

# ANNUAL REPORT 2014

Kommunalbanken Norway

## HIAS IKS

HIAS is an intermunicipal water, sewage and sanitation company owned by the municipalities Hamar, Løten, Stange and Ringsaker. The facility handles household waste, sewage, recycling and ensures residents of the region a secure and safe water source. HIAS was expanded in 2014 with green funding from KBN.



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# HIGHLIGHTS 2014

## KBN IN NUMBERS

98

PERCENT

of the Norwegian municipalities are KBN customers

3

ØRE

KBN costs three øre in administration for every hundred kroner we manage

100

PERCENT

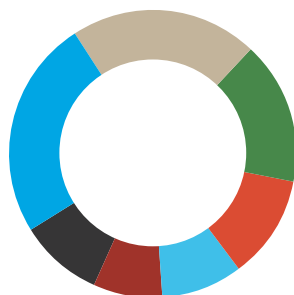
KBN is 100% owned by the central government

10.6

BILLION KRONER

KBN's loan amount to climate friendly projects in Norwegian municipalities

LOAN VOLUME 2014  
by sector



3

KBN is the third largest financial institution in Norway measured by total assets

595

NEW LOANS

was granted in 2014

- Infrastructure 25 %
- Kindergarten and education 21 %
- Water supply and waste disposal 16 %
- Residential and industry 12 %
- Health services 9 %
- Culture, religion and sports 8 %
- Other purposes 9 %

1927

For nearly 90 years KBN has financed the local government sector in Norway

247

BILLION KRONER

KBN's loans to the local government sector

56

EMPLOYEES

Number of employees at KBN in 2014

43

PERCENT

reduction in paper consumption in 2014

# KEY FIGURES

(Amounts in NOK 1 000 000)

	2014	2013
<b>RESULTS</b>		
Net interest income	1 515	1 634
Core earnings <sup>1</sup>	1 026	1 131
Profit before tax	673	1 496
Profit for the year	491	1 083
Return on equity after tax <sup>2</sup>	6.13 %	14.94 %
Return on equity after tax (core earnings) <sup>2</sup>	12.82 %	15.61 %
Return on assets after tax <sup>2</sup>	0.12 %	0.30 %
Return on assets after tax (core earnings) <sup>2</sup>	0.26 %	0.31 %
<b>LENDING</b>		
New disbursements	42 680	43 717
Outstanding loans <sup>3</sup>	247 116	240 863
<b>LIQUIDITY PORTFOLIO<sup>3</sup></b>	<b>155 305</b>	<b>102 358</b>
<b>BORROWINGS</b>		
New long-term borrowings	116 739	162 539
Repurchase of own debt	1 753	4 910
Redemptions	108 080	148 390
Total borrowings <sup>3</sup>	391 285	326 470
<b>TOTAL ASSETS</b>	<b>455 466</b>	<b>361 918</b>
<b>EQUITY</b>		
Common equity Tier 1 capital adequacy ratio	12.26 %	12.39 %
Total capital adequacy ratio	14.53 %	14.91 %

1 Profit after tax adjusted for unrealised gain/(loss) on financial instruments after tax

2 Annualised return on equity and return on assets as percentage of average equity and average assets

3 Principal amounts

# LONG-TERM PARTNER

## CEO'S FOREWORD

2014 was in many ways an unusual year, and a year of change. The processes that will decide the future shape of the Norwegian local government sector started to move forward. Population growth and demographic trends are making it necessary for many public sector entities to adapt the welfare services they provide. This changing world is reflected in KBN's balance sheet.

IN 2014, KBN WAS CLASSIFIED as a financial institution that is systemically important for Norway. Systemically important financial institutions are defined as entities that are of particular importance for the Norwegian economy and financial system. KBN's activities cover a range that extends from global markets to everyday life at the local level. Market interest rates are historically low around the world, which led to good conditions for KBN's funding in 2014 but also to lower returns in the liquidity portfolio. The local government sector favoured short-term financing directly from the capital markets in 2014. At the same time, KBN can again report a solid performance and good financial results.

The local government sector plays a particularly important role in the development of our society. Local authorities are responsible for the delivery of many public welfare services, and in addition to this a great deal of investment in future welfare provision such as schools, health services, water and wastewater, and other infrastructure is carried out at the local government level. The local government sector is responsible for more than half of the production of welfare services in Norway. KBN is a large and important lender to the sector, and has fulfilled this role since its creation in 1927. The range of areas for which the local government sector is responsible has grown in recent years. KBN has been able to finance the increase in investment this has caused, and we

are currently the third-largest financial institution in Norway by total assets.

In 2014, KBN achieved the goals the state has stipulated for its ownership by ensuring that the local government sector had access to cost-effective financing as well as by delivering a competitive return on its equity capital.

KBN is first and foremost a long-term operator, which ensures that financing on attractive terms is available for important welfare projects regardless of the macroeconomic conditions. This aspect of its role was particularly apparent during the global financial crisis, which was also a time of difficult conditions in the Norwegian capital market. Norwegian municipalities were able to maintain a high level of activity in line with the targets set by the public authorities. KBN contributed to this.

**KBN'S LENDING GREW BY 2.6% in 2014.**

This rate of growth is lower than in previous years and needs to be understood in the context of the extremely strong liquidity in the capital markets and universally low interest rates. This combination resulted in a high level of demand from local government borrowers for short-term financing products. More and more of these customers are seeking to arrange financing on the basis of the lowest possible interest rate. This results in demand for loan products with variable interest rates and loans with short maturities. The demand for this type of loan has to a large extent been met by the capital markets in the form of debt

certificates or short-term bonds. As a consequence of this, there was less demand in 2014 for KBN's core products, which are loans that have long maturities in the same way as the underlying investment that is being financed.

The majority of debt growth is coming from those municipalities and counties that are experiencing strong population growth. Population growth is being seen due to urban migration and immigration of labour, both of which testify to the continuing robustness of the Norwegian economy. Total local government debt is low as a proportion of Norway's national wealth. The central government is now transferring many duties to the local government level, and also controls a major part of local government revenue. The growth of local government debt and the scale of KBN's lending must be seen in the context of the Norwegian welfare model rather than as any indication of fiscal laxity by local government borrowers.

**PUBLIC AUTHORITIES ACROSS** the world have introduced a range of capital adequacy requirements that are intended to address the shortcomings in the banks' business models that were brought to light by the financial crisis. Stricter capital requirements mean that financial institutions must have more equity for every krone they lend. The Norwegian Ministry of Finance last year issued regulations regarding the identification of systemically important financial institutions. They justified



this by reference to the fact that some financial institutions were systemically important because they were of particularly great significance to the financial system and the economy. The Norwegian Ministry of Finance decided that Kommunalbanken AS was to be regarded as systemically important.

The Norwegian Parliament increased the level of equity KBN has to hold by NOK 1,400 million in the 2015 National Budget. Strengthening KBN's capitalisation will ensure it fulfils the increased Tier 1 capital ratio requirement it will have to meet as a systemically important financial institution. An increased capital base will also strengthen KBN's position as a particularly robust financial institution.

The Norwegian Parliament has endorsed the government's plan to carry out a reform of municipalities. The aim is to create larger, more robust municipalities that have greater powers and more authority. What this means for KBN is that its customers will undergo a restructuring process, and KBN's role as a long-term partner that adapts to meet the sector's requirements will play an important role in this. We have the expertise and the capacity needed to meet the local government sector's future requirements.

**THE WORK UNDERTAKEN** to define KBN's corporate vision and values was completed in 2014. KBN's corporate vision is «A long-term partner for local

welfare», and this is supported by its values: «Open, responsible and engaging». The process involved close dialogue with employees, management and the Board of Directors. Adherence to the values is now part of the evaluation system used to assess managers and employees.

We are committed to operating in a professional and cost-effective manner. KBN is a knowledge-based organisation, and the role played by our highly skilled employees is of essential importance. Sound and effective work processes that clearly allocate roles and responsibilities are important preconditions for success. We recognise the need to automate procedures that were previously carried out manually in order to benefit from new solutions and make best use of our expertise. This ensures that KBN continues to be an effective tool for our owner and customers, now and in the future. The implementation of a new accounting and finance system represents a major step towards greater use of automated work processes. In addition, the new system enables us to comply with more demanding reporting requirements as well as strengthening our analytical capacity.

**AT A RECENT CONFERENCE**, the Norwegian Prime Minister expressed the view that knowledge development facilitates greater productivity, and investing in knowledge development offers one of the best returns from public spending. We agree entirely. KBN has worked over

many years to develop an organisation with extensive specialist knowledge. We are able to bring together the borrowing requirements of the local government sector and achieve extremely attractive funding costs within a prudent framework. This allows municipalities and county authorities to focus on their primary responsibilities, which include ensuring good conditions for education and knowledge development. Investment in schools and other learning venues can be financed cost effectively through KBN. This results in a good return from investment in knowledge development.

**LOOKING TO THE FUTURE**, it is essential that we all pay greater attention to sustainability. It is very pleasing to see that investments which make a positive contribution to climate change are attracting increasing numbers of investors around the world. We channel this source of funding to Norwegian municipalities and county authorities through a separate loan product available solely to finance climate friendly investments. We were pleased to see sound growth in demand for our 'green' lending product in 2014.

Kristine Falkgård  
President & CEO



2

1. Introduction  
2. The building  
3. The interior  
4. The exterior  
5. The landscape  
6. The history  
7. The future

3

3



## STORMEN CULTURAL CENTRE

The new cultural centre Stormen is located on the quay promenade in central Bodø. The building is the largest development in the municipality's history and consists of a theater and concert hall, library, cafes, showrooms, car park and large recreational areas. Stormen cultural centre is financed by KBN.



# INVESTING TO MEET TOMORROW'S WELFARE NEEDS

In a world of continuing social change, climate change and new reforms, the local government sector will continue to face additional demands for investment spending financed by borrowing in the years ahead. KBN is committed to continuing its 87-year history of supporting the local government sector by providing long-term financing.

THERE ARE TWO MAIN REASONS for loans from KBN to be an attractive source of funding for local government borrowers. Firstly, KBN is able to offer flexible financing that is structured to meet the specific requirements of each borrower. KBN can offer loans for periods from three months to 40 years, with no instalment payments for up to 10 years and some scope for making changes over the life of a loan.

Secondly, all borrowers benefit from the same attractive interest rate. As one of the largest funding operations in Norway and with its AAA rating, KBN is able to offer financing on reasonable terms for both small and large projects at short notice. Norwegian municipalities vary considerably in size, ranging from under 1,000 residents to large municipalities with several hundred thousand residents. However, what all local government borrowers have in common is that they represent the same low risk, and accordingly KBN offers the same interest rate and other terms and conditions to large and small municipalities. The local government sector's investments are by their nature long term. KBN believes that this kind of investment should also be financed on a long-term basis, and accordingly instalment loans with long maturities are KBN's core product. Some municipalities choose instead to arrange financing with much shorter maturity and no instalment payments, which

they then refinance in full at maturity. KBN aims to respond to its customers' requirements, and so it also offers loan products with shorter maturities that require more frequent refinancing.

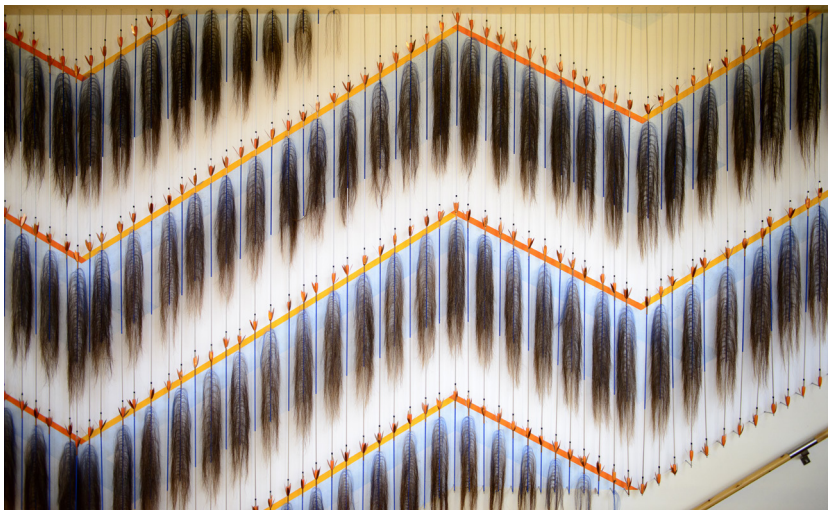
LOCAL GOVERNMENT DEBT increased by 7.4% in 2014 (Source: Statistics Norway C2 report) to exceed NOK 400 billion. In a little over 11 years, local government debt has doubled. KBN expects to see continuing strong demand for new loans, although the pace of growth is expected to slow somewhat after a period of particularly strong growth.

The factors driving growth in local government borrowing are the direct result of the significant scale of investment that continues to be required to expand the provision of welfare services in response to demographic changes, a backlog of maintenance requirements, the effect of climate change, and new requirements caused by changes in policy. Norway is seeing demographic changes in its population in several respects. The country is experiencing population growth due to greater life expectancy, a relatively high birth rate and a high level of immigration. The period to 2050 will also see an increase in the proportion of older people in the population. However, the change in the age composition of the population will be less dramatic than in some countries in southern Europe. Even so, the change will make it necessary for most

municipalities to increase their investment spending on care for the elderly.

The health co-ordination reform carried out in 2012 transferred to municipalities much of the responsibility for caring for patients when they leave hospital. The reform provided incentives for municipalities to invest in preventative health measures. In the aftermath of the reform, and taking into account the expected increase in the proportion of older people in the population, many municipalities have invested in building local medical centres. KBN has provided financing for local medical centres in a number of locations around Norway, and these centres are typically joint projects carried out through collaboration between several municipalities.

The implementation of the government administration reform of 2010 gave the local government sector greater responsibility for infrastructure, and this involved a 60% increase in the road network for which county authorities are responsible. County authorities were given additional central government funding and new arrangements were made to compensate the local government sector for the interest costs incurred on new investments, intended in part to help them catch up with an increasing backlog of investment in welfare services. In total, the local government sector is now responsible for 88 % of the Norwegian road network. KBN has been the most



#### **Høyås living and rehabilitation**

**centre:** Høyås living and rehabilitation centre in Opppegård municipality has departments for dementia care and outpatient ward. To provide room for more residents, the center expanded in 2014 with a new wing built in the environmentally passive house standard. eRoom, touchscreens that provide easy access to information about the residents, is used in all resident rooms. Høyås is the first building in the municipality heated with geothermal energy. KBN has financed the new wing with green lending rate.

important source of financing for toll road projects over recent years. Projects such as the Hardanger Bridge, the Ryfast tunnel, the new section of the E6 at Mjøsa, and the Atlantic Ocean Road, are examples of major road and infrastructure investments financed with loans from KBN.

Norway again experienced extreme weather conditions in 2014, with extensive damage in a number of locations. It is expected that increasing investment will be needed in the years ahead to manage the consequences of climate change, in Norway as elsewhere. Areas that will require investment include water management, drainage, and landslide risks. In addition, many municipalities and counties are committed to reducing their climate gas emissions and reducing energy consumption. All local authorities are required to

have a climate and energy action plan, and these plans identify the measures needed to meet the authority's targets for energy efficiency, climate change and reduction in climate gas emissions. KBN has developed a green funding program that gives investors the opportunity to finance only green projects. KBN offers municipalities and counties the opportunity of a lower interest rate on borrowing for projects that form part of their climate and energy action plans. KBN is pleased to report increased demand for green financing that is helping to meet its objectives for an increasing proportion of the investments it finances to be defined as climate friendly or as contributing to reducing energy consumption.

[KOMMUNAL RAPPORT](#), the local government sector's newspaper, reports that

340 of Norway's 428 municipalities have evaluated the proposals for the future structure of local government or are in the process of so doing. The local government's objective is for the municipal reform that will create larger and more robust municipalities to be approved by the Norwegian Parliament before the election due in 2017. Larger municipalities with wider responsibilities will also have greater investment requirements. Larger municipalities with more borrowings will also be able to operate a more professional finance function, and will accordingly make even greater demands of their sources of financing. KBN has always adapted its activities in pace with changes in the local government sector's responsibilities and requirements, and will continue to do so.

# KBN'S FUNDING

KBN brings together the borrowing requirements of the entire Norwegian local government sector, and is accordingly able to access major investors and important capital markets around the world. This gives KBN good access to reasonably priced funding, which in turn ensures low interest rates for its customers. In 2014, KBN carried out its first benchmark bond issue denominated in euro.

**KBN DIFFERS FROM BANKS** in that it does not take deposits. All the money KBN lends out to the local government sector is raised by issuing securities in the capital markets. KBN is currently the largest Norwegian borrower on the international markets. The highest possible credit rating (Aaa/AAA) from Moody's and Standard & Poor's gives strong demand for KBN's bonds and ensures that KBN achieves low funding costs.

In order to be a stable source of financing for the local government sector, KBN needs to avoid being dependent on market conditions in any particular market. KBN's funding program spreads its activities across all the continents and between different types of investors - everything from national central banks through to private investors.

KBN has historically raised most of its funding in Japanese yen, US dollar and a range of other currencies, with relatively little funding denominated in euro. However, in 2014 KBN carried out its first euro benchmark bond issue. The issue size was EUR 1 billion, and was extremely well received by the market. Following this issue, KBN has a solid foothold in all the major capital markets.

