is determined using the discounted cash flow method with discount rates derived from observable swap interest rates. Equity and commodity linked derivatives with embedded options are valued using the same valuation models as corresponding loans and are classified as Level 3.

NOTE 13 HEDGE ACCOUNTING

(Amounts in NOK 1 000 000)

KBN applies fair value hedge to transactions in selected economic hedges of interest rate and cross-currency risk. Fair value hedge is applied at individual transaction level where hedging instrument is explicitly linked to the hedged item (”micro hedge”), and hedge relationship is properly documented. Hedge effectiveness is measured on an ongoing basis and all ineffectiveness is recognised under ”Net unrealised gain/(loss) on financial instruments”.

Carrying value of financial instruments in fair value hedges	**2012**	**2011**
Notes, bonds and other interest-bearing securities	14 942	13 645
Senior securities issued	71 514	58 692
Financial derivatives	1 419	1 488
Total	**87 875**	**73 824**

Fair value changes on financial instruments in fair value hedges	**2012**	**2011**
Notes, bonds and other interest-bearing securities	21	(98)
Senior securities issued	(10)	(1 399)
Financial derivatives	83	1 404
Total	**94**	**(94)**

Fair value changes are a result of changes in underlying risk factors, such as interest rates and currency basis swap spreads.

NOTE 14 DEPOSITS WITH CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2012	**2011**
Deposits with credit institutions without agreed period of notice	0	150
Deposits with credit institutions with agreed period of notice	1 030	2 350
Cash collateral pledged	4 910	651
Total deposits with credit institutions	**5 940**	**3 151**

NOTE 15 INSTALMENT LOANS

(Amounts in NOK 1 000 000)

	2012	**2011**
Principal amount	219 204	207 572
Accrued interest	1 099	1 327
Adjustment for fair value	1 642	1 247
Total loans to customers	**221 945**	**210 146**
Other loans	51	43
Total instalment loans	**221 996**	**210 189**

Geographic distribution	**2012**	**2011**
Østfold	11 715	11 476
Akershus	19 965	18 986
Oslo	4 167	4 481
Hedmark	8 665	7 469
Oppland	7 167	6 714
Buskerud	18 489	14 606
Vestfold	7 527	7 753
Telemark	8 235	8 522
Aust-Agder	5 625	4 766
Vest-Agder	11 875	10 982
Rogaland	15 821	17 021
Hordaland	26 884	25 807
Sogn og Fjordane	6 940	6 396
Møre og Romsdal	15 118	14 111
Sør-Trøndelag	12 019	12 180
Nord-Trøndelag	10 397	10 042
Nordland	13 343	12 464
Troms	9 420	8 486
Finnmark	5 778	5 263
Svalbard	53	48
Loans to customers	**219 204**	**207 572**

NOTE 16 NOTES, BONDS AND OTHER INTEREST-BEARING SECURITIES

(Amounts in NOK 1 000 000)

Assets by issuer

	2012	2011
Domestic		
Issued by public bodies[1]	0	0
Issued by other borrowers	2 470	2 080
Non-domestic		
Issued by public bodies[1]	80 319	85 035
Issued by other borrowers	19 435	29 542
Total notes, bonds and other interest-bearing securities	**102 223**	**116 657**

[1]Issued by or guaranteed by sovereigns, central banks, regional authorities and multilateral development banks.

Assets by maturity

	2012	2011
Under 1 year	56 523	53 818
1-5 years	45 700	60 911
Over 5 years	0	1 927
Total notes, bonds and other interest-bearing securities	**102 223**	**116 657**

NOTE 17 OTHER ASSETS

(Amounts in NOK 1 000 000)

	2012	2011
Intangible assets	1	1
Fixed assets	11	11
Other assets	1	1
Prepaid, non-accrued expenses and accrued income	2	2
Total other assets	**15**	**15**

NOTE 18 LOANS FROM CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2012	2011
Loans from credit institutions without agreed period of notice	6	0
Loans from credit institutions with agreed period of notice	391	510
Cash collateral received	5 644	11 405
Total loans from credit institutions	**6 041**	**11 915**

NOTE 19 SENIOR SECURITIES ISSUED

(Amounts in NOK 1 000 000)

	2012	2011
Senior securities issued (nominal amounts) at 1 January	**338 615**	**290 231**
New issuance	98 192	142 341
Redemptions	(88 192)	(107 578)
Amortisation	409	(81)
Translation differences	(36 157)	13 702
Senior securities issued (nominal amounts) at 31 December	**312 867**	**338 615**
Accrued interest	1 880	2 667
Adjustment for fair value	2 361	(4 340)
Total senior securities issued	**317 108**	**336 942**
Gain/(loss) from adjustment for fair value as a result of change in own credit risk	*(21)*	*381*

There was no breach in debt covenants as of 31 December 2012.

Adjustments to fair value as a result of the Company's credit risk is a part of the change in fair value not attributable to changes in parameters associated with market risk. It is assumed that the market risk in senior securities issued is limited to changes in observable money market interest rates. Changes in fair value attributable to changes in credit risk in senior securities issued are calculated as the difference between the discounted values applying:

a) Relevant money market interest rates at the reporting date adjusted for the credit risk at time of recognition; and
b) Relevant money market interest rates at the reporting date adjusted for the credit risk at the reporting date.

NOTE 20 FINANCIAL DERIVATIVES

(Amounts in NOK 1 000 000)

KBN uses financial derivatives solely for hedging against exposure to interest rate and currency risks arising in the Company's business activities. KBN enters into swap contracts with counterparties with high credit rating and all derivative exposure is subject to risk limits approved by the Board. Bond debt denominated in foreign currency is hedged with interest rate and cross-currency swaps so that KBN only has limited exposure against changes in 3-month money market interest rates in NOK, USD and EUR. Swap contracts linked to the commodity index or equity index are used to hedge risk in borrowing where the return is linked to such indices.