## GREEN BONDS

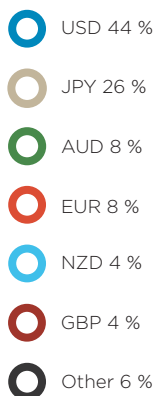
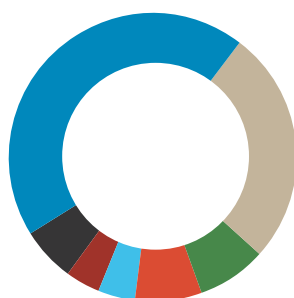
KBN has issued green bonds since 2010. In the first couple of years, KBN's issuance of green bonds targeted Japanese private investors through the Uridashi market. Global interest in green bonds among institutional investors

began to develop in 2013. KBN became one of the first European issuers of green bonds when it sold a USD 500 million three-year green bond issue with the funds earmarked for 'green' projects. The issue was a success, and was heavily oversubscribed. KBN's ambition is to issue green bonds on a regular

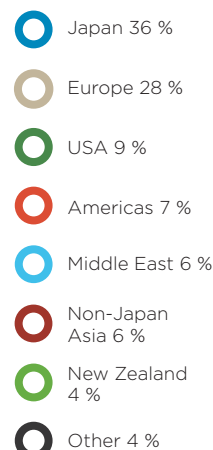
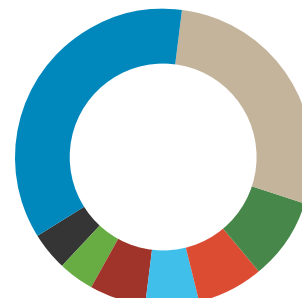
basis in the future.

KBN is a financial institution with a clearly defined role for the benefit of society as a whole. Fulfilling this role is entirely dependent on ensuring that KBN can give its customers access to reasonably priced financing at all times.

TOTAL BORROWING 2014  
by currencies



TOTAL BORROWING 2014  
by investor geography



## EURO BENCHMARK

Frankfurt is the fifth largest city in Germany. Frankfurt is the largest financial metropolis in continental Europe and one of Europe's most important cultural cities. In 2014, KBN issued its first major benchmark bond in euros. The bond was purchased by investors from large parts of Europe.



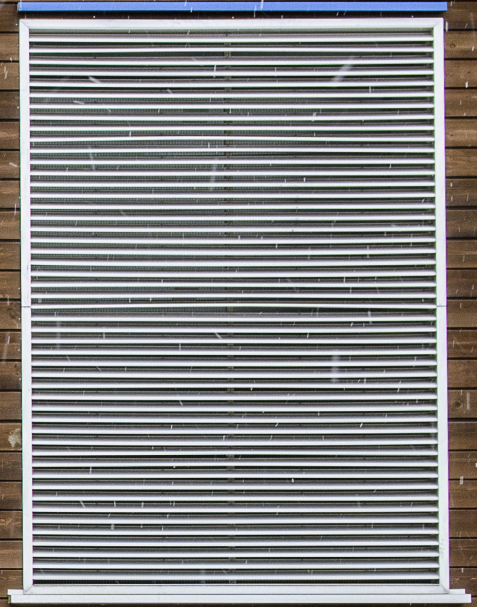
## SPONGDAL PRIMARY AND SECONDARY SCHOOL

Spongdal school in Trondheim municipality accommodates 50 employees and 351 students. The new school building includes a large auditorium where the pupils and teachers can gather at meals and other events. Electronic smart boards are replacing the traditional blackboards in all classrooms. KBN has financed Spongdal school.





# SPONGDAL SKOLE BYNESHALLEN



# AN UPDATE ON THE NORWEGIAN ECONOMY

The Norwegian economy maintained a stable performance in 2014, despite the lower oil price and a fall in economic activity on the Norwegian continental shelf. Unemployment remained low, and the mainland Norway economy grew by 2.3%. At the same time, the current account surplus remained notably strong at 8.7% of GDP.

A weaker Norwegian krone exchange rate and moderate growth in wages created favourable conditions for Norwegian exporting companies. In addition, the lower oil price led to faster growth for Norway's most important trading partners, and this provided further growth impetus for traditional exports. Residential property prices continued to increase throughout 2014, and consumer price inflation

headcount reductions and temporary layoffs in the autumn of 2014. However, a weaker Norwegian krone exchange rate served to moderate the fall in the oil price measured in Norwegian krone, and this in turn moderated the decline in investment in the sector. The level of activity on the Norwegian continental shelf remains extremely high, and work already underway on oil field development

## TOTAL EXPORTS INCREASED

For the rest of the Norwegian economy, the lower oil price had a positive effect on other exporting industries. The Norwegian krone exchange rate weakened markedly towards the end of 2014 as a result of the low official interest rate and the fall in the price of oil. In terms of the import-weighted krone exchange rate index (I-44), by December 2014 the Norwegian krone was at its weakest since 2009. The weaker exchange rate improves the competitiveness of Norwegian export industries since Norwegian products become cheaper in foreign currency terms. In addition, Norway's most important trading partners, including Germany and Great Britain, are net importers of oil. This means that a lower oil price gives these countries greater purchasing power, which can lead to greater demand for Norwegian goods. As a result of these developments, exports of traditional goods experienced more favourable conditions in the latter part of 2014. Exports of traditional goods increased by 2.7% for 2014 as a whole, while exports as a whole increased by 1.7%. Stronger growth for export-oriented industries will serve to offset the effects of slower growth in oil-related industries, and if the Norwegian krone exchange rate remains relatively weak this will facilitate economic readjustment for the Norwegian economy.

## UNEMPLOYMENT REMAINS LOW

The fall in the oil price has so far had only a modest effect on unemployment in Norway. The Statistics Norway labour force survey reported average

## THE NORWEGIAN KRONE EXCHANGE RATE WEAKENED MARKEDLY TOWARDS THE END OF 2014 AS A RESULT OF THE LOW OFFICIAL INTEREST RATE AND THE FALL IN THE PRICE OF OIL

was stable at around 2%. In summary, it is apparent that the fall in the price of oil has so far had only a limited effect on the Norwegian economy.

## LOWER OIL PRICE, BUT OFFSET BY A WEAKER NOK EXCHANGE RATE

The oil price fell sharply in the second half of 2014 as a result of weaker global economic conditions and excess supply of oil. This resulted in slower growth for the Norwegian petroleum sector in 2014. Investment in extraction of crude oil and gas increased by just 1% over the course of the year. Companies in a number of oil-related industries began to report

will not be affected by the fall in the price of oil to any great extent.

The maritime-based segment of the oil services industry is relatively flexible, and is more able to turn to markets elsewhere in the world when demand in Norway weakens. This serves to mitigate the effect of the lower oil price on the level of activity in the Norwegian oil services industry. However, the international oil services segment is also affected by a lower oil price, and this can make it somewhat challenging for Norwegian companies to make their activities more export-oriented.



unemployment of 3.5% in 2014. One of the reasons for this limited impact is that many of those who have lost their jobs were workers from other countries on temporary contracts who have returned home to await new contract opportunities. At the same time the lower oil price, combined with the lower central bank key policy interest rate, has resulted in a sharp weakening of the Norwegian krone exchange rate. This has meant that other export industries have become significantly more competitive and have accordingly increased their exports. Growth in exports has increased demand for labour in export-oriented industries. Oil-related industries typically have a highly educated workforce with extensive expertise, and this also makes it easier for their employees to find work in other industries, so reducing the effect of a lower oil price on overall unemployment.

#### GROWTH IN RESIDENTIAL PROPERTY PRICES

Norges Bank's decision to cut its key policy interest rate in December 2014, combined with low unemployment and a shortage of residential properties, is reflected in continuing growth in residential property prices despite the lower oil price. Statistics Norway reports that overall residential property prices increased by 3% over the course of 2014.

#### MODERATE GROWTH IN CONSUMPTION

Growth in Norwegian household consumption has been at a moderate level over recent years. This has been accompanied by a rising savings rate. However, lower interest rates, the continuing low level of unemployment and rising residential property prices may offset this trend and produce stronger growth in private consumption than is currently anticipated. Consumer price inflation remains at a low and stable level, with a 2% increase in the consumer price index in 2014.

#### OVERALL ECONOMIC GROWTH TO REMAIN STABLE, BUT SOMEWHAT SLOWER

In overall terms, the outlook for the Norwegian economy remains rather stable, with growth expected to continue over the next few years. Low unemployment and the strength of public sector finances ensure that the Norwegian economy is well-equipped to manage the changes that will now be needed. However, if the oil price remains low over a sustained period this will have a relatively serious effect on some industrial sectors. In this scenario, the Norwegian government would be able to draw on the oil revenue reserves in the Government Pension Fund to avoid a material downturn in the economy were this to become necessary.

*The text is written by Menon Business Economics for KBN.*

#### KEY MACROECONOMIC INDICATORS FOR 2014 AND FORECASTS FOR 2015.

Percentage change from previous year. Source: Statistics Norway

	2014	2015
Private consumption	2.1	2.1
Public consumption	2.5	2.5
Gross fixed capital formation	1.2	-3.6
- Mainland Norway	1.8	1.4
Exports	1.7	1.7
- Crude oil and natural gas	0.9	-0.5
- Traditional goods	2.7	5.1
Imports	1.6	1.8
GDP	2.2	0.9
GDP - Mainland Norway	2.3	1.1
Unemployment rate (level as a percentage)	3.5	3.9
Consumer Price Index	2.0	2.3
Current account surplus (percentage of GDP)	8.7	5.2
Government budget surplus (percentage of GDP)	9.8	9.7

## THE NORWEGIAN ECONOMY

Norway is a small open economy, with a highly educated population and extensive natural resources. The Norwegian economy is characterised by stability, and Norway's GDP per capita is one of the highest in the world. The Government Pension Fund - Global, commonly known as the Oil Fund, has generated a stable positive return over many years, and the government budget surplus, including the Oil Fund, is in excess of 10% of GDP.

The oil sector is by far the largest industry in Norway, but a diverse industrial structure gives the Norwegian economy more than one leg to stand on. Industries in which Norway is a significant global player include merchant shipping, metal production and fisheries.

Unemployment in Norway is at a low and stable level, and Statistics Norway reports that unemployment has averaged 2.6% over the last 10 years. Norway has a high rate of population growth, principally as a result of immigration.

## MODERATE GROWTH IN LOCAL GOVERNMENT FINANCES

Over the period from 2004 to 2013, Norwegian local government authorities have on average seen annual growth in revenue of around 2.8% in real terms. This is due in part to strong population growth, which has increased local government tax revenues. The 2015 National Budget estimates that growth in total local government revenue in 2014 was around NOK 4.4 billion in real terms, and anticipates that total revenue growth in real terms in 2015 will be in line with 2014.

The level of activity in the local government sector grew at a moderate rate in 2014. Growth in production volumes slowed somewhat during the course of the year, but the 2015 National Budget forecast that local government production will increase by 2.1% in 2015. Growth in investment by the local government sector also slowed somewhat, but is nonetheless at a high level. The National Budget forecasts that investment spending grew by 4% in 2014. Employee numbers in the local government sector increased by around 2% in 2014.

# INVESTING IN THE NORWEGIAN LOCAL GOVERNMENT SECTOR

The sound financial position of the Norwegian local government sector and the strict financial framework within which it operates make the sector a creditworthy borrower. The local government sector accounts for a large proportion of public sector services production in Norway, and with the help of a government system of revenue transfers is able to offer a unified standard of services throughout the country.

THE NORWEGIAN LOCAL government sector is made up of borrowers that represent extremely low risk. This is a result of factors including the sector's sound financial position and a robust framework that defines the duties and responsibilities of local government authorities and imposes strict limits for their financial conduct. This includes clearly defined restrictions on what activities municipalities and counties are permitted to finance by borrowing. Local government borrowers principally take up loans to finance investment in delivering welfare services such as schools, nurseries and sheltered housing for the elderly, as well as the provision of services for drinking water, sewage and waste collection. The local government sector receives a large proportion of its revenue from central government transfers. The objective of the system is to compensate for differences between municipalities in order to ensure a unified service delivery throughout the country. Municipalities and counties are responsible for areas including education, primary health care, public transport and infrastructure.

## ORGANISATIONAL STRUCTURE OF THE PUBLIC SECTOR

The public sector in the Nordic region is made up of local government authorities and central government authorities. In Norway, Sweden and Denmark, the local government authorities comprise two levels: counties and municipalities. This means that

there are three levels of public administration charged with providing for the needs of the population at the local, regional and national level.

In Norway, the principle of local democracy is considered to be very important, but in contrast to several other European countries, this principle is not enshrined in the Norwegian constitution. The legal framework for local government is laid down by the Norwegian Parliament through legislation and decisions, and Parliament decides on the division of duties between the levels of local government authorities. In addition, the government can impose new duties on municipalities and counties by legislation or Parliamentary decisions. This means that Norway has more comprehensive centralised control of local government authorities than is the case in many other European countries.

Municipalities and counties have an important position in Norwegian society, and account for a large proportion of public sector services production. Measured in terms of working hours in the Norwegian economy as a whole, the local government sector accounted for 15.5% of employment in 2014.

## RELATIONSHIP BETWEEN CENTRAL AND LOCAL GOVERNMENT

The accounting and budgeting processes of municipalities and counties are subject to extensive control by the central authorities. The state's administration of the local government sector aims to balance national interests and

the principle of local democracy. This involves giving municipalities and counties scope to prioritise and adapt services in response to local conditions and needs. The Ministry of Local Government and Modernisation is responsible for implementing policy

## NORWEGIAN MUNICIPALITIES AND COUNTIES

- Norway is divided into 19 counties (fylker), which are split up into 428 municipalities (kommuner).
- More than half of the municipalities have fewer than 5,000 residents. 13 municipalities have over 50,000 residents.
- The total revenue of the local government sector was estimated in the National Budget for 2014 to be NOK 435 billion. This is equivalent to around 18.5% of GDP for mainland Norway.
- The local government sector employs approximately 19% of the country's workforce.
- The local government sector is responsible for welfare services such as health care, education, transport and infrastructure.
- Municipalities and counties are subject to strict central government control, regulation and supervision.
- Municipalities and counties are not permitted to declare themselves insolvent.



**Ryfast sub-sea tunnel system:** Ryfast is a sub-sea tunnel system in construction between Ryfylke and Northern Jæren, and Hundvåg and Stavanger. The project will open up new areas of industry, commerce and housing. This will also provide more opportunities for business cooperation in the region. Funding for the project is a partnership between government, municipality and toll road company. KBN is the largest lender to the toll road company.

in the local government sector. The Ministry is also the owner of KBN.

The legislative framework for the local government sector is stipulated in the Local Government Act. The purpose of this legislation is to facilitate functional municipality and county democracy, with efficient and effective management of municipality and county duties with a view to sustainable development. The Local Government Act stipulates that local government authorities are not permitted to declare themselves insolvent. In addition, the legislation gives central government the authority to make changes to a local government authority's budget and financial plan in order to ensure that its activities are on a financially sound basis within a reasonable time. The Local Government Act stipulates that a municipality or county authority that is in 'financial imbalance' must be put onto a publicly available watch list. 'Financial imbalance' may mean that the authority is budgeting for a deficit in its annual budget or in a four-year financial plan. All municipalities and counties that are on the list, known as the ROBEK list, must seek approval from the Ministry of Local

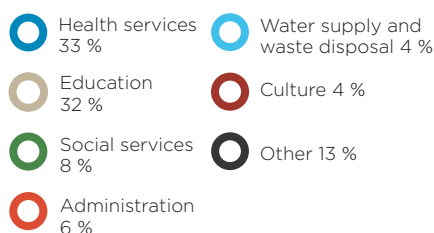
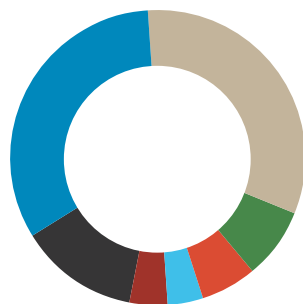
Government and Modernisation for all borrowings and for their financial plan.

It is extremely unlikely that a municipality or county could experience difficulties in meeting its liabilities, but

in such a situation central government would intervene to appoint a supervisory board. KBN has not incurred a loss on its lending at any time in the 87 years that it has been in existence.

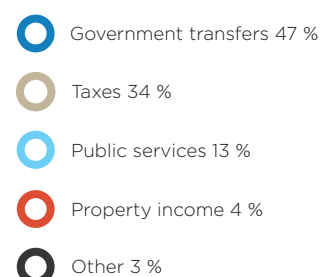
#### MUNICIPALITY EXPENDITURES

Source: Statistics Norway



#### MUNICIPALITY REVENUES

Source: Statistics Norway



# CORPORATE SOCIAL RESPONSIBILITY

KBN recognises its responsibility to contribute to sustainable social development and long-term value creation by operating its business in a responsible way that pays proper attention to environmental, ethical and social issues.

**THE STARTING POINT FOR** reporting on corporate social responsibility at KBN is an analysis of which areas are of importance. An extensive program of work was carried out in 2013 to map stakeholders' various expectations and to identify the risks and opportunities that KBN faces. Based on this, the following areas were prioritised: ethical conduct and anti-corruption and climate and environment. KBN worked actively throughout 2014 on the objectives that were set for the year.

## **ETHICAL CONDUCT AND ANTI-CORRUPTION**

In order to ensure KBN's employees adhere to high ethical standards, work was carried out in 2014 to train managers and employees in ethical issues. A workshop specifically on ethics was run in January for all KBN's employees. Following this, KBN's ethical guidelines were revised and updated by the Board of Directors in October 2014. The updated ethical guidelines include measures to prevent money laundering and new procedures for employees to self-report in relation to any gifts or other benefits that they give or receive.