Borrowings in foreign currency are converted to Norwegian kroner through basis swaps in which KBN receives interest payments in foreign currency and pays the interest in Norwegian kroner. Interest rate risk arising from fixed interest rate on loans to customers is hedged with interest rate swaps and FRA. Interest rate and currency swaps are also used to hedge against market risk in the liquidity portfolio. The Company has no credit derivatives in the portfolio.

Counterparty risk arising from derivative contracts is mitigated by using standard ISDA-agreements that give the right to offset liabilities and assets in the case of default. In addition, the Company enters into collateral agreements with all new swap counterparties. Derivative exposure is monitored on an ongoing basis.

	2012			2011		
	Nominal value	**Assets**	**Liabilities**	**Nominal value**	**Assets**	**Liabilities**
Held for trading:						
Interest rate derivatives	94 662	1 242	2 187	102 404	848	1 525
Currency derivatives	384 611	10 984	10 333	410 817	23 111	7 347
Equity-related derivatives	73 285	3 891	1 747	86 393	10 291	159
Commodity-related derivatives	941	11	68	1 436	33	16
	553 498	**16 129**	**14 336**	**601 050**	**34 283**	**9 047**
Fair value hedges:						
Interest rate derivatives	65 129	1 751	50	51 461	1 661	32
Currency derivatives	17 609	900	1 182	17 843	944	1 086
	82 738	**2 651**	**1 232**	**69 304**	**2 606**	**1 118**
Total financial derivatives	**636 236**	**18 780**	**15 568**	**670 354**	**36 889**	**10 165**

Most financial derivatives are accounted for as "Held for trading", with the exception of contracts designated as hedging instruments in fair value hedges. As standard master netting agreements do not give a currently enforceable legal right to offset the recognised amounts, the financial derivatives are presented gross in statement of financial position. All financial derivatives are measured at fair value through profit or loss.

NOTE 21 COLLATERAL

(Amounts in NOK 1 000 000)

	2012	2011
Cash collateral received	5 644	11 405
Cash collateral pledged	(4 910)	(651)
Total cash collateral	**734**	**10 754**

Credit Support Annex is required for all counterparties in derivative agreements. KBN accepts only cash collateral in USD or EUR. Cash collateral received or pledged as additional security for derivative exposure is presented as cash received or cash paid respectively, with a relevant liability or asset item. Collateral is a part of KBN's cash management.

NOTE 22 SUBORDINATED DEBT

(Amounts in NOK 1 000 000)

	Currency	Nominal amount in CCY	Redemption right	Interest rate	2012	2011
Perpetual subordinated loan capital[1]	NOK	400 million	2020		0	400
Perpetual subordinated loan capital[1]	NOK	102 million	2019		0	102
Perpetual subordinated loan capital[1]	EUR	20 million	2012		0	155
Perpetual subordinated loan capital	NOK	8 million		3.09%[2]	8	8
Perpetual subordinated loan capital	JPY	3 billion	2012		0	233
Ordinary subordinated loan capital	CAD	275 million	2016	3.74%	1 542	1 617
Ordinary subordinated loan capital	NOK	80 million	2012		0	80
Total subordinated debt					**1 550**	**2 594**

[1]Hybrid Tier 1 capital instruments

[2]Interest rate is adjusted every 3 months

NOTE 23 SHARE CAPITAL

	2012		2011	
	Number of shares	Share in %	Number of shares	Share in %
The Kingdom of Norway	2 144 625	100	1 220 625	100
Total	**2 144 625**		**1 220 625**	

NOTE 24 RISK MANAGEMENT

State ownership, customer base and social responsibility imply that KBN maintains low risk in all operations. Risk limits are set in accordance with the requirements of the Board of Directors, shareholders and supervisory authorities. The risk limits reflect the Company's risk tolerance measured by potential impact on profits and regulatory capital.

Risk management and internal control are established to systematically identify, assess and monitor the risk in all operations. Risk management and internal control are an integral part of KBN's strategy and business processes. Risk management activities are adapted to the nature and scope in the risk exposure.

Organisation of risk management

Board of Directors. The Board of Directors in KBN determines the long-term risk strategy through a sustainable risk policy, predefined risk limits and delegation of authority. All risks are subject to internal limits.

Delegation of authority. General authorisation defines the authority to approve loans to customers, and take risk positions in all financial operations.

Responsibility. The President & CEO has an overall responsibility for risk taking and risk management in the Company.

Risk management. The Board of Directors determines the risk policies and limits, including transactions in new products. The Board reviews financial risk policy at least twice a year. Lending policies are reviewed at least annually. The Board assesses the capital situation and approves KBN's principles for capital management annually.

Risk controlling. Risk controlling entities are independent from the operational departments: Lending, Funding and Treasury. KBN portfolio and risk management system is Adaptiv360 delivered by Sungard. Internal audit is performed by KPMG.

Risk exposure

All material risks of the Company are identified and monitored to ensure that they are within the conservative internal risk framework aiming to ensure KBN's credit rating and access to the interbank markets. Credit risk and liquidity risk are generally low. The Company takes no open risk positions in interest rates or foreign currencies.

The following risk factors are identified as the most important for KBN's goal achievement:
Credit risk and counterparty risk

- Loss on loans granted to customers
- Counterparty default – derivative transactions
- Counterparty default – liquidity portfolio
- Spread risk

Market risk

- Interest rate risk and cross currency risk

Capital level
Liquidity risk
Operational risk

Credit risk

KBN’s assets consist of loans to municipalities and a liquidity portfolio of bonds and notes issued by or guaranteed by sovereigns, regional authorities, multilateral development banks, covered bonds and financial institutions with high credit rating.

Framework for credit risk management. The credit risk in loans granted is based on the economic assessment of municipalities. The analysis takes into account quantitative and qualitative key performance indicators, including operating conditions, regulatory framework, financial standing, debt profile, management and an overall economic assessment of the geographic region. The rating estimates based on the internal credit ranking corresponds to the range between AA- and AA+.

All financial transactions in bonds, notes and derivatives are subject to the conservative risk policy. The lowest acceptable rating for investments in bonds and notes is A2/A from Moody’s and Standard and Poor’s.

The credit risk in derivative transactions is managed by using standard ISDA agreements. In addition, KBN enters into collateral agreements with all new swap counterparties.

Credit risk management consists of a set of tasks and processes aimed to monitor and control credit risk on an ongoing basis. The management assesses and approves all new limits and counterparties, based on KBN’s internal credit risk models, available risk capital, counterparties’ external ratings, types of financial instruments and tenor. The Board of Directors annually approves the credit policy for municipal lending, and all special exposures are assessed by the management.

Credit risk assessment. KBN’s client base is the local government sector, which has high creditworthiness. The credit risk in loans granted is limited to payment delays. The local Government Act states that a municipality cannot go bankrupt. Should a municipality face payment difficulties, the central government would assume control of the municipality until it’s able to meet its payment obligations.

KBN enters into derivative transactions with financial institutions to hedge exposure to interest rates and FX-rates. All new transactions are subject to strict rating requirements and also require an ISDA agreement and a collateral agreement with the counterparty.

Credit risk related to the liquidity portfolio is low. An average rating of the portfolio is AA+ (based on the lowest of S&P and Moody’s), and 76 per cent of the portfolio is invested into securities with a BIS-weight of 0 per cent. Average maturity of the portfolio was 1.1 years as of 31 December 2012. The spread risk in the portfolio is managed at a counterparty level and is limited due to the portfolio’s short maturity.

Market risk

Market risk occurs in the form of interest rate risk and currency risk. KBN’s risk policy allows only low exposure to changes in interest rates and FX-rates. The interest rate and currency risk are managed through matching of assets and liabilities as well as through economic hedges with derivative instruments.

Capital management

KBN is subject to the Capital Adequacy requirements and minimum standards for regulatory capital. In addition the Company assesses its capital level taking into account all substantial risks the Company is exposed to. The Board of Directors discusses the capital level and assesses all the risks annually to ensure that the Company’s capital level is sufficient based on the actual and expected risk exposure.

In the process of capital assessment, the management identifies and measures all the risks the Company may be exposed to and estimates the capital level necessary to cover all external and internal risks. The following risks are assessed separately: credit risk, market risk, liquidity risk and operational risk. In addition the management considers concentration risk, key personnel risk, strategic risk, business risk, reputation risk, risk of changes in regulatory framework and compliance risk.

The Board pays special attention to the risk of changes in regulatory framework. The impending changes to CRD IV and to the national capital requirements increase the Company’s capital charge.

KBN’s Core Tier 1 capital ratio is 12.27 per cent, and Core Tier 1 capital ratio including the sovereign exposure buffer imposed by EBA is 11.95 per cent. KBN is compliant with all regulatory capital requirements.

Liquidity risk

Liquidity risk is managed by matching maturity profiles and interest rate reset periods for assets and liabilities. Liquidity portfolio is maintained at a level that over time equals a minimum of 12 months’ net debt redemptions, and the lowest allowed limit of 10 months’ net debt redemptions. Short average time to maturity ensures that KBN’s liquidity requirements can be met without selling assets. Surplus liquidity is invested in liquid bonds and notes with high credit rating and short time to maturity. Liquidity reserves should constitute between 25 and 35 per cent of total assets. KBN also aims to have duration of the liabilities equal or exceeding that of the assets.

Operational risk

Operational risk arises from all functions and is minimised by effective internal control, high professional level and focus on ethical behaviour. The management reports to the Board on the operational risk and loss or near-loss events.

NOTE 25 CREDIT RISK

(Amounts in NOK 1 000 000)

KBN has exposure to municipal sector, as well as sovereigns, financial institutions, local authorities, multilateral development banks and covered bonds within the OECD. Loans given to municipalities may have maturities of up to 50 years, and the credit limits are regulated by Large Exposure regulation. Credit exposures to financials must have a rating of A/A-1 or above.

KBN grants loans to public sector entities that carry out work for local and regional authorities. The conditions for such loans are that local or regional authorities provide guarantees that have been approved by the government, represented by the County Governor or the Ministry of Local Government and Regional Development. In addition, the loans are secured by collateral in the entities' assets. KBN has had no losses on loans to customers in 2012. There is no evidence of impairment as at 31 December 2012.

KBN does not issue financial guarantees.

Amounts in the table below represent actual credit exposure

	2012								
Maturity	**< 1 year**			**> 1 year**					
Risk class	**A-3**	**A-1/A-1+**	**Not rated**	**A-**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Sovereigns and central banks	232	6 300	0	0	0	5 475	2 472	0	**14 479**
Regional authorities [1]	0	22 858	8 932	0	0	15 534	7 234	214 630	**269 187**
Multilateral development banks	0	7 634	0	0	0	1 870	9 093	0	**18 597**
Financial institutions	0	7 305	119	0	45	0	64	0	**7 532**
Securitisation	0	143	0	0	0	0	0	0	**143**
Covered bond	0	10 259	1 102	0	0	388	2 479	0	**14 229**
Total	**232**	**54 499**	**10 152**	**0**	**45**	**23 268**	**21 342**	**214 630**	**324 168**

[1] Including loans to municipal sector of NOK 221.9 billion.

Undisbursed loan commitments amount to NOK 7.06 billion as at 31 December 2012.