KBN's corporate vision and values were established in 2014. The corporate vision and values were defined and adopted at a meeting of all KBN's employees in May.

In order to increase awareness of issues associated with corruption and to minimise the risk that KBN might be linked with such issues, KBN became a member of Transparency International

in 2014. Representatives from Transparency International participated in a workshop with KBN employees. KBN has carried out a comprehensive and unified review of its business processes through to financial reporting. Further work will be done on this in 2015 with action taken as required.

## **CLIMATE AND ENVIRONMENT**

KBN has a lending product specifically designed to finance investment in climate-friendly projects by the local government sector. The interest rate on this 'green loan' product is lower than KBN's ordinary floating rate. The proportion of KBN's lending portfolio represented by lending at this green floating rate increased from 3.6% in 2013 to 4.3% in 2014. Efforts were made throughout 2014 to raise awareness of this product, with more advertising and greater prominence on KBN's website.

KBN had stands at the annual conferences of Norwegian Water and Waste Management Norway, and distributed information at these events about the green loan product. KBN dedicated a section of its annual conference to the climate issues faced by the local government sector.

KBN operates a green funding program in order to finance investment in climate-friendly projects by the Norwegian local government sector. The plan to issue new green bonds in 2014 was postponed to 2015. In order to reassure investors that their money is used for climate-friendly investments, the climate

research centre CICERO has carried out an independent assessment of the projects financed in this way. KBN plans to be a regular issuer of green bonds in the future in order to finance municipal climate and energy-related projects.

KBN's activities do not have any adverse effect on the external environment other than the effect of normal office operations and business travel. Its office premises provide good opportunities for efficient energy use. Energy consumption is monitored by a network of sensors for power, cooling and heating. Detailed recording and monitoring of energy consumption provides a unique opportunity to control and reduce KBN's energy consumption. Measures have been introduced for recycling and waste reduction, as well as systems to reduce energy consumption, and these will continue to operate.

Due to the nature of its activities, KBN's direct effect on total greenhouse gas emissions and its impact on the environment are minimal. KBN prepares an annual environmental report which details its performance in relation to a range of established criteria. The presentation of performance measures is based on the climate calculator for companies provided by Klimaløftet, which is the national governmental campaign for awareness on climate change. KBN is Eco-Lighthouse certified, and is also a control member of the Green Dot Norway (Grønn Punkt Norge) recycling scheme.

Green IT, a joint ICT industry initiative, has been implemented by making all

KBN's servers virtual and by replacing all workstations with ultra-thin clients. KBN's guidelines state that employees must use the most environmentally friendly means of travel possible when travelling on business. KBN invested in a video conference suite in 2014 to reduce the amount of business travel required.

KBN applies environmental criteria to its suppliers of goods and services, and actively prefers suppliers that

have environmental certification. The proportion of suppliers used by KBN that have environmental certification increased in 2014.

#### PRIORITIES FOR 2015

The priority areas for 2015 will again be ethical conduct and anti-corruption and climate and environment. Many of the targets set for 2014 will be continued and developed in 2015. In addition, the

society, working conditions and equality area is now part of reporting on corporate social responsibility.

The table below presents the targets that were set for 2014, the current status of work on achieving these and the targets KBN will work towards in 2015.

### AREA 1: ETHICAL CONDUCT AND ANTI-CORRUPTION

<i>2014 target</i>	<i>2014 result</i>	<i>2015 target</i>
Education and training for managers and employees in ethical conduct and challenges.	Accomplished.	Continue to raise awareness and to conduct training activities for employees, with a separate program and a follow-up system for self-reporting.
Establish KBN's corporate vision and values.	Accomplished.	Continue work on integrating KBN's corporate vision and values into the organisation.
Increase awareness of corruption and money-laundering, and minimise the risk that KBN might be linked to such issues.	Achieved.	Continue the focus on minimising the risk of corruption and money laundering in central business processes and develop the partnership with Transparency International.

### AREA 2: CLIMATE AND ENVIRONMENT

<i>2014 target</i>	<i>2014 result</i>	<i>2015 target</i>
Loan product with favourable interest rate for climate-friendly investments by municipalities and counties.	Accomplished.	Continue.
Increase awareness and knowledge of KBN's green loan product.	Achieved.	Further increase awareness of KBN's green loan product.
Issue new green bonds in 2014.	Issuance postponed until 2015.	Issue green bonds in 2015.
Environmentally friendly operations at KBN.	Environmental impact of KBN's activities has been reduced in certain areas.	Renew Eco-Lighthouse certification in 2015 and ensure the environmental impact of KBN's activities steadily declines.

### AREA 3: SOCIETY, WORKING CONDITIONS, EQUALITY

<i>2014 target</i>	<i>2014 result</i>	<i>2015 target</i>
New in 2015.	New in 2015.	Increase awareness of KBN's corporate social responsibility both internally and externally. Set up a project for the corporate social responsibility area in 2015.
Emphasise equality and diversity when recruiting.	Accomplished.	Have a good gender balance and increase diversity at all levels of KBN. At least 40% of all managers at all levels to be women and 40% of all employees at KBN to be women.
Ensure all employees are treated equally in relation to promotion and personal and professional development.	Accomplished.	Have strategies and measures in place that ensure highly capable employees are recruited, helped to develop and retained.



## KRISTIANSAND CITY HALL

The City Hall in Kristiansand has been transformed into a new municipal administrative center. The venerable brick facade of Kristiansand City Hall now hides a modern, climate-smart office environment that meets Kristiansand's future needs without breaking tradition with the past. The City Hall is a modern office building with low energy consumption, built with environmentally friendly materials. Kristiansand City Hall is funded by KBN with KBN's green lending rate.



# THE BOARD OF DIRECTORS' ANNUAL REPORT 2014

Kommunalbanken Norway's (KBN's) vision is to be a long-term partner to the local government sector and its financing of local welfare. KBN granted 595 new loans in 2014 totalling NOK 42.7 billion. The loan product offered by KBN specifically to finance investment in climate and energy projects saw particularly good growth. As a state administrative body with low risk assets and a high credit rating, KBN is trusted by the markets. KBN's low borrowing costs and efficient operating base allow it to offer the local government sector long-term flexible financing solutions on attractive terms.

KBN'S LENDING GREW BY 2.6% in 2014. This rate of growth is lower than in previous years and needs to be seen in the context of the high level of demand from local government borrowers for short-term financing products from the capital markets. Local government debt growth slowed to 7.4% in 2014 from 8.5% in 2013. Population growth, government initiatives and a large maintenance backlog have contributed to a high level of investment and strong growth in borrowing by the local government sector in recent years. KBN finances investment in a broad range of local welfare areas, such as the health and care sector, schools and nurseries, infrastructure, and projects that have a positive effect on the climate.

KBN's presence also significantly contributes to ensuring that the local government sector will be able in the future to access the finance it needs in order to invest in statutory and prioritised welfare projects, regardless of macroeconomic or market conditions. The local government sector increasingly depends on specialist institutions such as KBN and the capital markets for cost-effective financing. New, stricter capital requirements and high targets for return on equity mean that it is not particularly profitable for normal banks to grant loans to municipalities on terms that properly reflect their high creditworthiness. Experience has also shown that the level of lending activity and the capacity of financial institutions are

influenced by macroeconomic conditions. In the aftermath of the financial crisis, Nordic publicly-owned banks that lend to municipalities, such as KBN, grew materially, whilst at the same time private sector credit intermediation came to a halt. It is important, even in difficult market conditions, that public welfare projects can be financed and completed, and that financing is available with pricing that reflects the public sector's creditworthiness. It is part of KBN's public policy mandate and its commitment to corporate social responsibility to help correct this type of market failure. In order to fulfil such a function, KBN has to have a continual presence in the markets, even in normal times.

Profit for the year 2014 was NOK 491 million as compared to NOK 1,083 million in 2013. KBN's financial results were influenced by unrealised losses on financial instruments at fair value as well as by lower interest rate margins due to greater stability in the financial markets. Return on equity after tax was 6.13% as compared to 14.94% in 2013.

KBN is Norway's third-largest financial institution by total assets and in May 2014 the Norwegian Ministry of Finance decided that KBN shall be regarded as systemically important. As a consequence KBN will need to meet an increased Tier 1 capital requirement from 1 July 2015 and a further increase from 1 July 2016. The 2015 Norwegian National Budget approved KBN's increased equity requirement. The NOK 1.4 billion increase will be raised

by increasing share capital by NOK 1 billion and by withholding the 2014 dividend of almost NOK 400 million.

KBN had total assets of NOK 455.5 billion at 31 December 2014. Its loans to Norwegian municipalities and counties totalled NOK 247.1 billion. Its liquidity portfolio at 31 December 2014 was NOK 155.3 billion.

The Norwegian state, represented by the Ministry of Local Government and Modernisation, is the sole owner of KBN. KBN's registered office is in Oslo.

## ANNUAL ACCOUNTS

The Board of Directors confirms, in accordance with Section 3-3a of the Norwegian Accounting Act, that KBN's ability to continue as a going concern remains unchanged, and that the financial statements (for 2014) have been prepared on a going concern basis. The Board of Directors considers that the financial statements and accompanying notes for the year ending 31 December 2014 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).

Profit for the year 2014 was NOK 491 million as compared to NOK 1,083 million for 2013. KBN's financial results are influenced by fluctuations in the fair values of financial instruments. Net unrealised losses on financial instruments reduced profit before tax by NOK 734 million in 2014. In 2013, net unrealised losses on



financial instruments reduced profit before tax by NOK 68 million. These unrealised losses primarily relate to an increase in the market value of KBN's outstanding debt, which is the result of lower borrowing costs in 2014. These unrealised losses will be reversed when KBN's debt matures. In addition, the pricing of currency hedging contracts became more favourable in 2014, which also led to unrealised losses on existing contracts that were entered into at different rates.

Net interest income from lending and from managing the liquidity portfolio was NOK 1,515 million in 2014 as compared to NOK 1,634 million in 2013. Normalisation of the market for currency hedging instruments led to higher funding costs in Norwegian kroner. Profit margins on securities investments were also lower, in line with lower yields in bond markets.

Net trading income (from repurchasing KBN's own bonds, selling securities held in the liquidity portfolio and termination of currency swaps) were NOK 39 million in 2014, down from NOK 58 million in 2013.

Total operating expenses in 2014 were NOK 123 million as compared to NOK 106 million in 2013. Total operating expenses amounted to 0.03% of total assets in 2014.

KBN had total assets at 31 December 2014 of NOK 455.5 billion as compared to NOK 361.9 billion at 31 December 2013. A significant reason for the increase was the weakening of the Norwegian krone as a large proportion of KBN's balance sheet is converted from foreign currencies.

KBN's total primary capital at 31 December 2014 was NOK 10.1 billion, NOK 8.5 billion of which is total common equity Tier 1 capital. KBN's Tier 1 capital consists of share capital and retained earnings. The Tier 1 capital ratio at 31 December 2014 was 12.26%, and the total capital ratio was 14.53%.

#### LENDING

KBN granted 595 new loans in 2014 totalling NOK 42.7 billion. Total lending to the local government sector at the end of 2014 was NOK 247.1 billion, which represents an increase of 2.6% over the year. KBN's market share for the sector was approximately 47.5%. There was a clear change in the type of loan sought in 2014. More and more customers wanted loans with maturities of between three months and three years. This type of loan accounted for 50% of new borrowing by the local government

sector in 2014, an increase from 37% in 2013. The demand for this type of loan has to a large extent been met by the capital markets in the form of debt certificates or short-term bonds. As a consequence of this, there was less demand in 2014 for KBN's core products, which are long-term loans. The change in demand is leading to the sector facing greater refinancing risk as a result of short-term loans maturing and needing to be refinanced.

All Norwegian counties and 98% of the country's 428 municipalities, as well as Longyearbyen Local Council, had loans with KBN at the end of 2014. In addition, a range of municipality and inter-municipality companies have loans from KBN. Loans to limited liability companies require municipality or county authority guarantees, principally in the form of an unconditional guarantee of payment.

The local government sector continues to have high investment requirements, in part due to population growth and changes in Norway's age distribution. A large proportion of the new loans made in 2014 were ultimately used for schools, nurseries, care homes and water, wastewater and sanitation (WWS) projects. KBN's green lending product has been used to finance a significant proportion of investment in the WWS sector.

KBN granted loans totalling NOK 28.5 billion to toll road companies in 2014. Fewer loans were made to toll road companies in 2014 than in previous years. This, in conjunction with the general decrease in the number of requests for financing from municipality-owned companies in 2014 relative to 2013, contributed to KBN growing more slowly in 2014 than in previous years.

The market in which KBN operates is characterised by a strong degree of competition, not least from the debt certificate and bond market. KBN offers the same interest rate to all types of municipalities, thereby ensuring all have equal access to competitive financing terms.

KBN places great emphasis on building good relationships with its customers, and seeks to do this by participating in activities such as customer meetings and regional seminars on relevant topical issues. KBN provides real-time financial information on the internet, direct access to municipalities' individual loan portfolios via its website and a loan administration solution that municipalities can use as a tool for liability management.

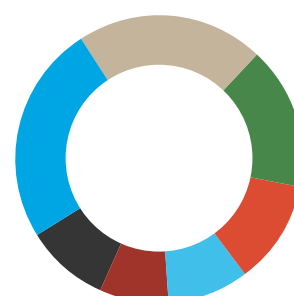
KBN experienced no loan losses in 2014. No losses resulting from defaults or problems with payment are

LOAN VOLUME 2014  
by type of borrower



- Municipalities 76 %
- Counties 12 %
- Municipally owned companies 12 %

LOAN VOLUME 2014  
by sector



- Infrastructure 25 %
- Kindergarten and education 21 %
- Water supply and waste disposal 16 %
- Residential and industry 12 %
- Health services 9 %
- Culture, religion and sports 8 %
- Other purposes 9 %

expected in 2015.

The Public Procurement Act states that municipalities must put out key banking contracts to tender. KBN assists municipalities with putting out payment service contracts to tender as a neutral party, and negotiated 11 such contracts in 2014.

#### GREEN LENDING AND GREEN FUNDING

KBN is committed to helping Norwegian municipalities achieve their climate targets. It has therefore launched a separate green floating interest rate product specifically to finance investment in climate projects. The product offers an interest rate that is 0.1% lower than the ordinary floating rate and can be used for projects associated with municipalities' climate and energy action plans. The proportion of lending destined for climate-friendly projects increased by 23.4% in 2014, and at the end of 2014 the volume of outstanding loans of this sort was NOK 10.6 billion. The green floating interest rate product was used in 2014 not only to finance investment in the WWS area and energy reduction measures, but also for other sorts of projects, such as a project to increase the use of public transport.

There is increasing demand globally for socially-responsible investments and projects that benefit the climate. KBN has its own green borrowing program, and intends to issue its next green bond in 2015. In order to reassure investors that their money is used for climate-friendly investments, the climate research centre CICERO has carried out an independent assessment of the projects financed in this way. KBN plans to be a regular issuer of green bonds in the future in order to finance municipal climate and energy-related projects.

#### FUNDING

KBN has the highest possible credit rating of AAA/Aaa from S&P and Moody's with stable outlook. Strong creditworthiness is related to the creditworthiness of its customers, state ownership, Norway's solid fiscal position and KBN's public policy mandate to provide low cost funding to the Norwegian local government sector.

KBN pursues a diversified funding strategy that ensures it has good market access, favourable borrowing terms and a broad investor base. New long-term borrowings amounted to NOK 116.7 billion in 2014, which is NOK 45.8 billion less than in 2013. The decrease is principally due to lower lending growth and less refinancing in the Japanese market.

KBN continued to borrow more in the Japanese market in 2014 than in any other single market, but there was an increase in 2014 in the proportion of its borrowing that comes from Europe. KBN also borrows significant amounts in the American and Asian markets. KBN issued loans in a total of 15 currencies in 2014, and issued benchmark bonds in USD totalling USD 3.75 billion. KBN also issued its first EUR-denominated benchmark bond for EUR 1 billion. Total borrowings increased in 2014 from NOK 326.5 billion to NOK 391.3 billion.

#### LIQUIDITY MANAGEMENT

In line with its current financial policies, KBN holds cash and cash equivalents equal at all times to its net capital requirements for the subsequent 12 months with lending growth taken into account. This means that KBN is able in any situation to meet all its obligations over the next 12 months without having to raise additional funds.

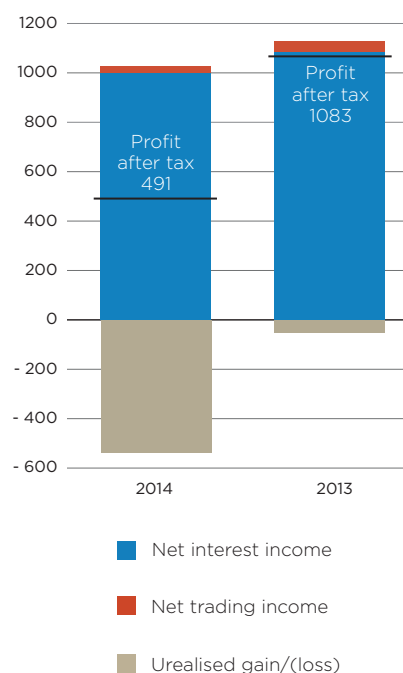
The liquidity portfolio is managed in a way that reflects KBN's target of having liquidity reserves sufficient to allow it to meet its obligations at all times. Excess liquidity is managed according to an investment strategy that is low risk in terms of credit risk and market risk. KBN's liquidity reserves are invested in fixed income securities issued by governments, regional authorities, multilateral development banks and financial institutions that have high credit ratings as well as in covered bonds. The average time to maturity of these securities at 31 December 2014 was one year.

#### RISK MANAGEMENT AND INTERNAL CONTROL

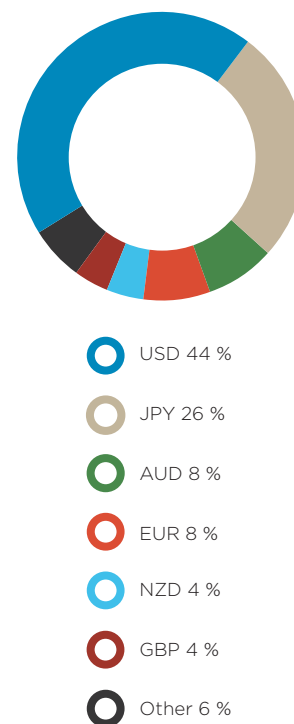
The purpose of risk management is to ensure that KBN manages its assets and maintains its highest possible credit rating responsibly. KBN is subject to requirements for risk management and internal control set by the Financial Supervisory Authority of Norway. The Board of Directors sets financial policies and risk limits on a yearly basis, including in relation to the KBN's lending activities. The Board of Directors has also produced policies on internal control and considers the management's assessment of internal control on a yearly basis. Work on implementing a new finance system is underway and this will help to further improve the efficiency of work processes in 2015.

The Board of Directors is regularly informed of KBN's activities, financial

PROFIT AFTER TAX  
(amounts in NOK mill)



2014 DEBT PORTFOLIO



position and earnings situation. The Board considers the management's assessment of risk and adverse events on a quarterly basis, with this forming an integral part of KBN's activity reporting processes.

The Audit Committee's role is to help the Board of Directors monitor financial reporting and oversee the systems for internal control and audit by preparing issues related to these areas for the Board's consideration. The Board of Directors draws up an audit schedule on a yearly basis and uses internal audit as an independent supervisory and control function as part of its monitoring of KBN's activities.

A new Risk Management Committee was set up in 2014. Its role is to help the Board of Directors oversee KBN's overall management of risk by preparing issues related to this area for the Board's consideration.

*Credit risk* in the lending portfolio is limited to payments being deferred as payment obligations cannot be cancelled. Section 55 of the Local Government Act stipulates that municipalities and county authorities cannot declare themselves insolvent. The Local Government Act also contains provisions regarding the procedures that must be followed if payments have to be deferred. These provisions stipulate that the State, operating through the Ministry of Local Government and Modernisation, will take charge of running a municipality if it is unable to meet its payment obligations. This in practice protects lenders from any losses in relation to debt and accrued interest.

The credit risk associated with KBN's liquidity management and hedging operations is low, and KBN's Board of Directors sets financial policies with requirements for the ratings, maturities, instrument types, counterparty types and counterparty's home countries permitted.

The credit risk associated with instruments used to hedge against losses due to interest rate and currency risks is reduced by the margin requirements to be marked to market on a daily basis.

KBN's counterparty exposure is continually monitored, with daily reports produced by the risk management department. The Board of Directors is informed of KBN's counterparties in the activity reports and extended market updates that it receives.

*Market risk* primarily consists of interest rate risk and currency risk. KBN's policies allow only minimal exposure to interest rate changes and currency fluctuations. Interest rate risk and currency risk are managed by ensuring that the risk exposure arising from KBN's assets and liabilities is balanced at all times.

*Liquidity risk* is minimised by ensuring the liquidity portfolio remains equal at all times to KBN's net capital requirements for the subsequent 12 months. In addition, the portfolio is invested in liquid short-term securities with very high credit ratings. New regulation in the form of short-term liquidity requirements (liquidity coverage ratio, LCR) and long-term lending requirements (net stable funding ratio, NSFR) will probably be formally introduced in

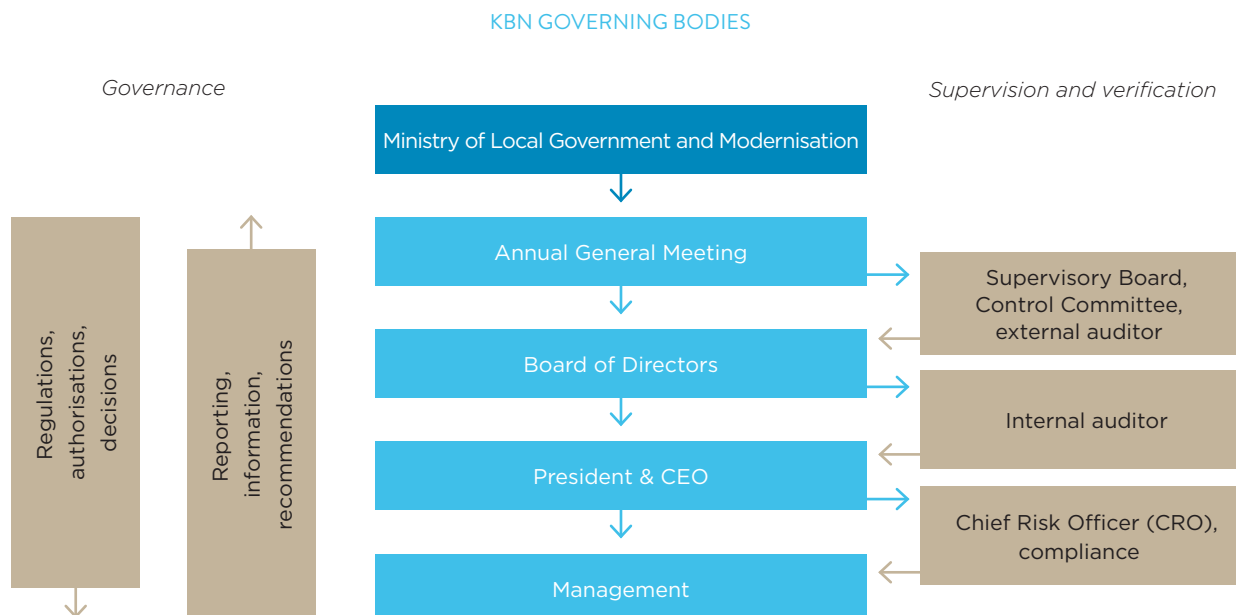
Norway during 2015. KBN operates within the requirements that are expected to be introduced.

*Operational risk* is minimised by good internal control, which consists of ensuring there is an adequate separation of duties between operational and control functions, that there are documented work processes and controls, and that in relation to critical functions there is a sufficient number of employees with a high level of expertise. The Board of Directors is kept informed of operational risk and adverse events by quarterly activity and risk reports.

#### CORPORATE GOVERNANCE

KBN complies with the Norwegian Code of Practice for Corporate Governance in those areas that are relevant to its organisation and ownership structure. The objective of the Code of Practice is that Norwegian companies practice corporate governance that regulates the division of roles between shareholders, the Board of Directors and management more comprehensively than is required by legislation. The aim of corporate governance is to strengthen confidence in companies, and to help ensure the greatest possible value creation over time in the best interests of shareholders, employees and other stakeholders.

KBN's governing bodies are organised in accordance with the provisions of the Norwegian Public Limited Liability Companies Act and the Financial Institutions Act, as well as KBN's Articles of Association. The Board of Directors, the Supervisory Board and the Control Committee are



elected by the Annual General Meeting. The Supervisory Board oversees that KBN's objectives are pursued in accordance with the law, KBN's Articles of Association and any resolutions made, and it also appoints a state authorised public accountant to act as auditor and carries out instructions from the Control Committee. The Control Committee's role is to supervise KBN's activities, including the plans of the Board of Directors. The Board of Directors manages KBN's activities, which includes appointing the CEO, granting loans and authorising delegated lending authority, deciding to borrow and authorising delegated borrowing authority, and appointing the internal auditor. The Board of Directors has set up three committees that prepare cases for its consideration, namely the Audit Committee, the Risk Management Committee, and the Remuneration Committee. The members of these committees are chosen by and from among the Board's members. The CEO is responsible for running KBN on a day-to-day basis in accordance with the Board of Directors' instructions as approved by the Supervisory Board. The internal control and supervisory functions are carried out by the Head of Risk Management and the Head of Governance, Support and Compliance, both of whom report directly to the CEO.

Internal control is designed to ensure that risk analysis and risk monitoring are carried out, and that KBN's activities are conducted in accordance with its approved strategies and policies. Internal control is an integral part of KBN's management and planning process. Status and risk are monitored at the departmental level and are reported to the CEO and Board of Directors. Internal control over financial reporting ensures the accounting information contained in the monthly, quarterly and annual reports is reliable. The internal control systems and risk analysis systems are evaluated on a continual basis by the internal auditor, the Audit Committee, the Risk Management Committee, and the Board of Directors.

#### CORPORATE COMMUNICATION AND PUBLIC RELATIONS

The Board of Directors regards regular, high quality contact with KBN's owner, customers, the authorities and other stakeholders as an important means of ensuring that KBN operates in the best possible manner.

KBN aims to help identify issues

that constitute potential obstacles to its ability to achieve its purpose or that represent challenges to its customers' interests. It is important to ensure KBN's activities are well understood, as this increases its ability to function effectively and to recruit skilled employees. KBN works closely with a range of organisations in the local government sector and is active in discussions concerning important local government finance issues. KBN arranged a number of specialist conferences and seminars in 2014, some independently and some in partnership with other parties that work in the local government sector. It held its annual conference in April 2014, and this year's theme was how climate change and financial turmoil influence the provision of local welfare. The main target audience for this year's annual conference, in addition to customers for KBN's lending products, consisted of key members of parliament, consultants, and the official authorities.

KBN has carried out various marketing initiatives with a view to highlighting its position as a leading financial institution in the local government sector. Its new visual profile and its new website were launched at the start of the fourth quarter.

A customer satisfaction survey was carried out in 2014, with KBN scoring highly on customer satisfaction, attractiveness and the extent to which customers would recommend it to others. At the same time, there is clearly room for improvement in the information KBN provides to its customers and in the extent to which it is a useful dialogue partner.

#### ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

Principle 10 of the government's report to Parliament on Active Ownership (White Paper 27 (2013-2014)) states that state-owned companies «must work in a targeted way to fulfil their corporate social responsibility». With a market share for loans to the local government sector of almost 50%, KBN plays an important role in society. KBN's role is to be a long-term financing partner to municipalities, counties and municipal companies in order to help them achieve their welfare objectives. To be a long-term partner, the institution has to conduct itself responsibly and help to promote sustainable development for the benefit of society as a whole.

In order to maintain high ethical standards and to combat and prevent

corruption, KBN focuses closely on having clear ethical guidelines in place and as part of this increased focus updated its ethical guidelines in 2014. The objective is to contribute to increased awareness of, and compliance with, the high ethical standards required of KBN employees. KBN regards providing training and education about central ethical risk areas as very important, and held sessions for all its employees to highlight and discuss various ethical issues during the course of 2014.

#### CORPORATE SOCIAL RESPONSIBILITY PRIORITY AREAS

The Board of Directors has set out provisions on corporate social responsibility in the various policy documents that regulate KBN's activities, including in its Code of Conduct. No guidelines specifically on the subject of corporate social responsibility have been produced.

The starting point for reporting on corporate social responsibility at KBN is an analysis of which areas are of importance. KBN is in regular dialogue with its customers, its owner, the authorities, investors, employees and suppliers. Their feedback provides important insight when assessing the areas of corporate social responsibility that need to be the focus of efforts. In 2015 the priority areas will be:

- Ethical conduct and anti-corruption
- Climate and environment
- Society, diversity and equality

A separate section containing the 2014 corporate social responsibility report and information about the measures and targets for 2015 can be found on page 20 of this annual report.

#### ORGANISATION AND EMPLOYEES CULTURE, VALUES AND EXPERTISE

KBN is dependent on skilled employees to carry out everyday activities that cover a wide range from participating in global financial markets to financing investment in local welfare projects. KBN is committed to measuring its performance against the best participants in all the specialist areas in which it operates.

The work undertaken to define KBN's corporate vision and values was completed in 2014. KBN's corporate vision is «A long-term partner for local welfare», and this is supported by its values: «Open, responsible and engaging». The process involved close dialogue with employees, management and the Board of Directors.

Adherence to the values is now part of the evaluation system used to assess managers and employees.

As a follow-up to the changes made to the organisational structure in 2013, a management development programme was run for all managers. The programme ended with the managers receiving 360-degree evaluations and personal development plans. In addition, an employee survey was carried out that revealed that KBN's employees generally consider the working environment, corporate culture and career development opportunities to be good. The Working Environment Committee discussed and decided on a number of improvement measures which have now been included in KBN's activity plan.

#### DIVERSITY AND EQUALITY

KBN values equality and diversity. It treats all employees equally and gives them the same opportunities with regard to professional and personal development, promotion and remuneration.

Recruitment procedures in all departments emphasise the promotion of diversity, and no consideration will be given to nationality, gender, disability or age when candidates' professional and personal qualifications are being assessed. Flexible working hours are offered to facilitate arrangements for employees who have care responsibilities at home.

KBN had 56 employees at the end of 2014, which is the same as at the end of 2013. With regard to gender distribution, 49% of KBN's employees are women and 51% are men. The average age of female employees is 46, and the average age of male employees is 40. Five employees are under 30 and four are over 60. The management is 50% female and 50% male. The CEO is a woman. The proportion of women on the Board of Directors is 44.4%. The Chair of the Board is a woman. 5% of employees do not hold Norwegian nationality.

#### HEALTH, SAFETY AND ENVIRONMENT

KBN places emphasis on ensuring all employees have good working conditions. The Working Environment Committee's aim has been to actively contribute to the creation of a good working environment and the promotion of good physical health by building a corporate culture characterised by well-being and collaboration. The Committee held regular meetings and carried out safety inspections and risk assessments in relation to

health, safety and environment issues. Regular health-promoting and social activities for all employees were offered, and were arranged in conjunction with KBN's various activity groups. In general, the Working Environment Committee considers the working environment to be good.

No accidents or serious injuries were recorded as having occurred during working hours or in connection with journeys to and from work or for work purposes. Consequently, no accidents or injuries were reported to the Norwegian Labour Inspection Authority. The sickness rate in 2014 was 3.6% as compared to 4.3% in 2013. The sickness rate is not related to the working environment. KBN works actively on health, safety and environment issues, on preventing and following up sick leave, and on facilitating a swift return to work for employees.

#### ALLOCATION OF PROFIT

The Board of Directors of Kommunalbanken AS proposes the following allocation of the profit for the 2014 accounting year: NOK 478 million is to be transferred to retained earnings.

#### FUTURE PROSPECTS

The outlook for the world economy is uncertain and this affects Norway as a small, open economy. Lower oil prices mean that the level of activity in the oil sector is declining after many years of high activity. There is a high degree of uncertainty looking ahead, and the expected growth rate for Norway has been revised down in response to these developments. Despite this, Norway is recognised as a country with a very robust economy. A high level of worker immigration has led to strong population growth in Norway. KBN anticipates continuing strong growth as demographic changes influence local government investment plans. The level of investment and the amount of loan financing required are expected to be high over the coming years through the combination of demographic changes, a large maintenance backlog and the adaptations required due to the weather becoming wetter and more extreme.

The government's municipal reforms will eventually lead to there being a smaller number of larger municipalities that have more professionalised operations. KBN currently has a strong market share, including among Norway's large municipalities, and it has the expertise and capacity required to meet the sector's future requirements. KBN's greatest

competition in today's market comes from lending products available on the capital markets. The proportion of municipalities choosing to finance their investments in the capital markets has grown significantly. The capital markets are characterised by their willingness to provide loans with maturities shorter than the loans arranged by credit institutions such as KBN, which have maturities of up to 40 years.

Exceptionally low interest rates serve to demonstrate that economic conditions continue to be extremely difficult in many countries. Over the last few years, debt growth in the local government sector has exceeded revenue growth. The expectation is that these growth rates will eventually become more in line with each other.

Some of the local government sector's borrowing, and consequently some its interest rate exposure, relates to self-cost investments or areas where the state provides interest cost subsidies. A significant proportion of all the sector's interest bearing debt is hedged either through the use of fixed rate loans or interest rate derivatives. The local government sector's immediate interest rate risk exposure is therefore much less than the overall debt burden would indicate. Over time, however, the debt burden on the local government sector will move in step with changes in the general interest rate. Interest rate risk will increase with continued debt growth.

Our focus for developing KBN's activities must be on our customers' requirements and our owner's expectations. At the same time, we will seek to work in a targeted way to fulfil our corporate social responsibility. KBN is a major participant in the market for lending to the local government sector, and in May 2014 the Norwegian Ministry of Finance decided that KBN was to be regarded as a systemically important financial institution. As a result of this, KBN will need to meet an increased capital requirement and will be more closely supervised by the authorities. KBN's profitability must be seen in the context of the risk profile of its borrowing customers and its high risk-adjusted capital base. At the same time, its earnings must generate future lending capacity in line with its mandate. KBN's assets must be managed so that it is in a position to meet its customers' financing needs on terms that reflect their creditworthiness. KBN's earnings must generate a competitive return for its owner in line with the purpose of its activities.