Credit exposure by country

	2012								
Maturity	**< 1 year**			**> 1 year**					
Risk class	**A-3**	**A-1/A-1+**	**Not rated**	**A-**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Australia	0	237	0	0	0	0	32	0	**269**
Belgium	0	1 982	0	0	0	0	0	0	**1 982**
Canada	0	1 243	0	0	0	0	0	0	**1 243**
Denmark	0	3 788	0	0	0	0	614	36	**4 437**
Finland	0	490	399	0	0	0	452	593	**1 935**
France	0	4 500	0	0	0	5 863	276	0	**10 639**
Japan	0	0	0	0	0	0	0	0	**0**
Luxembourg	0	675	0	0	0	0	0	0	**675**
Netherlands	0	1 680	0	0	0	0	64	0	**1 744**
Norway	0	1 204	9 581	0	45	0	0	213 585	**224 415**
Austria	0	44	0	0	0	0	0	0	**44**
Spain	232	18	0	0	0	0	0	0	**250**
Supranational	0	7 634	0	0	0	1 870	9 093	0	**18 597**
Switzerland	0	0	0	0	0	0	0	0	**0**
Sweden	0	4 459	172	0	0	915	1 367	0	**6 912**
Germany	0	20 604	0	0	0	14 619	7 683	416	**43 323**
United Kingdom	0	5 848	0	0	0	0	1 762	0	**7 610**
USA	0	93	0	0	0	0	0	0	**93**
Total	**232**	**54 499**	**10 152**	**0**	**45**	**23 268**	**21 342**	**214 630**	**324 168**

2011									
Maturity	**< 1 year**			**> 1 year**					
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**A-**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Sovereigns and central banks	0	7 421	0	0	0	1 115	5 136	0	**13 673**
Regional authorities [1]	0	18 273	18 869	0	674	21 207	12 837	189 604	**261 464**
Multilateral development banks	0	7 909	0	0	0	0	12 135	0	**20 044**
Financial institutions	230	14 175	1 474	0	1 188	195	184	0	**17 446**
Securitisation	0	279	0	0	0	0	0	0	**279**
Covered bond	0	4 057	0	0	0	0	9 840	0	**13 897**
Total	**230**	**52 114**	**20 343**	**0**	**1 862**	**22 517**	**40 132**	**189 604**	**326 802**

[1]Including loans to municipal sector of NOK 210.1 billion.

Credit exposure by country

2011									
Maturity	**< 1 year**			**> 1 year**					
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**A-**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Australia	0	1 085	0	0	0	84	0	0	**1 169**
Belgium	0	196	0	0	0	619	0	0	**815**
Canada	0	218	0	0	674	124	0	0	**1 017**
Denmark	37	9 590	0	0	0	0	557	0	**10 183**
Finland	0	598	0	0	0	0	498	423	**1 519**
France	0	7 768	0	0	0	0	2 799	0	**10 567**
Japan	0	0	0	0	0	166	0	0	**166**
Netherlands	0	2 452	0	0	0	111	266	0	**2 829**
Norway	0	893	18 869	0	1 188	0	3 037	188 239	**212 226**
Spain	0	572	0	0	0	638	0	0	**1 210**
United Kingdom	193	1 586	0	0	0	0	6 325	0	**8 105**
Supranational	0	7 909	0	0	0	0	11 964	0	**19 873**
Switzerland	0	958	0	0	0	0	0	0	**958**
Sweden	0	706	0	0	0	360	3 311	941	**5 319**
Germany	0	17 243	1 474	0	0	20 415	11 328	0	**50 461**
Austria	0	340	0	0	0	0	47	0	**387**
Total	**230**	**52 114**	**20 343**	**0**	**1 862**	**22 517**	**40 132**	**189 604**	**326 802**

NOTE 26 INTEREST RATE RISK

(Amounts in NOK 1 000 000)

Interest rate risk occurs as a result of the differences in the interest rate periods for assets and liabilities, and the fact that incoming and outgoing payments are due at different times. As part of interest risk management, the Company actively buys and sells securities issued by financial institutions and sovereigns and enters into derivative contracts.

The Company's assets and liabilities are denominated in several currencies, but all interest risk is hedged perfectly at a transaction level for all currencies except NOK, USD and EUR. The interest risk in these three currencies is hedged using interest rate swaps, so that the Company only has exposure to changes in 3 month money market interest rates. Interest rate sensitivity is measured as a change in fair value of assets and liabilities with 100 basis points change in interest rates (parallel shift).

The Board has adopted a total limit for interest rate risk of NOK 24 million. The interest rate sensitivity is measured assuming 50 days to an adjustment of the floating rate on the lending portfolio, and the lowest value is reported. The interest rate sensitivity in the main currencies is shown in the table below:

Effect of 100 bp change in interest rate	**Net interest rate risk**	**Gross interest rate risk**
NOK	(12.4)	12.4
USD	(1.6)	1.6
EUR	1.3	1.3
Total	**(12.7)**	**15.3**

Interest rate sensitivity can affect the income statement during the next three month period.

NOTE 27 CURRENCY RISK

(Amounts in NOK 1 000 000)

Currency risk is defined as the risk of loss in market value as a result of fluctuations in FX-rates. The currency risk occurs as a result of the Company's funding mainly being in foreign currency, while lending is provided in NOK. The Company's risk policy requires hedging of all currency risk in the assets and liabilities. However, short-term net positions in the income statement items may occur in EUR and USD. The currency risk is hedged both at transaction level and portfolio level. The limit for currency risk is set to NOK 12 million for a 10 per cent absolute change in all currencies.

	2012		**2011**	
Currency	**Net position**	**10% change in FX-rate**	**Net position**	**10% change in FX-rate**
USD	(1)	0	(39)	4
EUR	(1)	0	(4)	0
Other currencies	3	1	1	1
Total	**1**	**1**	**(42)**	**5**

The table above shows an absolute effect on the income statement of a 10 per cent change in FX-rates relative to NOK. The amount is calculated based on assets and liabilities denominated in foreign currencies at 31 December 2012. Sensitivity analysis does not take into account correlation between FX-rates and other market risk factors.

NOTE 28 LIQUIDITY RISK

(*Amounts in NOK 1 000 000*)

Liquidity risk is defined as a risk for the Company not being able to meet its commitments and/or finance lending demand without significant extra costs being incurred in the form of value loss in assets that have to be sold, or in the form of more expensive funding.

Liquidity risk is monitored and managed through internal control and financial policy. KBN's financial policy requires to maintain net cash balances over time equivalent to a minimum 12 months' net debt redemptions with the lowest allowed limit of 10 months' net debt redemptions. This means that in any given situation the Company can cover all its debt obligations for the next 12 months without new borrowing.