The accounts for 2014 show that KBN achieved results that are satisfactory given the current market conditions and the regulatory framework within which it operates. KBN is well-positioned to contribute to the long-term financing of local government welfare services in the years ahead. The Board of Directors would like to thank KBN's employees for a job well done.

Oslo, 31 December 2014

20 March 2015

The Board of Directors of Kommunalbanken AS

Else Bugge Fougner  
*Chair*

Nils R. Sandal  
*Vice Chair*

Rune Midtgaard  
*Board member*

Martha Takvam  
*Board member*

Nanna Egidius  
*Board member*

Rune Sollie  
*Board member*

Martin Skancke  
*Board member*

Marit Urmo Harstad  
*Employee representative*

Jarle Byre  
*Alternate to the  
employee representative  
Roald Fischer*

Kristine Falkgård  
*President & CEO*



# THE BOARD OF DIRECTORS





ELSE BUGGE FOUGNER

*Chair since 1999*

Lawyer.

Chair, KBN Compensation Committee. Member, KBN Risk Committee.

Partner, Hjort law firm.

Chair, Eksportkreditt Norge AS and Morgenstjerne Eiendom AS.

Member of the Board, Aberdeen Eiendomsfond Norge II ASA, Aker Kværner Holding ASA and Protector Forsikring ASA.

NILS R. SANDAL

*Vice Chair since 2010*

Member, KBN Compensation Committee.

Chair, Norsk Kulturskoleråd, Stryn Betong A/S, Knutepunktfestivalen Norsk Countrytreff, Norsk Kvernsteinsenter.

Member of the Board, Fjord1.

RUNE MIDTGAARD

*Member of the Board since 2014*

Master of Business and Authorised Financial Analyst (AFA).

Member, KBN Compensation Committee.

CFO Finance and IT, ArcusGruppen.

MARTHA TAKVAM

*Member of the Board since 2005*

Master of Business and MBA in finance.

Chair, KBN Audit Committee. Member, KBN Risk Committee.

Director Group Internal Audit, Telenor ASA.

NANNA EGIDIUS

*Member of the Board since 2004*

Master of Business.

Member, KBN Audit Committee.

Director of Strategic Planning and Development, Lillehammer municipality.

General Manager, Stiftelsen Lillehammer Etterbruksfond.

Vice Chair, Ikomm AS and Norsk Luftambulanse AS.

RUNE SOLLIE

*Member of the Board since 2011*

State Authorised Public Accountant.

Member, KBN Audit Committee.

CFO, Norske Skogindustrier ASA.

MARTIN SKANCKE

*Member of the Board since 2013*

Master of Business, MSc. Chair, KBN Risk Committee.

Owner and general manager, Skancke Consulting.

Chair, Principles for Responsible Investment, Fronteer Solutions AS. Member of the Board, Storebrand and Norfund.

MARIT URMO HARSTAD

*Employee representative since 2014*

Bachelor of Management.

Senior Relationship Manager, KBN.

Member of the Board, Nedre Bekkelaget skolemusikkorps.

Personal alternate is Kristine Henriksen Lien.

ROALD FISCHER

*Employee representative since 2011*

Master, International Business Management.

Head of Documentation & Back Office, KBN.

Personal alternate is Jarle Byre.

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## INCOME STATEMENT

<i>(Amounts in NOK 1 000 000)</i>	Note	2014	2013
Interest income		6 011	5 776
Interest expense		4 496	4 142
<b>Net interest income</b>	<b>1</b>	<b>1 515</b>	<b>1 634</b>
Fees and commission expenses	2	24	22
Net unrealised gain/(loss) on financial instruments	3	(734)	(68)
Net trading income	4	39	58
<b>Total other operating income</b>		<b>(719)</b>	<b>(32)</b>
Salaries and administrative expenses	5,6,7	93	82
Depreciation on fixed assets		3	4
Other expenses	9	27	20
<b>Total operating expenses</b>		<b>123</b>	<b>106</b>
<b>Profit before tax</b>		<b>673</b>	<b>1 496</b>
Income tax	8	182	414
<b>Profit for the year</b>		<b>491</b>	<b>1 083</b>

## STATEMENT OF COMPREHENSIVE INCOME

<i>(Amounts in NOK 1 000 000)</i>	Note	2014	2013
Profit for the year		491	1 083
<b>Other comprehensive income</b>			
<i>Items which will not be reclassified in profit or loss</i>			
Actuarial gain/(loss) on defined benefit plan		(18)	(13)
Of which is tax		(5)	(3)
<b>Total other comprehensive income</b>		<b>(13)</b>	<b>(10)</b>
<b>Total comprehensive income for the year</b>		<b>478</b>	<b>1 073</b>

## STATEMENT OF FINANCIAL POSITION

<i>(Amounts in NOK 1 000 000)</i>	Note	2014	2013
<b>Assets</b>			
Deposits with credit institutions	10,12,14,21	16 219	5 257
Instalment loans	10,11,12,15	249 928	243 114
Notes, bonds and other interest-bearing securities	10,11,12,13,16	157 364	101 696
Financial derivatives	10,12,13,20	31 776	11 806
Deferred tax asset	8	86	0
Other assets	17	93	44
<b>Total assets</b>		<b>455 466</b>	<b>361 918</b>
<b>Liabilities and equity</b>			
Loans from credit institutions	10,12,18,21	25 135	3 656
Senior securities issued	10,11,12,13,19	398 669	329 139
Financial derivatives	10,12,13,20	20 919	18 559
Other liabilities		47	36
Current tax liabilities	8	404	440
Deferred tax liabilities	8	0	139
Pension liabilities	7	61	48
Subordinated debt	10,12,22	1 895	1 687
<b>Total liabilities</b>		<b>447 130</b>	<b>353 702</b>
Share capital	23	2 145	2 145
Retained earnings		6 191	6 071
<b>Total equity</b>		<b>8 336</b>	<b>8 216</b>
<b>Total liabilities and equity</b>		<b>455 466</b>	<b>361 918</b>

## STATEMENT OF CHANGES IN EQUITY

### 2014

<i>(Amounts in NOK 1 000 000)</i>	Note	Share capital	Retained earnings	Total equity
Equity as of 1 January 2014		2 145	6 071	8 216
Profit for the year		0	491	491
Total other comprehensive income		0	(13)	(13)
Dividends		0	(357)	(357)
<b>Equity as of 31 December 2014</b>	<b>23</b>	<b>2 145</b>	<b>6 191</b>	<b>8 336</b>

### 2013

<i>(Amounts in NOK 1 000 000)</i>	Note	Share capital	Retained earnings	Total equity
Equity as of 1 January 2013		2 145	5 251	7 395
Profit for the year		0	1 083	1 083
Total other comprehensive income		0	(10)	(10)
Dividends		0	(253)	(253)
<b>Equity as of 31 December 2013</b>	<b>23</b>	<b>2 145</b>	<b>6 071</b>	<b>8 216</b>

## STATEMENT OF CASH FLOWS

<i>(Amounts in NOK 1 000 000)</i>	Note	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Interest received		5 977	5 844
Interest paid		(4 390)	(4 036)
Fees and commissions paid		(25)	(23)
Receipts from repurchase of issued securities		39	58
Cash payments to employees and suppliers		(120)	(102)
Income taxes paid		(437)	(576)
Net disbursement of loans to customers		(6 209)	(21 641)
Net (increase)/decrease in deposits with credit institutions		11 015	(1 840)
Net (increase)/decrease in notes, bonds and other interest-bearing securities		(45 046)	6 530
Net (increase)/decrease in other assets		0	(1)
Net increase/(decrease) in other liabilities		6	6
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>		<b>(39 189)</b>	<b>(15 781)</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Net (purchase)/sales of property and equipment		(50)	(33)
<b>NET CASH FLOWS FROM INVESTING ACTIVITIES</b>		<b>(50)</b>	<b>(33)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Repayment of commercial paper		0	(359)
Proceeds from issuance of debt securities		116 690	162 514
Repayment of debt securities		(109 570)	(153 387)
Repayment of subordinated debt		0	(7)
Dividends paid		(357)	(253)
<b>NET CASH FLOWS FROM FINANCING ACTIVITIES</b>		<b>6 763</b>	<b>8 508</b>
<b>NET CASH FLOWS</b>		<b>(32 476)</b>	<b>(7 306)</b>
Effects of foreign exchange differences		32 468	7 342
<b>NET CASH FLOWS AFTER FOREIGN EXCHANGE DIFFERENCES</b>		<b>(9)</b>	<b>35</b>
Cash and cash equivalents at 1 January		29	(6)
Net change in cash and cash equivalents		(9)	35
<b>Cash and cash equivalents at 31 December</b>		<b>21</b>	<b>29</b>
<i>Deposits with credit institutions without agreed time to maturity</i>	<b>14</b>	21	29
<i>Loans from credit institutions without agreed time to maturity</i>	<b>18</b>	0	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 VII's gate 5B, Oslo. The financial statements for the year ended 31 December 2014 were approved by the Board of Directors on 20 March 2015.

### 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 at fair value through profit or loss
- Financial instruments classified as Loans and receivables or Other liabilities that are hedged items and where the carrying amount is adjusted for value changes attributable to the risks that are being hedged

### FOREIGN CURRENCY TRANSLATION

The Company's functional and presentation 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, with the exception of notes 6 and 7 that are presented in NOK thousand.

### SIGNIFICANT ESTIMATES AND ACCOUNTING JUDGEMENTS

The preparation of financial statements in accordance with IFRS requires management to make judgements and assumptions, and use estimates that will affect the use of accounting policies. The estimates and accounting judgements affect carrying amounts 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. When inputs are to a significant extent not observable, management makes assumptions and uses estimates when considering credit risk and liquidity risk related to financial instruments. 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 also apply to the allocation of financial instruments measured at fair value in the IFRS 13 hierarchy (Level 1, 2 or 3).

### 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. At initial recognition all financial assets and liabilities are measured at fair value. For financial assets that are not categorised as at fair value through profit or loss, the value at initial recognition includes transaction costs that are directly attributable to acquisition. Recognition and derecognition of financial instruments takes place on the settlement date. For regular way purchase or sale 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. When issued debt securities are repurchased, the liability is derecognised. Any difference between the settlement amount and the carrying amount is recognised in the income statement as gain or loss at the transaction date.

### CLASSIFICATION AND MEASUREMENT

Classification of financial instruments into categories takes place at initial recognition and determines the subsequent measurement according to IAS 39. The category of financial instruments is determined by the characteristics of the instruments and management's intention at acquisition or issue.

#### *Financial assets and liabilities designated at fair value through profit or loss (FVO)*

Selected bonds and notes in the liquidity portfolio, fixed rate loans, NIBOR-indexed loans to customers and issued bonds are designated as at fair value through profit or loss at initial recognition, in order to achieve similar treatment as related derivatives contracts used to hedge interest rate and currency risk, which are measured at fair value. This leads to a reduction in measurement inconsistency between on the one hand bonds and notes, loans and issued bonds, and on the other financial derivatives.

#### *Financial assets held to maturity*

Financial assets in this category are primarily 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 the "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 classified 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 fair value hedge accounting is used, the value change that is attributable to the hedged risk is recognised as part of the carrying amount under "Notes, bonds and other interest-bearing securities", and in the income statement as "Net unrealised gain/(loss) on financial instruments".

#### *Financial liabilities measured at amortised cost*

Public benchmark loans and some loans from institutional investors in public niche markets are classified as financial liabilities measured at amortised cost using the effective interest method. Liabilities in this category are designated as hedged items and hedge accounting is applied. This implies that value changes that are attributable to the hedged risk are recognised as part of the carrying amount under "Senior securities issued" and 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

Financial instruments are categorised into the fair value hierarchy, based on the lowest level input that is significant to

the fair value measurement.

#### *Level 1*

For securities traded in an active market with frequent market observations quoted prices on the reporting date are used in the measurement of fair value. 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.

#### *Level 2*

For financial instruments that are not traded in an active market quoted prices on similar instruments in active markets, or valuation techniques where significant inputs are based on observable market data are used where possible.

Level 2-inputs might include:

- Observable interest rate yield curves, basis swap spreads, 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 the 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*

For financial instruments that are not traded in an active market and where observable data is to a large extent not available, fair value is determined using valuation techniques where input is based significantly on unobservable 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 where inputs are to a large extent unobservable, and OTC-derivatives with option elements.

The same type of input might be used to determine the fair value of notes and bonds classified as Level 2 and Level 3, however the significance of adjustments of market data and to what extent the adjustment is done based on observable data are given weight when the instrument is categorized according to IFRS 13. 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 bond and credit default swap indices, for similar instruments
- Non-binding price quotes from different sources
- Historical or implied volatilities

#### *Fair value disclosures*

For financial instruments categorised in the fair value hierarchy at several period ends a reconciliation of movements between the levels is done at the end of each reporting period. The valuation technique used to determine fair value of financial

instruments categorised in Level 2 or Level 3 is determined based on the instruments' features. Fair value of financial instruments without embedded derivatives is determined using the discounted cash flows method, where discount rates are derived from the relevant observable money market interest rates and other risk factors that may significantly affect the fair value of the instruments. When such factors cannot be reliably observed at a reporting date, management may make assumptions and use estimates when determining the fair value.

Fair value of financial instruments with embedded derivatives is determined using option pricing models with observable market data and estimates as inputs. The most significant unobservable inputs used in the valuation in Level 2 and Level 3 are related to the credit premium for financial instruments not traded in an active market.

#### **OFFSETTING OF FINANCIAL ASSETS AND LIABILITIES**

KBN does not offset any financial assets and liabilities in the Statement of Financial Position. Standard master netting agreements do not qualify for offsetting and net presentation, 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 the event of default, but do not qualify for offsetting under IAS 32. Cash collateral is presented on a gross basis in the Statement of Financial Position.

#### **IMPAIRMENT OF FINANCIAL ASSETS**

Financial instruments classified as Loans and receivables or Held to maturity are assessed for impairment. When there is objective evidence of value loss, the assets are impaired and shall be written down.

##### *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 regarding the macroeconomic conditions that can impact on the issuer'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 and cross currency swaps are used to hedge interest rate and currency risk in assets and liabilities. When a hedge relationship between a bond and a swap fulfils the criteria for hedge accounting and is designated as such, it is accounted for as a fair value hedge. The hedged items in the portfolio of bonds and notes are classified as Loans and receivables and hedged issued bonds are classified as Other liabilities. The hedge relationship is documented at designation, including the hedging strategy, and hedge effectiveness is measured on an on-going basis using Dollar-offset method. Any ineffective part of the 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 value change of the hedged items that is attributable to the hedged risk, is recognized as part of the carrying amount of the item and in the income statement as "Net unrealised gain/(loss) on financial instruments".

#### STATEMENT OF CASH FLOWS

The 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 time to maturity.

#### RECOGNITION OF REVENUES

Interest and commissions are recognised in the income statement as they are earned or accrued, and interest is presented as interest income or interest expense independent of underlying assets and liabilities. Interest income for assets and liabilities measured 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 attributable to the hedged risk on hedged items under hedge accounting are recognised in income statement under "Net unrealised gain/(loss) on financial instruments". 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. A newly acquired portfolio system under implementation is also classified as an intangible asset. Upon completion of the implementation process, the acquisition cost will be amortised over the useful life. 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 linear 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 administrative expenses. The value of net pension liabilities is calculated based on economic and actuarial assumptions.

#### LEASES

A lease that does not transfer substantially all the risks and

rewards related 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 in the income statement as they accrue, i.e. the income tax is based on profit before tax. Temporary and permanent differences are adjusted for 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. The corporate income tax rate in Norway is reduced from 28 per cent to 27 per cent effective from 1 January 2014.

#### 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.

#### IMPLEMENTATION OF NEW ACCOUNTING STANDARDS

KBN has not implemented any new IFRS standards in 2014.

IAS 32 *Financial Instruments: Presentation* was amended with effect from 1 January 2014, to clarify the meaning of "currently has a legally enforceable right to set-off", and that some gross settlement systems may be considered equivalent to net settlement. These changes have not had effect for the financial statements of KBN, as the accounting policies were already compliant with new, clarified rules.

#### CHANGES IN ACCOUNTING POLICIES

The accounting standards applied to the financial statements are consistent with those used in the previous year. In 2014 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

IFRS 9 *Financial Instruments* was completed and published by the IASB in July 2014, with effective date 1 January 2018 (early implementation is possible). This standard replaces IAS 39 *Financial instruments: Recognition and Measurement*. KBN will assess the effect of the changes for its financial statements, and it is expected that the new rules may give some effects for the loan loss provisioning (impairment) of the Company, based on the new standard using an expected loss method, while the current standard uses an incurred loss method. This may imply a degree of change in loan losses for loans and bond investments measured at amortised cost. The new standard also includes a new model for hedge accounting, and hence the adoption may entail changes for KBN's approach to hedge accounting.