The liquidity portfolio is managed using a conservative investment policy to keep both credit risk and market risk low. Surplus liquidity is invested in notes and bonds issued by sovereigns, sub-sovereigns, regional authorities, multilateral development banks and financials with a high credit rating. Most of the portfolio matures within 12 months. Liquidity risk is further reduced by matching maturities on assets and liabilities. The Company also has a short-term funding programme and a credit line with DNB to manage short-term liquidity.

Exposure by maturity	**Total**	**< 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**>5 years**	**Without maturity**
Deposits with credit institutions	**5 940**	5 940	0	0	0	0	0
Instalment loans	**221 996**	609	2 881	6 152	20 081	192 273	0
Notes, bonds and other interest-bearing securities	**102 223**	11 555	19 955	25 013	45 700	0	0
Total assets	**330 159**	**18 104**	**22 836**	**31 166**	**65 781**	**192 273**	**0**
Loans from credit institutions	**6 041**	6 035	0	0	0	0	6
Commercial paper	**362**	362	0	0	0	0	0
Senior securities issued	**317 108**	8 757	20 560	40 102	203 037	44 651	0
Other liabilities	**811**	8	18	583	167	0	35
Subordinated debt	**1 670**	0	0	0	1 670	0	0
Hybrid Tier 1 capital instruments	**0**	0	0	0	0	0	0
Total liabilities	**325 992**	**15 163**	**20 578**	**40 685**	**204 875**	**44 651**	**41**
Financial derivatives	**3 212**	**(826)**	**(374)**	**498**	**(1 157)**	**5 070**	**0**
Net liquidity exposure	**7 379**	**2 115**	**1 884**	**(9 021)**	**(140 251)**	**152 692**	**(41)**

Exposure by interest rate reset	**Total**	**< 1 month**	**1-3 months**	**3-12 months**	**1-5 years**	**>5 years**	**Without maturity**
Deposits with credit institutions	**5 940**	5 940	0	0	0	0	0
Instalment loans	**221 996**	90 746	72 808	17 131	34 761	6 551	0
Notes, bonds and other interest-bearing securities	**102 223**	15 847	34 107	22 587	29 682	0	0
Total assets	**330 159**	**112 533**	**106 914**	**39 718**	**64 443**	**6 551**	**0**
Loans from credit institutions	**6 041**	6 035	0	0	0	0	6
Commercial paper	**362**	362	0	0	0	0	0
Senior securities issued	**317 108**	36 101	87 214	53 357	125 041	15 395	0
Other liabilities	**811**	8	18	583	167	0	35
Subordinated debt	**1 670**	0	0	0	1 670	0	0
Hybrid Tier 1 capital instruments	**0**	0	0	0	0	0	0
Total liabilities	**325 992**	**42 506**	**87 232**	**53 940**	**126 878**	**15 395**	**41**
Financial derivatives	**3 212**	**(22 248)**	**(71 632)**	**25 831**	**62 448**	**8 812**	**0**
Net liquidity exposure	**7 379**	**47 779**	**(51 949)**	**11 609**	**13**	**(32)**	**(41)**

NOTE 29 CAPITAL ADEQUACY AND CAPITAL MANAGEMENT

(Amounts in NOK 1 000 000)

The Company's capital consists of share capital, retained earnings, Hybrid Tier 1 capital and supplementary capital. A healthy capital level is regarded as essential to maintain the Company's AAA rating and ensure efficient market competition. The Board assesses the capital situation on an ongoing basis and approves KBN's principles for capital management.

The Company is subject to Capital Adequacy Requirements and shall have a sufficient capital level for its risk profile and current market situation. Capital level is measured as core capital ratio and total capital ratio relative to the risk-weighted assets. KBN's capital situation is assessed in relation to risk in day-to-day market conditions and through stress tests. Regulatory minimum requirements for Core Tier 1 capital ratio is set to 9 per cent including a sovereign exposure buffer. KBN is compliant with all regulatory capital requirements as of 31 December 2012.

In order to maintain a sufficient capital level, the Company can, depending on the market situation, reduce or increase its total assets or enter into a dialog with the shareholder to change the Company's capital structure through dividend policy or share capital.

	2012			2011		
	Book value	**Risk-weighted assets**	**Minimum capital requirement**	**Book value**	**Risk-weighted assets**	**Minimum capital requirement**
Credit risk						
Sovereigns and central banks	7 796	116	9	6 390	238	19
Regional governments and local authorities	274 010	47 972	3 838	265 591	43 806	3 505
Of which are Norwegian municipalities	*221 974*	*47 824*	*3 826*	*208 782*	*43 778*	*3 502*
Public sector entities	8 233	0	0	9 761	0	0
Multilateral development banks	18 597	0	0	20 043	0	0
Financial institutions	29 271	4 868	389	31 090	4 260	341
Of which counterparty exposure on derivatives	*14 515*	*1 917*	*153*	*22 929*	*2 628*	*210*
Corporates	319	64	5	0	0	0
Claims secured by residential property	49	49	4	1 407	1 407	113
Covered bonds	14 229	1 423	114	13 897	1 390	111
Other assets	14	14	1	15	15	1
Securitisation	143	45	4	279	70	6
Total credit risk	**352 662**	**54 551**	**4 364**	**348 472**	**51 185**	**4 095**
Market risk	**74**	**2**	**0**	**13 687**	**539**	**43**
Operational risk—Basic Indicator Approach		**2 946**	**236**		**2 373**	**190**
Minimum capital requirement		**57 499**	**4 600**		**54 097**	**4 328**
Total capital ratio			**14.97 %**			**13.22 %**
Core capital ratio			**12.27 %**			**9.79 %**

Supplementary capital cannot exceed 100 per cent of Tier 1 capital. KBN's capital satisfies the capital adequacy requirements. KBN's capital comprises the following elements:

	2012	**2011**
Core capital:		
Share capital	2 145	1 221
Retained earnings	5 249	3 373
Total equity	**7 393**	**4 594**
Hybrid Tier 1 capital instruments	0	666
Deferred tax asset	0	0
Goodwill	(1)	(1)
Allocated to dividend	(253)	0
Unrealised gains on liabilities attributable to changes in own credit risk	(83)	36
Total Tier 1 capital	**7 057**	**5 295**
Supplementary capital:		
Ordinary subordinated debt	1 542	1 651
Perpetual subordinated debt	8	204
Total supplementary capital	**1 550**	**1 855**
Total capital	**8 607**	**7 150**

Subordinated capital has been calculated pursuant to the Regulation governing calculation of subordinated capital for financial institutions. Unrealised gain/loss on liabilities that are due to changes in own credit risk include both non-derivative and derivative liabilities.

Statement from the Board of Directors

Pursuant to §5-5 of the Securities Trading Act

We confirm that the financial statements for 2012 are, to the best of our knowledge, prepared in accordance with International Financial Reporting Standards, IFRS, and that the information in the financial statements provides a true and fair view of the Company's assets, liabilities, financial position and profit or loss.

To the best of our knowledge, the financial statements provide a true and fair view of important events during the accounting period in question and their effects on the financial statements, and also the principal risks and uncertainties facing the Company in the next accounting period.

Oslo, 31 December 2012
18 March 2013
The Board of Directors
Kommunalbanken AS

Else Bugge Fougner
Chairman

Nils R. Sandal
Vice Chairman

Frode Berge
Board Member

Nanna Egidius
Board Member

Roald Fischer
Board Member

Åmund T. Lunde
Board Member

Trine Tafjord
Board Member

Rune Sollie
Board Member

Martha Takvam
Board Member

Kristine Falkgård
President & CEO

Control Committee's and Supervisory Board's statements

Control Committee's statement
The Control Committee has examined Kommunalbanken AS' annual report and accounts as well as the Auditor's report for 2012.

The Control Committee recommends that the annual report and accounts presented be approved as Kommunalbanken's accounts for 2012 and that the application of profits is adopted by the Annual Shareholders' Meeting in accordance with the Board of Directors' proposals.

Oslo, 20 March 2013
Control Committee for Kommunalbanken AS

Britt Lund
Chairman

Anne-Ma Tostrup Smith

Kjell Inge Skaldebø
Vice Chairman

Roy Jevard

Supervisory Board's statement
To the Annual Shareholder's Meeting of Kommunalbanken AS

In accordance with § 15 in Kommunalbanken's Articles of Association, the annual accounts and report for 2012 have been examined by the Supervisory Board.

The Supervisory Board recommends that the Board of Directors' proposals for the income statement and the statement of financial position as well as the application of profit, NOK 1,875,582,806, is adopted by the Annual Shareholders' Meeting.

Oslo, 11 April 2013
Supervisory Board for Kommunalbanken AS

Elin Eidsvik
Chairman

Auditor’s report

To the Annual Shareholders’ Meeting in Kommunalbanken AS

Report on the financial statements
We have audited the accompanying financial statements of Kommunalbanken AS, which comprise the statement of financial position as at 31 December 2012, the statements of income, comprehensive income, cash flows and changes in equity for the year then ended, a summary of significant accounting policies and other explanatory information.

The Board of Directors’ and President & CEO’s responsibility for the financial statements
The Board of Directors and President & CEO are responsible for the preparation and fair presentation of these financial statements in accordance with the International Financial Reporting Standards as adopted by the EU, and for such internal control as the Board of Directors and President & CEO determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor’s responsibility
Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the financial statements of Kommunalbanken AS have been prepared in accordance with laws and regulations and present fairly, in all material respects, the financial position of the Company as at 31 December 2012 and its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards as adopted by the EU.

Report on other legal and regulatory requirements
Opinion on the Board of Directors' report and the statement on corporate governance
Based on our audit of the financial statements as described above, it is our opinion that the information presented in the Directors' report and the statement on corporate governance concerning the financial statements, the going concern assumption and the proposal for the allocation of the result is consistent with the financial statements and complies with the law and regulations.

Opinion on registration and documentation
Based on our audit of the financial statements as described above, and control procedures we have considered necessary in accordance with the International Standard on Assurance Engagements (ISAE) 3000, «Assurance Engagements Other than Audits or Reviews of Historical Financial Information», it is our opinion that the Board of Directors and President & CEO have fulfilled their duty to ensure that the Company's accounting information is properly recorded and documented as required by law and generally accepted bookkeeping practice in Norway.

Oslo, 18 March 2013
ERNST & YOUNG AS

Eirik Tandrevold
State Authorised Public Accountant (Norway)

(This translation from Norwegian has been made for information purposes only.)

Articles of Association of KBN

The Articles of Association were last changed by the Annual General Meeting 21 June 2012, and approved by the Financial Supervisory Authority of Norway 12 July 2012

Chapter I - Company, objectives, registered office

§ 1 The Company's name is Kommunalbanken AS.

§ 2 The Company is a direct continuation of the enterprise carried out by the government administrative body, Norges Kommunalbank.

The State's shares may be assigned to municipalities, counties, intermunicipal companies and municipal pension funds. Such assignment will be done in accordance with the Company's aim of maintaining highest possible creditworthiness.

§ 3 The Company's objectives are to provide loans to local governments, counties, intermunicipal companies and other companies that carry out local government tasks against either a municipal guarantee, government guarantee, or other satisfactory security.

The Company can also undertake other tasks appropriate to the Company's business.

§ 4 The Company's registered office is to be situated in Oslo.

Chapter II - Equity and subordinated loan capital - shares

§ 5 The Company's share capital is NOK 2,144,625,000 (two billion, one hundred and forty-four million, six hundred and twenty five thousand Norwegian kroner) divided into 2,144,625 shares of NOK 1,000 (one thousand Norwegian kroner) each.

§ 6 The acquisition of shares is conditional on the consent of the Company's Board of Directors. Consent can only be withheld on grounds of fact.