## NOTES TO THE FINANCIAL STATEMENTS

### NOTE 1

#### NET INTEREST INCOME

(Amounts in NOK 1 000 000)

2014	Total	At fair value through profit or loss					Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge	Held to maturity			
Deposits with credit institutions	21	21	0	0	0	0	0	
Instalment loans	5 912	3 678	0	0	0	2 234	0	
Notes, bonds and other interest-bearing securities	2 214	1 872	0	0	2	340	0	
Financial derivatives	(2 136)	0	(1 925)	(211)	0	0	0	
<b>Total interest income</b>	<b>6 011</b>	<b>5 571</b>	<b>(1 925)</b>	<b>(211)</b>	<b>2</b>	<b>2 574</b>	<b>0</b>	
Loans from credit institutions	5	5	0	0	0	0	0	
Senior securities issued	8 625	6 487	0	0	0	0	2 138	
Financial derivatives	(4 157)	0	(2 648)	(1 509)	0	0	0	
Subordinated debt and Hybrid Tier 1 capital instruments	23	23	0	0	0	0	0	
<b>Total interest expenses</b>	<b>4 496</b>	<b>6 515</b>	<b>(2 648)</b>	<b>(1 509)</b>	<b>0</b>	<b>0</b>	<b>2 138</b>	
<b>Net interest income</b>	<b>1 515</b>	<b>(944)</b>	<b>723</b>	<b>1 298</b>	<b>2</b>	<b>2 574</b>	<b>(2 138)</b>	

2013	Total	At fair value through profit or loss					Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge	Held to maturity			
Deposits with credit institutions	27	27	0	0	0	0	0	
Instalment loans	5 792	3 560	0	0	0	2 232	0	
Notes, bonds and other interest-bearing securities	2 153	1 711	0	0	42	399	0	
Financial derivatives	(2 196)	0	(1 938)	(257)	0	0	0	
<b>Total interest income</b>	<b>5 776</b>	<b>5 298</b>	<b>(1 938)</b>	<b>(257)</b>	<b>42</b>	<b>2 632</b>	<b>0</b>	
Loans from credit institutions	2	2	0	0	0	0	0	
Senior securities issued	8 874	7 240	0	0	0	0	1 634	
Financial derivatives	(4 756)	0	(3 633)	(1 123)	0	0	0	
Subordinated debt and Hybrid Tier 1 capital instruments	22	22	0	0	0	0	0	
<b>Total interest expenses</b>	<b>4 142</b>	<b>7 264</b>	<b>(3 633)</b>	<b>(1 123)</b>	<b>0</b>	<b>0</b>	<b>1 634</b>	
<b>Net interest income</b>	<b>1 634</b>	<b>(1 966)</b>	<b>1 695</b>	<b>866</b>	<b>42</b>	<b>2 632</b>	<b>(1 634)</b>	

### NOTE 2

#### FEES AND COMMISSION EXPENSES

(Amounts in NOK 1 000 000)

	2014	2013
Expenses of banking services	14	12
Other transaction costs	10	11
Other income	0	0
<b>Total fees and commission expenses</b>	<b>24</b>	<b>22</b>

## NOTE 3

### NET UNREALISED GAIN/(LOSS) ON FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

2014	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge		
Instalment loans	607	607	0	0	0	0
Notes, bonds and other interest-bearing securities	125	214	0	0	(89)	0
Financial derivatives	2 804	0	2 653	151	0	0
Loans from credit institutions	1	1	0	0	0	0
Senior securities issued	(4 250)	(4 214)	0	0	0	(36)
Subordinated debt and Hybrid Tier 1 capital instruments	(21)	(21)	0	0	0	0
<b>Net unrealised gain/(loss) on financial instruments</b>	<b>(734)</b>	<b>(3 413)</b>	<b>2 653</b>	<b>151</b>	<b>(89)</b>	<b>(36)</b>

2013	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge		
Instalment loans	(529)	(529)	0	0	0	0
Notes, bonds and other interest-bearing securities	(862)	(657)	0	0	(204)	0
Financial derivatives	(327)	0	978	(1 305)	0	0
Loans from credit institutions	0	0	0	0	0	0
Senior securities issued	1 645	186	0	0	0	1 459
Subordinated debt and Hybrid Tier 1 capital instruments	6	6	0	0	0	0
<b>Net unrealised gain/(loss) on financial instruments</b>	<b>(68)</b>	<b>(995)</b>	<b>978</b>	<b>(1 305)</b>	<b>(204)</b>	<b>1 459</b>

Unrealised gain/(loss) on financial instruments comprise value changes on financial instruments that are measured at fair value through profit or loss, as well as value changes on hedged items in fair value hedges.

Changes in fair value are the result of changes in market parameters and risk factors, mainly prices on bonds, market interest rates, credit spreads, basis swap spreads and FX rates, and are reflected in carrying amounts in the statement of financial position and in the income statement. In cases where the changes in fair value are realised on sale, repurchase or termination before maturity, the resulting gain or loss is presented as "Net trading income" in the income statement.

Financial derivatives in fair value hedges, see Note 13 Hedge accounting, are measured at fair value through profit or loss. The related hedged items comprise NOK 13.3 billion in "Notes, bonds and other interest-bearing securities" and NOK 145.1 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 for the hedged item that is attributable to the hedged risk adjust the carrying amount of the item, and are recognised and presented in the income statement as "Net unrealised gain/(loss) on financial instruments".

## NOTE 4

### NET TRADING INCOME

(Amounts in NOK 1 000 000)

	2014	2013
Gain/(loss) from repurchase of securities issued	13	58
Gain/(loss) from sales of bond investments and derivatives terminations	26	0
<b>Net trading income</b>	<b>39</b>	<b>58</b>

## NOTE 5

### SALARIES AND ADMINISTRATIVE EXPENSES

(Amounts in NOK 1 000 000)

	2014	2013
Salaries	57	46
Employer contributions	7	7
Pension costs	4	9
Other personnel benefits	2	2
Administrative expenses	23	19
<b>Total salaries and administrative expenses</b>	<b>93</b>	<b>82</b>
<i>Average number of man-years</i>	54	53

## NOTE 6

### REMUNERATION

(Amounts in NOK 1 000)

Kommunalbanken's policy for remuneration to executive personnel is anchored in the value proposition of the Company, the personnel policy and in line with the owner's expectations to the Company and its system for total remuneration to senior executives. Remuneration to senior executives is compliant with the Financial Institutions Act, the regulation on remuneration schemes in financial institutions and the State guidelines for remuneration to senior executives in state owned companies. The Board of Directors sets annual guidelines for remuneration to senior executives and for variable, profit-based remuneration to all employees. The compensation committee prepares the Board's treatment of the guidelines and remuneration to senior executives.

Total remuneration for senior executives consists of fixed salary,

variable salary, pension plan and other benefits, where fixed salary is the main part of total remuneration. The variable, profit-based scheme comprises all employees and is limited to 1.5 months' pay per employee. The pension plan consists of a public sector defined benefit plan for salary up to 12xbase amount, with a service period of 30 years giving the right to a retirement pension of 66 percent of base salary from the time of resignation. The supplemental pension plan covering salaries above 12xBase amount was closed to new participants from 1 April 2011. For senior executives with salaries above 12xBase amount that are not members of the supplemental plan a provision for a liability related to pension above 12xBase amount in the amount of NOK 1.5 million has been made in the annual financial statements of 2014. A new scheme will be established when State guidelines for executive salaries are in place. The CEO has an agreed right to up to 12 months salary in the event of resignation based on certain requirements. The CEO and the COO also receive a fixed, annual car benefit.

### 2014

Remuneration to senior executives	Fixed salary	Variable salary accrued in the period*	Other benefits	Pension costs
Kristine Falkgård (President & CEO)	2 474	306	143	199
Martin Spillum (COO)	2 816	269	111	441
Karina Folvik (CFO until 30.04.14)	808	0	14	87
Jannicke Trumpy Granquist (CFO from 04.08.14)	661	83	11	55
Tor Ole Steinsland (CCO)	1 180	144	26	146
Frank Øvrebø (CRO)	1 354	161	13	163
Ilse Margarete Bache (Chief of Staff from 01.01.14)	1 210	163	18	136
<b>Total remuneration to senior executives</b>	<b>10 503</b>	<b>1 126</b>	<b>336</b>	<b>1 225</b>
<b>Total remuneration to employees whose professional activities affect the risk position of the institution</b>	<b>15 039</b>	<b>1 796</b>	<b>548</b>	<b>2 399</b>
<b>Total remuneration to the employees in the independent control functions</b>	<b>11 878</b>	<b>1 619</b>	<b>349</b>	<b>2 024</b>

\*Paid out in the following year

### 2013

Remuneration to senior executives	Fixed salary	Variable salary accrued in the period	Other benefits	Pension costs
Kristine Falkgård (President & CEO) <sup>1</sup>	1 778	0	122	135
Martin Spillum (COO) <sup>2</sup>	2 125	0	97	360
Karina Folvik (CFO)	1 467	0	20	259
Tor Ole Steinsland (CCO)	1 106	0	29	127
Frank Øvrebø (CRO)	1 188	0	13	138
<b>Total remuneration to senior executives</b>	<b>7 663</b>	<b>0</b>	<b>281</b>	<b>1 019</b>
<b>Total remuneration to employees whose professional activities affect the risk position of the institution</b>	<b>18 701</b>	<b>0</b>	<b>581</b>	<b>2 711</b>
<b>Total remuneration to the employees in the independent control functions</b>	<b>4 853</b>	<b>0</b>	<b>214</b>	<b>644</b>

<sup>1</sup>President & CEO from 01.03.13

<sup>2</sup>Acting President & CEO in the period 1 December 2012—28 February 2013.

Senior executives have a 3 month notice period, and may borrow on the same terms as other employees in KBN.

<b>Remuneration to Board of Directors</b>	<b>2014</b>	<b>2013</b>
Chairman Else Bugge Fougner <sup>1 3</sup>	282	240
Vice-chairman Nils R. Sandal <sup>1</sup>	143	123
Board member Frode Berge <sup>1</sup>	68	102
Board member Nanna Egidius <sup>2</sup>	158	153
Board member Åmund T. Lunde (until 18.06.13) <sup>1 2</sup>	0	111
Board member Martha Takvam <sup>2 3</sup>	185	153
Board member Rune Sollie <sup>2</sup>	184	179
Board member Martin Skancke (from 18.06.13) <sup>3</sup>	105	52
Board member Rune Midtgaard (from 17.06.14) <sup>1</sup>	59	0
Board member employees' representative Trine Tafjord	52	102
Board member employees' representative Roald Fischer	105	102
Board member employees' representative Marit Urmo Harstad (from 17.06.14)	59	0
Alternate Board member employees' representative Trine Tafjord (17.06.2014 - 30.11.14)	0	0
Alternate Board member employees' representative Kristine Henriksen Lien (from 01.12.14)	0	0
Alternate Board member employees' representative Jarle Byre	5	10
<b>Total remuneration to Board of Directors</b>	<b>1 405</b>	<b>1 324</b>

<sup>1</sup>Member of compensation committee

<sup>2</sup>Member of audit committee

<sup>3</sup>Member of risk committee

<b>Remuneration to Control Committee</b>	<b>2014</b>	<b>2013</b>
Chairman Britt Lund (until 17.06.2014)	27	53
Committee member Kjell Inge Skaldebø (from 17.06.14)	45	33
Committee member Anne-Ma Tostrup Smith	34	33
Committee member Ole Rødal (from 17.06.14)	17	0
Committee alternate member Roy Jevard	34	46
<b>Total remuneration to Control Committee</b>	<b>157</b>	<b>165</b>

<b>Remuneration to Supervisory Board</b>	<b>2014</b>	<b>2013</b>
Chairman Elin Eidsvik (until 17.06.14)	11	21
Chairman Svein Ludvigsen (from 17.06.2014)	14	0
Board members	66	66
<b>Total remuneration to Supervisory Board</b>	<b>91</b>	<b>87</b>

<b>Fees to the statutory auditor</b>	<b>2014</b>	<b>2013</b>
Statutory audit fees	935	894
Other financial audit and attestation services	1 119	957
Tax services	0	8
Other services not related to audit	15	57
<b>Total fees excl. VAT</b>	<b>2 069</b>	<b>1 915</b>

## 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). Pension benefits include retirement pensions, disability pensions and pensions for spouses and dependent children, and is coordinated with benefits from the National Insurance Scheme. The defined benefit plan is compliant with the requirements of the Norwegian Mandatory Service Pension Act.

Employer contributions are included in pension costs and liabilities.

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

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). This 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.

Economic estimates used in calculation of pension costs and defined benefit obligation	31.12.2014	31.12.2013
Discount rate	2.30 %	4.00 %
Estimated wage growth	2.75 %	3.75 %
Estimated growth in Base amount	2.50 %	3.50 %
Expected growth in benefit levels	1.73 %	2.72 %

KBN has used Norwegian covered bonds as input when determining the discount rate for 2014 and 2013. The actuarial assumptions are based on standard assumptions related to demographic factors recommended by the Norwegian Accounting Standards Board. Changed assumptions regarding mortality (K2013) were implemented in 2013. As of 2014 there has been an additional adjustment to life expectancy for pension benefit plans in the public sector. The adjustment is treated as a plan amendment. This is a one-off effect in 2014 reducing the pension costs by NOK 7 million for the funded plan and NOK 1.4 million for the unfunded plan.

Pension costs	Funded plan		Unfunded plan	
	2014	2013	2014	2013
Net periodic pension cost	6 530	6 088	695	996
Net interest	1 250	798	525	446
Service cost	192	277	0	0
Employer contributions	1 124	1 010	172	203
Pension costs recognised in income statement incl. employer contributions and service costs	(6 996)	0	(1 431)	0
<b>Total pension cost recognised in income statement</b>	<b>2 101</b>	<b>8 173</b>	<b>(39)</b>	<b>1 645</b>
Actuarial gain/(loss) recognised in other comprehensive income	12 002	11 024	6 302	2 432
<b>Net pension costs</b>	<b>14 102</b>	<b>19 196</b>	<b>6 263</b>	<b>4 077</b>

Pension liabilities	Funded plan		Unfunded plan	
	2014	2013	2014	2013
Defined benefit obligation	92 546	75 904	19 068	13 801
Plan assets	(58 340)	(47 658)	0	0
Employer contributions	4 823	3 983	2 689	1 946
<b>Net pension liabilities</b>	<b>39 029</b>	<b>32 229</b>	<b>21 757</b>	<b>15 747</b>

Movement in pension liabilities	Funded plan		Unfunded plan	
	2014	2013	2014	2013
Net pension liabilities as of 1 January	32 229	19 446	15 747	12 163
Net pension costs	14 102	19 196	6 263	4 077
Contribution to the pension scheme	(7 302)	(6 413)	(254)	(493)
<b>Net pension liabilities as of 31 December</b>	<b>39 029</b>	<b>32 229</b>	<b>21 757</b>	<b>15 747</b>

Movement in the fair value of plan assets	Funded plan		Unfunded plan	
	2014	2013	2014	2013
Fair value of plan assets as of 1 January	47 658	42 252	0	0
Net interest	1 784	1 742	0	0
Actuarial gain/(loss)	3 600	(1 172)	0	0
Service cost	(192)	(277)	0	0
Contribution to the pension scheme	6 400	5 621	222	0
Benefits paid	(909)	(508)	(222)	0
<b>Fair value of plan assets as of 31 December</b>	<b>58 340</b>	<b>47 658</b>	<b>0</b>	<b>0</b>

## NOTE 8

### TAX

(Amounts in NOK 1 000 000)

The corporate income tax rate was reduced from 28 percent to 27 percent from 1 January 2014.

	2014	2013
Current taxes	404	440
Change in deferred tax	(220)	(26)
Too low/high expense previous years	(3)	0
<b>Total income tax</b>	<b>182</b>	<b>414</b>

Current taxes	2014	2013
Current tax payable	404	440
<b>Total current taxes</b>	<b>404</b>	<b>440</b>

Reconciliation of effective income tax rate	2014	2013
Profit before tax	673	1 496
Calculated income tax (27 %)	182	414
<b>Tax expense</b>	<b>182</b>	<b>414</b>
Effective income tax rate	27.0 %	27.7 %

Deferred tax liability/(asset)	2014	2013
Deferred tax liability/(asset) as at 1 January	139	167
Change in deferred tax	(220)	(26)
Changes in deferred tax on items recognised in other comprehensive income	(5)	(3)
<b>Deferred tax liability/(asset) as at 31 December (27%)</b>	<b>(86)</b>	<b>139</b>

Temporary differences	2014	2013
Fixed assets	0	1
Pension liabilities	(42)	(37)
Provisions	(18)	(3)
Financial derivatives	323	383
Unrealised gain/loss on financial instruments	(554)	180
<b>Total temporary differences in the income statement</b>	<b>(291)</b>	<b>524</b>
Actuarial gain/(loss) recognised in other comprehensive income	(29)	(10)
<b>Total temporary differences</b>	<b>(320)</b>	<b>514</b>
<b>Deferred tax liability/(asset)</b>	<b>(86)</b>	<b>139</b>

## NOTE 9

### LEASES

(Amounts in NOK 1 000 000)

<b>Future minimum lease payments</b>	<b>2014</b>	<b>2013</b>
Under 1 year	6	6
1-5 years	24	24
Over 5 years	5	11
<b>Total future minimum lease payments</b>	<b>35</b>	<b>41</b>
<b>Lease payments recognised as an expense in the period</b>	<b>7</b>	<b>6</b>

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

## NOTE 10

### CATEGORISATION OF FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

2014	Total	At fair value through profit or loss			Held to maturity	Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge			
Deposits with credit institutions	16 219	9 619	0	0	0	6 600	0
Instalment loans	249 928	150 328	0	0	0	99 600	0
Notes, bonds and other interest-bearing securities	157 364	143 962	0	0	113	13 289	0
Financial derivatives	31 776	0	29 598	2 178	0	0	0
<b>Total financial assets</b>	<b>455 287</b>	<b>303 909</b>	<b>29 598</b>	<b>2 178</b>	<b>113</b>	<b>119 489</b>	<b>0</b>
Loans from credit institutions	25 135	0	0	0	0	0	25 135
Commercial paper	0	0	0	0	0	0	0
Senior securities issued	398 669	253 570	0	0	0	0	145 099
Financial derivatives	20 919	0	19 826	1 093	0	0	0
Subordinated debt	1 895	1 895	0	0	0	0	0
<b>Total financial liabilities</b>	<b>446 618</b>	<b>255 465</b>	<b>19 826</b>	<b>1 093</b>	<b>0</b>	<b>0</b>	<b>170 234</b>
<b>2013</b>	<b>Total</b>	<b>At fair value through profit or loss</b>			<b>Held to maturity</b>	<b>Loans and receivables</b>	<b>Other liabilities</b>
		<b>Fair value option</b>	<b>Held for trading</b>	<b>Fair value hedge</b>			
Deposits with credit institutions	5 257	704	0	0	0	4 553	0
Instalment loans	243 114	141 341	0	0	0	101 773	0
Notes, bonds and other interest-bearing securities	101 696	85 773	0	0	931	14 992	0
Financial derivatives	11 806	0	9 999	1 807	0	0	0
<b>Total financial assets</b>	<b>361 873</b>	<b>227 818</b>	<b>9 999</b>	<b>1 807</b>	<b>931</b>	<b>121 318</b>	<b>0</b>
Loans from credit institutions	3 656	0	0	0	0	0	3 656
Commercial paper	0	0	0	0	0	0	0
Senior securities issued	329 139	225 790	0	0	0	0	103 349
Financial derivatives	18 559	0	16 999	1 559	0	0	0
Subordinated debt	1 687	1 687	0	0	0	0	0
<b>Total financial liabilities</b>	<b>353 040</b>	<b>227 477</b>	<b>16 999</b>	<b>1 559</b>	<b>0</b>	<b>0</b>	<b>107 005</b>



## NOTE 11

### FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

(Amounts in NOK 1 000 000)

2014	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	9 619	0	9 619
Instalment loans	0	103 872	46 456	150 328
Notes, bonds and other interest-bearing securities	82 882	56 887	4 193	143 962
Financial derivatives	0	30 664	1 112	31 776
<b>Total financial assets measured at fair value</b>	<b>82 882</b>	<b>201 043</b>	<b>51 761</b>	<b>335 686</b>
Loans from credit institutions	0	0	0	0
Senior securities issued	0	164 008	89 562	253 570
Financial derivatives	0	9 402	11 517	20 919
Subordinated debt	0	0	1 895	1 895
<b>Total financial liabilities measured at fair value</b>	<b>0</b>	<b>173 410</b>	<b>102 974</b>	<b>276 384</b>

There were no significant transfers between Level 1 and Level 2 in the reporting period.

2013	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	704	0	704
Instalment loans	0	94 817	46 524	141 341
Notes, bonds and other interest-bearing securities	47 470	34 314	3 989	85 773
Financial derivatives	0	10 606	1 200	11 806
<b>Total financial assets measured at fair value</b>	<b>47 470</b>	<b>140 441</b>	<b>51 713</b>	<b>239 624</b>
Loans from credit institutions	0	0	0	0
Senior securities issued	0	123 016	102 774	225 790
Financial derivatives	0	10 882	7 677	18 559
Subordinated debt	0	0	1 687	1 687
<b>Total financial liabilities measured at fair value</b>	<b>0</b>	<b>133 898</b>	<b>112 138</b>	<b>246 035</b>

There were no significant transfers between Level 1 and Level 2 in the reporting period.

Reconciliation of movements in Level 3	2013	Additions	Disposals	Gain/(loss)	Transfers	2014
Instalment loans	46 524	25 663	(24 088)	367	(2 010)	46 456
Notes, bonds and other interest-bearing securities	3 989	1 781	(3 782)	1	2 204	4 193
Financial derivatives	1 200	121	(576)	367	0	1 112
<b>Total financial assets at fair value in Level 3</b>	<b>51 713</b>	<b>27 565</b>	<b>(28 446)</b>	<b>735</b>	<b>194</b>	<b>51 761</b>
Senior securities issued	102 774	36 368	(60 845)	11 265	0	89 562
Financial derivatives	7 677	(3 263)	4 050	3 053	0	11 517
Subordinated debt	1 687	0	0	208	0	1 895
<b>Total financial liabilities at fair value in Level 3</b>	<b>112 138</b>	<b>33 105</b>	<b>(56 795)</b>	<b>14 526</b>	<b>0</b>	<b>102 974</b>

	2012	Additions	Disposals	Gain/(loss)	Transfers	2013
Instalment loans	51 552	2 214	(3 153)	(313)	(3 776)	46 524
Notes, bonds and other interest-bearing securities	1 616	3 181	(1 801)	32	961	3 989
Financial derivatives	2 095	0	(202)	(696)	4	1 200
<b>Total financial assets at fair value in Level 3</b>	<b>55 263</b>	<b>5 395</b>	<b>(5 156)</b>	<b>(977)</b>	<b>(2 811)</b>	<b>51 713</b>
Senior securities issued	111 788	48 503	(57 830)	312	0	102 774
Financial derivatives	3 154	0	(237)	4 760	0	7 677
Subordinated debt	1 670	0	0	17	0	1 687
<b>Total financial liabilities at fair value in Level 3</b>	<b>116 612</b>	<b>48 503</b>	<b>(58 068)</b>	<b>5 089</b>	<b>0</b>	<b>112 138</b>

Notes, bonds and other interest-bearing securities amounting to NOK 2.2 billion were in 2014 transferred from Level 2 or 1 based on very little market activity with little observable data for these securities despite a generic improvement in liquidity in the markets through the year. For Instalment loans the transfer out of Level 3 is due to customers starting or ending a period of fixed interest, i.e. a product change.

All gains/(losses) related to financial instruments in Level 3 are presented in the income statement as "Net interest income", "Net trading income" or "Net unrealised gain/(loss) on financial instruments". Unrealised gain for Level 3 instruments that are still recognised on the reporting date amounts to NOK 927 million.

**Impact of changes in key assumptions**

	2014		2013	
	Carrying amount	Impact of changes in key assumptions	Carrying amount	Impact of changes in key assumptions
Instalment loans	46 456	(151)	46 524	(141)
Notes, bonds and other interest-bearing securities	4 193	(7)	3 989	(1)
Financial derivatives	(10 405)	(24)	(6 477)	(322)
Senior securities issued	89 562	217	102 774	136
Subordinated debt	1 895	3	1 687	4
<b>Total</b>	<b>131 701</b>	<b>38</b>	<b>148 497</b>	<b>(324)</b>

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.

**INFORMATION ON FAIR VALUE**

Methods used for the determination of fair value fall within three categories, which reflect different degrees of valuation uncertainty:

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

Level 2—Valuation techniques with observable inputs

Level 3— Valuation techniques where inputs are to a significant degree unobservable.

Valuation techniques used for the determination of fair value of financial instruments in Level 2 and 3 include discounted cash flows and option pricing models using both observable market data and estimates as inputs. All changes in fair value of financial instruments adjust the carrying amounts of assets and liabilities, and recognised in the income statement as “Net unrealised gain/ (loss) on financial instruments”. The same judgements have been made when allocating to Levels in 2014 and 2013.

**Deposits with credit institutions**

Deposits with credit institutions that are measured at fair value include short term 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. Within these loan products the customers have more flexibility in refinancing the loans with other lenders when market conditions change. As a result, these types of loans are subject to greater competition and better liquidity in the market and allows the use of observable prices on new loans to be used as inputs in the valuation of these loan products.

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 input for such loans is the credit spread, which is estimated at each reporting date. Credit risk is considered to be the same for all municipalities. As observable credit spreads are not available, management makes assumptions and estimates relevant adjustments for credit risk based on among other things prices on new loans and any additional security.

**Notes, bonds and other interest-bearing securities**

Determination of fair value based on quoted prices in an active market with many willing buyers and sellers gives a fair value estimate with the lowest degree of valuation uncertainty (Level 1). Level 1 inputs for Notes, bonds and other interest-bearing securities include quoted prices provided by international vendors (Reuters/Bloomberg), which represent actual transactions in an active market.

The fair value of notes and bonds where quoted prices are not available to a sufficient degree on the reporting date is determined using the discounted cash flow method, where discount rates are derived from observable money market interest rate yield curves. Discount rates are adjusted for credit and liquidity risk of the issuer, to as large a degree as possible based on observable market data. When applying credit/liquidity adjustments to discount rates, the assets are grouped based on the issuer’s credit rating, currency, time to maturity, underlying exposure and geographic location. On each reporting date management assesses the valuation uncertainty level for the investments. To some extent unobservable credit spreads are used. Where these are significant for the valuation the security is allocated to Level 3, which reflects significant valuation uncertainty. For more information about inputs used in fair value measurement, see the 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 USD and EUR benchmark loans, loans in public niche markets, private placements and retail loans. The two first groups are characterised by listed syndicated loans in various currencies, where the size of the loan forms the primary difference between the two groups. For listed benchmark bonds quoted prices in an active market exist such that these are assessed to belong to Level 1, with limited valuation uncertainty. For Senior securities issued in public niche markets quoted prices are also available to some extent, however, the market activity and liquidity is assessed as somewhat lower such that it is assessed that the determination of fair value is mainly done using valuation techniques and observable market data. For these bonds the discounted cash flows method is used with discount rates based on observable market data, such as market interest rates, quoted prices and prices on similar instruments adjusted for differences in time to maturity, size and currency (Level 2). Prices on new issues are used as an important indicator in the valuation, and in addition KBN also collects non-binding price indications from brokers.

Group three is private placements 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. The bonds in these two groups are not listed and normally not traded in the secondary market, and are to a large extent structured products with option elements linked to equity indices or FX rates. Quoted prices are hence not available, and unobservable inputs are used to a significant degree in the valuation. These loans are therefore classified as Level 3 in the fair value hierarchy, and thus are characterised by significant valuation uncertainty. The choice of valuation techniques and inputs depend on the structure of each loan. For bonds without embedded options fair value is determined using the discounted cash flow method where inputs are current interest rate yield curves and credit spreads estimated from prices on new issues. For structured bonds with option elements fair value is determined using option pricing models that use both interest rates, FX-rates and historical volatilities as inputs.

#### *Financial derivatives*

All financial derivatives are OTC-contracts used only in economic hedges of interest rate and currency risk. For basis swaps (USD-NOK, USD-EUR and EUR-NOK) and plain vanilla interest rate and cross currency swaps without option elements, fair value is determined using the discounted cash flow method with discount rates derived from observable basis swap spreads and swap interest rates. This is hence Level 2 valuation, however, with to a large extent high market activity. Equity and commodity linked derivatives with embedded options are valued using the same valuation models as corresponding issued bonds and are classified as Level 3.

#### *Valuation techniques*

The methods used for determining the fair value of financial instruments is defined based on the instruments' features and structure. Fair value of financial instruments without embedded derivatives is determined using the discounted cash flows method, where discount rates are derived from the relevant observable money market interest rates and other significant risk factors that may affect the fair value of the instruments. When such factors cannot be reliably observed at a reporting date,

management may make assumptions and use estimates when determining fair value. The most significant unobservable inputs used in the valuation in Level 3 are credit spreads for financial instruments not traded in an active market. Fair value of financial instruments with embedded derivatives is determined using option pricing models with observable market data and estimates as inputs. For financial instruments measured at fair value that are part of the holdings over several periods a reconciliation of movements between the levels is done at the end of each reporting period.

KBN analyses the fair values and the period's value changes at period ends, including the reason for the development in fair values.

#### *Significant unobservable inputs in fair value measurement, within Level 3*

In cases of very little or no market activity for the relevant instrument the valuation is to a significant extent based on estimates as inputs to the valuation technique. The most significant estimate is an add-on (spread) to swap interest rates. For Senior securities issued the spread reflects liquidity risk, own credit risk and market risk in the relevant currency market. Credit spreads measured against USD 3M Libor used in valuation at 31 December 2014 vary from -20 bp to +57 bp for debt issuances. For notes, bonds and other interest-bearing securities the spread reflects liquidity risk, credit risk of the issuer and market risk in the relevant currency market. Measured against USD 3M Libor the spreads vary between -15 bp to + 250 bp for notes and bonds. Other significant unobservable inputs include volatilities within option pricing models, used for instruments with embedded options or option elements. The total credit spread and yield curve is sensitive to changes in each underlying factor. The fair value of the instrument will thus be affected by changes in credit spreads, liquidity risk or market risk. For more information on sensitivity to unobservable inputs, see table "Impact of changes in key assumptions".

## NOTE 12

### FINANCIAL INSTRUMENTS MEASURED AT AMORTISED COST

(Amounts in NOK 1 000 000)

	2014		2013	
	Carrying amount	Fair value	Carrying amount	Fair value
Instalment loans	99 600	99 549	101 773	101 708
Notes, bonds and other interest-bearing securities classified as Loans and receivables	13 289	13 238	14 992	15 045
Notes, bonds and other interest-bearing securities classified as Held to maturity	113	113	931	931
<b>Total financial assets measured at amortised cost</b>	<b>113 002</b>	<b>112 900</b>	<b>117 696</b>	<b>117 684</b>
Senior securities issued	145 099	145 138	103 349	103 637
<b>Total financial liabilities measured at amortised cost</b>	<b>145 099</b>	<b>145 138</b>	<b>103 349</b>	<b>103 637</b>

Information about the level within the fair value hierarchy, for financial instruments measured at amortised cost, where fair value is disclosed.

2014	Level 1	Level 2	Level 3	Total
Instalment loans	0	85 235	14 314	99 549
Notes, bonds and other interest-bearing securities classified as Loans and receivables	0	11 670	1 568	13 238
Notes, bonds and other interest-bearing securities classified as Held to maturity	0	113	0	113
<b>Total financial assets measured at fair value</b>	<b>0</b>	<b>97 018</b>	<b>15 882</b>	<b>112 900</b>
Senior securities issued	137 565	7 182	391	145 138
<b>Total financial liabilities measured at fair value</b>	<b>137 565</b>	<b>7 182</b>	<b>391</b>	<b>145 138</b>

2013	Level 1	Level 2	Level 3	Total
Instalment loans	0	85 656	16 052	101 708
Notes, bonds and other interest-bearing securities classified as Loans and receivables	0	13 347	1 698	15 045
Notes, bonds and other interest-bearing securities classified as Held to maturity	0	931	0	931
<b>Total financial assets measured at fair value</b>	<b>0</b>	<b>99 934</b>	<b>17 751</b>	<b>117 684</b>
Senior securities issued	94 765	8 872	0	103 637
<b>Total financial liabilities measured at fair value</b>	<b>94 765</b>	<b>8 872</b>	<b>0</b>	<b>103 637</b>

#### INFORMATION ON FAIR VALUE

See Note 11 Financial instruments measured at fair value for information regarding fair value measurement.

For assets and liabilities that are part of hedging relationships as hedged items (Notes, bonds and other interest-bearing securities classified as Loans and receivables and Senior securities issued classified as Other liabilities, see Note 13 Hedge accounting) value changes due to the hedged risk is calculated. This value change adjusts the carrying amount of the asset or liability and is recognized in the income statement on the line "Net unrealised gain/(loss) on financial instruments". Also for this purpose a discounted cash flow method is used, but where the discount rate reflects only the hedged risk (interest and currency element).

##### Instalment loans

Level 2: P.t. loans and Nibor-loans with fixed interest rate margin (time to maturity within 1 year) have time to maturity and/or interest rate terms that give the customer more flexibility to change the loan provider if market terms change. This leads to higher competition and better liquidity in the market and allows the use of observable prices on new loans to be used as inputs in the valuation of these loan products.

Level 3: Nibor-loans with fixed interest rate margin (time to maturity above 1 year) are granted bilaterally between KBN and a loan customer, and are not traded in an active market.

##### Senior securities issued

Senior securities issued measured at amortised cost consist of USD or Euro benchmark loans and loans in public niche markets.

## 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".

<b>Carrying amount of financial instruments in fair value hedges</b>	<b>2014</b>	<b>2013</b>
Notes, bonds and other interest-bearing securities	13 289	14 992
Senior securities issued	145 099	103 349
Financial derivatives	1 085	247
<b>Total</b>	<b>159 473</b>	<b>118 588</b>

<b>Fair value changes on financial instruments in fair value hedges</b>	<b>2014</b>	<b>2013</b>
Notes, bonds and other interest-bearing securities	(89)	(204)
Senior securities issued	(36)	1 459
Financial derivatives	151	(1 305)
<b>Total</b>	<b>26</b>	<b>(50)</b>

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)

	<b>2014</b>	<b>2013</b>
Deposits with credit institutions without agreed time to maturity	21	29
Deposits with credit institutions with agreed time to maturity	9 619	704
Cash collateral pledged	6 579	4 524
<b>Total deposits with credit institutions</b>	<b>16 219</b>	<b>5 257</b>

## NOTE 15

### INSTALMENT LOANS

(Amounts in NOK 1 000 000)

	2014	2013
Principal amount	247 067	240 808
Accrued interest	1 092	1 138
Fair value adjustment	1 720	1 113
<b>Total loans to customers</b>	<b>249 879</b>	<b>243 059</b>
Other loans	49	55
<b>Total instalment loans</b>	<b>249 928</b>	<b>243 114</b>
<b>Geographic distribution</b>	<b>2014</b>	<b>2013</b>
Østfold	10 998	10 773
Akershus	21 593	21 881
Oslo	4 415	4 475
Hedmark	10 515	10 202
Oppland	8 042	7 412
Buskerud	28 648	23 031
Vestfold	8 334	8 069
Telemark	8 302	9 679
Aust-Agder	5 924	6 091
Vest-Agder	12 420	12 349
Rogaland	20 080	19 381
Hordaland	29 213	29 096
Sogn og Fjordane	7 640	7 320
Møre og Romsdal	15 553	16 823
Sør-Trøndelag	12 133	11 966
Nord-Trøndelag	9 669	10 787
Nordland	16 111	14 796
Troms	10 961	10 323
Finnmark	6 462	6 308
Svalbard	54	46
<b>Loans to customers, principal amount</b>	<b>247 067</b>	<b>240 808</b>

## NOTE 16

### NOTES, BONDS AND OTHER INTEREST-BEARING SECURITIES

(Amounts in NOK 1 000 000)

<b>Notes, bonds and other interest-bearing securities by type of issuer</b>	<b>2014</b>	<b>2013</b>
Domestic		
Issued by other borrowers	6 748	3 704
Foreign		
Issued by public bodies <sup>1</sup>	108 762	74 870
Issued by other borrowers	41 853	23 123
<b>Total notes, bonds and other interest-bearing securities</b>	<b>157 364</b>	<b>101 696</b>

<sup>1</sup>Issued by or guaranteed by sovereigns, central banks, regional authorities and multilateral development banks.