§ 7 Pre-emption rights given to shareholders under section 4-19 of the Norwegian Companies Act can also be claimed for shares which have changed owner.

Chapter III - Board of Directors

§ 8 The Company's Board of Directors shall comprise of between five (5) and nine (9) members. Two (2) of the elected members of the Board shall be elected by and from amongst the Company's employees. For these members two (2) personal deputies shall be elected with the right to be present and to speak at board meetings.

The other members shall be elected by the Annual General Meeting for two-year terms, so that at least two (2) shall be elected annually, but no more than three (3) of the elected members. At least half the elected members shall retire at the end of the first year after the drawing of lots, and the remaining members shall retire at the end of the second year.

The Annual General Meeting shall elect the chairman and vice-chairman of the Board of Directors.

§ 9 The chairman of the Board shall ensure that the Board holds meetings as often as the Company's business necessitates, or when a member calls for a meeting to be held. The Board constitutes a quorum if more than half the members are present. Valid resolutions are those for which the majority of the members present have voted, although a proposal which implies an alteration or amendment requires more than one-third of all board members. If the votes on each side are equal, the chairman of the meeting shall have the casting vote.

§ 10 The Board is responsible for managing the Company's business and shall therefore inter alia:

1. Lay down guidelines for the conduct of the Company's business and check that they are followed
2. Grant loans and delegate authority
3. Make decisions and grant authority for new loans raised
4. Grant special powers and authorisation to sign on behalf of the company per procurationem
5. Present the annual accounts and directors' report to the Annual General Meeting
6. Make recommendations to the Annual General Meeting with respect to alterations to the Articles of Association
7. Appoint the managing director
8. Fix the managing director's salary
9. Prepare statements on remuneration policy.

§ 11 The chairman of the Board, the managing director or two members of the Board jointly shall sign for the Company.

§ 12 The managing director shall be responsible for the day-to-day management of the Company and its business in accordance with the instructions laid down by the Board and approved by the Supervisory Board.

Chapter IV - Supervisory Board

§ 13 The Supervisory Board shall consist of twelve members and five deputy members. The Supervisory Board should be composed of as broad a range of members as possible, so as to ensure that the various districts and interest groups affected by the Company's business are fairly represented. A member of the Board of Directors cannot also be member of the Supervisory Board.

One (1) of the members of the Supervisory Board shall be elected by and from amongst the Company's employees. For this member shall be elected one (1) personal deputy. The remaining members and deputy members shall be elected by the Annual General Meeting.

The members of the Supervisory Board shall be elected for two-year terms. One third of the members shall retire each year. Members elected by the shareholders shall be elected for two years. A minimum of one third of the members shall be elected annually. Following the first year one third of the members shall be up for election by drawing lots.

The Supervisory Board shall elect a chairman and vice-chairman from amongst its members to serve for a term of one year.

§ 14 The Supervisory Board shall be convened by the chairman and meet at least once a year or as often as the chairman finds necessary or when called for by the Board of Directors, the Control Committee or at least two of the members of the Supervisory Board. The notice of the meeting shall set out the business to be considered.

The Board of Directors, the Control Committee and the Company's auditor shall be called to attend the meetings of the Supervisory Board. Unless otherwise determined by the Supervisory Board in individual instances, the Board of Directors and members of the Control Committee are entitled to be present at the meetings of the Supervisory Board with the right to speak and the right of initiative. The Ministry of Local Government and Regional Development can participate in the Supervisory Board meeting with up to two observers.

The Supervisory Board constitutes a quorum when at least 2/3 of its members or deputy members are present. If the requisite number of members is not present, a new meeting of the Supervisory Board shall be called. The new meeting will constitute a quorum if more than half the members are present.

Valid resolutions of the Supervisory Board are those for which the majority of the members present have voted, although a resolution can only be passed if voted for by more than one third of all members. If the votes on each side are equal, the chairman of the meeting shall have the casting vote.

§ 15 The Supervisory Board shall supervise the Company's business to ensure that the Company's objectives are being promoted in accordance with law, regulation, memorandum and articles of association, and the resolutions of the Annual General Meeting and the Supervisory Board.

The Supervisory Board shall:

1. Approve the instructions for the managing director as laid down by the Board
2. Elect a state-authorised public accountant to act as auditor
3. Provide a statement to the Annual General Meeting in respect of the Board of Directors' proposals for the income statement and balance sheet, including any consolidated income statement and consolidated balance sheet, and the Board's proposals for the application of profit or covering of loss for the year
4. Scrutinise the directors' report, the auditor's report and the Control Committee's report
5. Adopt instructions for the Control Committee
6. Give an opinion on matters concerning the Company which are brought before the Supervisory Board by the Board of Directors or Control Committee.

Chapter V - Annual General Meeting

§ 16 The ordinary Annual General Meeting shall be held before the end of June.

An extraordinary General Meeting shall be held if called for by shareholders representing minimum a tenth of the share capital, two members of the Supervisory Board, the Board of Directors, the Control Committee or the Company's auditor.

The Ministry of Local Government and Regional Development shall call the Annual General Meeting.

The Annual General Meeting shall transact the following business:

1. The consideration and adoption of the Company's annual report and accounts, including the application of profit or covering of loss for the year, and the declaration of dividend.
2. The fixing of remuneration of the members of the Supervisory Board and the Board of Directors, the members of the Control Committee and the auditor.
3. Elections of members to the Board of Directors in accordance with § 8.
4. Elections of members and deputy members of the Control Committee in accordance with § 17 of the Articles of Association.
5. The Board of Director's statement on remuneration policy.
6. Other business referred to in the notice of the meeting or which by law or Articles of Association falls under the Annual General Meeting.

Chapter VI - Control Committee

§ 17 The Control Committee shall consist of three members and one deputy member who shall be elected by the Annual General Meeting. One member shall satisfy the requirements to be fulfilled by judges under section 54, second subsection of the Norwegian Courts of Justice Act of 13 August 1915. The election of this member must be approved by The Financial Supervisory Authority of Norway ("Finanstilsynet").

No member or deputy member of the Board of Directors, auditor or employee of the Company can be elected as a member or deputy member of the Control Committee. Nor can any person become a member who is under a legal disability or in a relationship of collaboration, subordinacy or dependency to, or married to, or related by marriage or blood in the direct ascending or descending line or the first collateral line to a member of the Board of Directors, auditor or officer of the Company. No person may be elected as a member whose estate is in bankruptcy, under debt settlement proceedings or private administration. Should circumstances arise which render a person no longer eligible for election, he shall retire from the Control Committee.

Members of the Control Committee shall be elected for two-year terms. The Control Committee shall elect a chairman and vice chairman from amongst its members.

The Control Committee shall supervise the business of the Company, including the transactions of the Board of Directors, and ensure inter alia that the business is run in accordance with law and the Articles of Association.

The Control Committee shall meet as often as may be considered necessary in order to ensure effective supervision. It shall keep such a record of its proceedings as is authorised by The Financial Supervisory Authority of Norway ("Finanstilsynet"), and shall annually deliver a report on its work to the Supervisory Board, the Annual General Meeting and The Financial Supervisory Authority of Norway ("Finanstilsynet").

Chapter VII - Auditor

§ 18 The Company's auditor shall be a state-authorised public accountant and shall be elected by the Supervisory Board.

The auditor's report shall be delivered at least two weeks prior to the meeting of the Supervisory Board which shall consider the accounts.

Chapter VIII

§ 19 The Company shall raise funds for lending by issuing bonds, certificates or other form of loan notes or by entering into loan agreements.

§ 20 Loans can only be granted to municipalities, counties, intermunicipal companies and other companies which carry out local government tasks against either a municipal guarantee, government guarantee or other satisfactory security. The Company can also undertake other tasks appropriate to the Company's business.

§ 21 The Board of Directors shall fix all lending terms and conditions as may be in force at any time.

§ 22 The Company's capitalisation and financial administration shall be satisfactory in relation to the Company's business and consistent with the Company's aims of maintaining highest possible creditworthiness.

Chapter IX - Annual Report and Accounts

§ 23 The Company's financial year shall follow the calendar year.

The Board of Directors shall deliver annual accounts and an annual report for each financial year.

The annual accounts shall be placed at the disposal of the auditor at least one month prior to the ordinary Annual General Meeting. The audited annual report and accounts shall be scrutinised by the Control Committee and Supervisory Board before being laid before the Annual General Meeting.

The Annual General Meeting shall adopt the annual report and accounts no later than the end of June.

The Board of Directors shall publish the annual report and accounts no later than one week after they have been adopted by the Annual General Meeting.

Chapter X - Age of retirement

§ 24 The age of retirement for the Company's Managing Director is 67 years.

Chapter XI - Entry into force

§ 25 These Articles of Association shall enter into force on the day on which they are approved by the King.

Chapter XII - Alterations to the Articles of Association

§ 26 The Articles of Association cannot be altered save with the approval of the King.

Governing bodies

Board of Directors

Else Bugge Fougner, Barrister-at-law (Supreme Court), Chairman
Nils R. Sandal, former Mayor of Sogn og Fjordane county, Vice-Chairman
Frode Berge, Development Manager, Stavanger Chamber of Commerce & Industry
Nanna Egidius, Director of Strategic Planning and Development, Lillehammer municipality
Åmund T. Lunde, CEO, Oslo Municipality Pension Fund
Rune Sollie, Chief AFC at Statoil Fuel & Retail
Martha Takvam, Director, Telenor ASA
Roald Fischer, Head of Documentation, employee representative
Trine Tafjord, portfolio manager, employee representative

Alternates to the Employee Representatives
Jarle Byre, alternate to Roald Fischer
Marit Urmo Harstad, alternate to Trine Tafjord

Supervisory Board

Elin Eidsvik, CEO, Hamarøy municipality, Chairman
Knut Wille, CEO, Skien municipality, Vice-Chairman
Hanne Braathen, municipal board member, Storfjord municipality
Berit Flåmo, Mayor, Frøya municipality
Karen Marie Hjelmeseter, county chairman of Sogn og Fjordane Sp
Arne Johansen, former CEO, Harstad municipality
Svein Ludvigsen, County Governor, Troms
Anita Orlund, municipal board member, Skedsmo municipality
Tore Sirnes, former CEO, Sandnes municipality
Bjørn Skjelstad, Mayor, Verran municipality
Bjørn Ove Nyvik, chief accountant, employee representative

Alternates to the supervisory board
Berit Koht, CFO, Troms County
Hans Seierstad, Mayor, Østre Toten municipality
Cecilie Hansen, Mayor, Sør-Varanger municipality
Rune Øygard, former Mayor, Vågå municipality

The Ministry of Local Government and Regional Development, Observers to the Supervisory Board
Thor Bernstrøm, Assistant Director General, Ministry of Local Government and Regional Development
Sølve Monica Steffensen, Deputy Secretary, Ministry of Local Government and Regional Development

Audit Committee

Britt Lund, former CEO, Tinn municipality, Chairman
Kjell Inge Skaldebø, CEO, Åfjord municipality, Vice-Chairman
Anne-Ma Tostrup Smith, Lawyer, Statoil ASA

Alternate to the audit committee
Roy Jevard, CEO, Melhus municipality

Auditor

Ernst & Young AS
Eirik Tandrevold, State Authorised Public Accountant

Internal auditor

KPMG AS
Are Jansrud, State Authorised Public Accountant

Management

Kristine Falkgård, President & CEO

Martin Spillum, CFO

Karina Folvik, Head of Accounting & Financial Reporting

Anette Berg, Head of Lending

Thomas Møller, Head of Capital Markets & Funding

Ellen Eskedal Scavenius, Head of Treasury

Knut Andresen, Head of MO - IT & Compliance

Frank Øvrebø, Head of MO - Credit Analysis & Risk Management

Hilde Jordfald, Head of HR

Tor Ole Steinsland, Head of Corporate Communication

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