<b>Notes, bonds and other interest-bearing securities by time to maturity</b>	<b>2014</b>	<b>2013</b>
Under 1 year	107 399	54 140
1-5 years	49 965	47 556
<b>Total notes, bonds and other interest-bearing securities</b>	<b>157 364</b>	<b>101 696</b>

## NOTE 17

### OTHER ASSETS

(Amounts in NOK 1 000 000)

	2014	2013
Intangible assets	80	34
Fixed assets	9	7
Other assets	1	1
Prepaid, non-accrued expenses and accrued income	3	3
<b>Total other assets</b>	<b>93</b>	<b>44</b>

Intangible assets mainly consist of a new portfolio system. The system will be in production in 2015 and amortisation starts in 2015.

### OTHER LIABILITIES

(Amounts in NOK 1 000 000)

	2014	2013
Accounts payable	3	4
Public fees	5	10
Other short term liabilities	20	3
Accrued expenses and received, not yet accrued interest	21	19
<b>Total other liabilities</b>	<b>47</b>	<b>36</b>

## NOTE 18

### LOANS FROM CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2014	2013
Cash collateral received	25 135	3 656
<b>Total loans from credit institutions</b>	<b>25 135</b>	<b>3 656</b>

## NOTE 19

### SENIOR SECURITIES ISSUED

(Amounts in NOK 1 000 000)

	2014	2013
<b>Senior securities issued (nominal amounts) as at 1 January</b>	<b>326 470</b>	<b>312 867</b>
New issuance	116 739	162 539
Redemptions*	(109 833)	(153 300)
Amortisation	264	(88)
Translation differences	57 646	4 451
<b>Senior securities issued (nominal amounts) as at 31 December</b>	<b>391 285</b>	<b>326 470</b>
Accrued interest	2 419	1 953
Fair value adjustment	4 966	716
<b>Total senior securities issued</b>	<b>398 669</b>	<b>329 139</b>
<i>Of which gain/(loss) from fair value adjustment that is due to changes in own credit risk</i>	<i>(305)</i>	<i>(135)</i>

\* Redemptions in 2014 includes buybacks of 1 753 million NOK.

There was no breach in debt covenants as of 31 December 2014.

Fair value adjustment (value changes) that are due to changes in KBN's credit risk is a part of the total value change for the bond, which is not due to changes in market parameters like interest or currency risk. Value changes resulting from changes in credit risk amount to the difference between the values calculated using two different discount rates:

- A) Relevant money market interest rate at the reporting date with an add-on for the credit risk on the issue date; and
- B) Relevant money market interest rate at the reporting date with an add-on for the credit risk on the reporting date (fair value on the reporting date)

## NOTE 20

### FINANCIAL DERIVATIVES

(Amounts in NOK 1 000 000)

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

Borrowing in foreign currency is converted to Norwegian kroner through basis swaps, where KBN receives interest payments in foreign currency and pays interest in Norwegian kroner. Interest rate risk arising from loans to customers with fixed rate terms is hedged with interest rate swaps and FRA contracts. Interest rate and currency swaps are also used to hedge market risk in the liquidity portfolio. KBN has no credit derivatives in the portfolio.

Counterparty risk related to financial derivatives contracts is mitigated by using standard ISDA agreements that give the right to offset assets and liabilities in the event of default, and in addition collateral agreements are entered into with all swap counterparties. The derivatives exposure is monitored on an ongoing basis.

	2014			2013		
	Notional amount	Assets	Liabilities	Notional amount	Assets	Liabilities
<b>Held for trading:</b>						
Interest rate derivatives	118 295	978	2 396	112 024	665	2 115
Currency derivatives	409 353	28 571	15 837	395 576	8 646	13 885
Equity-related derivatives	15 182	49	1 560	26 352	669	991
Commodity-related derivatives	180	0	33	259	19	8
	<b>543 011</b>	<b>29 598</b>	<b>19 826</b>	<b>534 211</b>	<b>9 999</b>	<b>16 999</b>
<b>Fair value hedges:</b>						
Interest rate derivatives	114 706	1 058	737	95 382	1 128	835
Currency derivatives	12 841	1 120	356	20 351	679	724
	<b>127 547</b>	<b>2 178</b>	<b>1 093</b>	<b>115 732</b>	<b>1 807</b>	<b>1 559</b>
<b>Total financial derivatives</b>	<b>670 557</b>	<b>31 776</b>	<b>20 919</b>	<b>649 943</b>	<b>11 806</b>	<b>18 559</b>

All financial derivatives are measured at fair value through profit or loss. Most contracts are categorised as "Held for trading". The remaining contracts are designated as hedging instruments in fair value hedges. As standard master netting agreements (ISDA) do not fulfil the requirements for netting under IAS 32,

financial derivatives are presented on a gross basis in the Statement of Financial Position, such that contracts with a positive fair value are presented as assets and contracts with a negative fair value are presented as liabilities.

## NOTE 21

### COLLATERAL AND OFFSETTING

(Amounts in NOK 1 000 000)

	2014	2013
Cash collateral received	25 135	3 656
Cash collateral pledged	(6 579)	(4 524)
<b>Total cash collateral</b>	<b>18 555</b>	<b>(868)</b>

Agreements regarding the exchange of collateral in the form Credit Support Annex (CSA) related to financial derivatives exposures are entered into with all derivatives counterparties. The collateral consists of cash in USD or EUR. Cash collateral received and cash collateral pledged is presented in the Statement

of financial position as Deposits with credit institutions or Loans from credit institutions with a related payable to or receivable from credit institutions. Cash collateral received is included in KBN's cash management, and is placed either in notes and bonds or in short term money market instruments.

### ITEMS COVERED BY NETTING AGREEMENTS, BUT NOT QUALIFIED FOR OFFSETTING IN THE STATEMENT OF FINANCIAL POSITION.

(Amounts in NOK 1 000 000)

	2014	2013
Financial derivatives	31 776	11 806
<b>Total assets</b>	<b>31 776</b>	<b>11 806</b>
Financial derivatives	20 919	18 559
<b>Total liabilities</b>	<b>20 919</b>	<b>18 559</b>

KBN has entered into ISDA agreements with derivatives counterparties. This implies that all exposures vs the counterparty may be netted in the event of default.



## Effect of offsetting and collateral

(Amounts in NOK 1 000 000)

Amounts that may not be presented net in the statement of financial position, but are subject to a netting agreement

2014	Gross fair value	Amounts that are offset in the statement of financial position	Carrying amount	Netting effect for counterparties with both asset and liabilities items	Net exposure	Cash collateral	Amounts after netting and collateral
<b>Assets</b>							
Financial derivatives	31 776	-	31 776	10 958	20 818	25 135	(4 317)
<b>Liabilities</b>							
Financial derivatives	20 919	-	20 919	10 958	9 961	6 579	3 381

Amounts that may not be presented net in the statement of financial position, but are subject to a netting agreement

2013	Gross fair value	Amounts that are offset in the statement of financial position	Carrying amount	Netting effect for counterparties with both asset and liabilities items	Net exposure	Cash collateral	Amounts after netting and collateral
<b>Assets</b>							
Financial derivatives	11 806	-	11 806	9 963	1 843	3 656	(1 813)
<b>Liabilities</b>							
Financial derivatives	18 559	-	18 559	9 963	8 596	4 524	4 072

## NOTE 22

### SUBORDINATED DEBT

(Amounts in NOK 1 000 000)

	Currency	Nominal amount in CCY	Redemption right	Coupon	Nominal amount in NOK	
					2014*	2013
Ordinary subordinated loan capital	CAD	275 million	2016	3.74%	1 760	1 571
<b>Total subordinated debt</b>					<b>1 760</b>	<b>1 571</b>

\*Nominal amount converted to NOK using the reporting date fx rate

## NOTE 23

### SHARE CAPITAL

	2014		2013	
	Number of shares	Share in %	Number of shares	Share in %
The Kingdom of Norway	2 144 625	100	2 144 625	100

It has been decided in the State Budget for 2015 that KBN will receive an additional NOK 1 billion in share capital in 2015. This is to ensure the fulfilment of increased capital requirements in the coming years.

## NOTE 24

### RISK MANAGEMENT

State ownership, customer group and sector political role imply that KBN maintains a low risk profile. Risk limits are set in accordance with the requirements of the Board of Directors, owner and supervisory authorities. The risk limits reflect KBN's risk capacity and tolerance for fluctuations in profits and capital.

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

#### ORGANISATION OF RISK MANAGEMENT

**Board of Directors.** The Board of Directors has the overall responsibility for the risk management and sets the risk profile of KBN. The risk profile and tolerance are implemented through the determination of risk limits. Risk taking shall be performed within approved limits.

**Risk committee of the Board.** The risk committee is a preparatory and advisory body to the Board. The main function of the committee is to assist the Board in the monitoring and management of KBN's total risk.

**Delegation of authority.** All approvals of Instalment loans as well as all taking of risk in financial operations are authorized via general authorization given to the relevant personnel.

**Responsibility.** The President & CEO has an overall responsibility for risk management and internal control, and on an ongoing basis follows up changes in KBN's risk exposures.

**Annual review.** All risk limits and trading in new financial instruments is approved by the Board. The financial guidelines are reviewed semi-annually by the Board. Guidelines for lending to municipalities are reviewed annually by the Board. The capital status of KBN is reviewed at least annually.

**Independent risk management functions.** Risk controlling entities are independent of the activities in the operational departments:

Lending, Funding and Treasury. KBN's portfolio and risk management system is Adaptiv360 provided by Sungard. Internal audit is performed by KPMG and reported to the Board of Directors.

#### RISK TYPES

The risk management and risk exposure in KBN are subject to strict internal guidelines to ensure the bank's credit rating and access to the interbank markets. Credit and liquidity risk are generally low. KBN takes no open risk positions in interest rates or foreign currencies.

The following risk factors are identified as the most important for KBN:

#### *Credit risk and counterparty risk*

- Loss on loans granted to customers
- Counterparty default – derivative transactions
- Issuer default – liquidity portfolio
- Price risk in the liquidity portfolio

#### *Market risk*

- Interest rate and currency risk

#### *Capital level*

#### *Liquidity risk*

#### *Operational risk*

#### CREDIT RISK

KBN's assets consist of loans to municipalities and similar 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*

KBN has a credit assessment system for loans based on economic assessment of municipalities and other debtors. The analysis takes into account quantitative and qualitative key indicators, including operating conditions, regulatory framework, financial standing, debt profile, management and an overall economic assessment of the geographic region.

KBN has strict guidelines for entering into financial instruments transactions, related to the liquidity portfolio and hedging instruments (financial derivatives). The lowest acceptable rating for investments in bonds and notes is A2/A from Moody's and Standard and Poor's.

The counterparty risk in derivative transactions is managed and reduced through standard ISDA agreements. In addition, KBN enters into collateral agreements which require posting of cash collateral, with all new swap counterparties.

Procedures and processes to monitor and control credit risk have been established. 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. All counterparties are also reviewed on an ongoing basis. The Board of Directors annually approves the credit policy for municipal lending, and all special exposures are assessed by management prior to granting of the loan.

#### *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 postponement, as the payment obligation cannot be eliminated. 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 is 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 65 per cent of the portfolio is invested in securities with a BIS-weight of zero per cent. Average time to maturity of the portfolio was under 1 year as of 31 December 2014. The price risk in the portfolio is managed at issuer level and is limited due to the portfolio's short duration.

#### MARKET RISK

Market risk consists of interest rate and currency risk. KBN's risk policy allows minimal exposure to changes in interest rates and FX-rates. 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 requirements for regulatory capital. In addition KBN assesses its capital level taking into account all substantial risks the bank 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, management identifies and measures all the risks KBN may be exposed to and estimates the capital level necessary to cover the total risk exposure. The following risks are assessed separately: credit risk, market risk, liquidity risk, operational risk and other non-financial 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 KBN's capital requirements.

KBN's common equity Tier 1 capital adequacy ratio is 12.26 per cent. KBN is compliant with all regulatory capital requirements, relating to regulatory minimum requirements and buffer requirements, and for all capital measures (common equity Tier 1 capital, total Tier 1 capital and total primary capital).

#### LIQUIDITY RISK

Liquidity risk is managed by matching maturity profiles and interest rate reset periods for assets and liabilities. The 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 funding equal to or exceeding that of the loan portfolio.

#### OPERATIONAL RISK

Operational risk arises in all functions and is minimised by effective internal control, high professional and competency level and focus on ethical behaviour. Management reports to the Board on the operational risk and incidents.

## NOTE 25

### CREDIT RISK

(Amounts in NOK 1 000 000)

KBN has credit exposures against the municipal sector in Norway, as well as against sovereigns, local authorities, multilateral development banks, financial institutions and covered bonds within the OECD. Loans given to municipalities may have time to maturity of up to 50 years, and credit limits are regulated by the regulation on large exposures. Credit exposures to financial institutions shall have a rating of A or

above.

KBN grants loans to public sector entities that carry out tasks for local and regional authorities. The conditions for such loans are that the municipalities or regional authorities provide guarantees that have been politically approved and authorised by government via the County governor or the Ministry of Local Government and Modernisation. KBN has no loan losses in 2014, and neither is there any evidence of default as at 31 December 2014. KBN does not issue financial guarantees.

Amounts in the table below represent actual credit exposure

2014

Time to maturity	< 1 year			> 1 year						Total
	A-3	A-1/A-1+	Not rated	BBB	A-	A	AA	AAA	Not rated	
Sovereigns and central banks	0	4 840	0	0	0	2 131	8 339	9 950	0	25 261
Regional authorities <sup>1</sup>	0	17 961	32 871	0	0	211	21 932	13 540	221 953	308 467
Multilateral development banks	0	13 099	0	0	0	0	1 021	12 994	0	27 114
Financial institutions	0	7 588	0	0	0	24 761	5 769	0	0	38 118
Securitisation	0	0	0	16	11	24	2	60	0	113
Covered bond	0	9 805	0	0	0	0	1 360	13 274	0	24 438
<b>Total</b>	<b>0</b>	<b>53 292</b>	<b>32 871</b>	<b>16</b>	<b>11</b>	<b>27 128</b>	<b>38 423</b>	<b>49 818</b>	<b>221 953</b>	<b>423 511</b>

<sup>1</sup> Including loans to municipal sector of NOK 249.9 billion.

Undisbursed loan commitments amount to NOK 5.7 billion as at 31 December 2014.

### Credit exposure by country

2014

Time to maturity	< 1 year			> 1 year						Total
	A-3	A-1/A-1+	Not rated	BBB	A-	A	AA	AAA	Not rated	
Australia	0	277	0	0	11	0	1 503	34	0	1 824
Belgium	0	136	0	0	0	0	1 716	0	0	1 852
Canada	0	2 081	0	0	0	3 125	706	0	0	5 912
Denmark	0	6 810	0	0	0	0	0	10 886	0	17 697
Finland	0	2 129	1 093	0	0	0	2 410	0	272	5 904
France	0	1 965	0	0	0	8 179	6 805	394	0	17 343
Japan	0	0	0	0	0	5 775	0	0	0	5 775
Luxembourg	0	0	0	0	0	0	903	0	0	903
Netherlands	0	972	1 023	0	0	3 980	267	281	183	6 706
Norway	0	6 985	30 235	0	0	2 485	139	1 122	219 693	260 658
Austria	0	0	0	0	0	0	424	0	0	424
Spain	0	0	0	16	0	0	0	0	0	16
Supranational	0	13 099	0	0	0	0	1 021	12 994	0	27 114
Switzerland	0	0	0	0	0	383	0	0	0	383
Sweden	0	8 709	483	0	0	0	740	746	0	10 678
Germany	0	9 211	37	0	0	2 499	21 511	17 101	1 805	52 164
United Kingdom	0	919	0	0	0	701	278	6 260	0	8 158
<b>Total</b>	<b>0</b>	<b>53 292</b>	<b>32 871</b>	<b>16</b>	<b>11</b>	<b>27 128</b>	<b>38 423</b>	<b>49 818</b>	<b>221 953</b>	<b>423 511</b>

## 2013

Time to maturity	< 1 year			> 1 year						Total
	A-3	A-1/A-1+	Not rated	BBB	A-	A	AA	AAA	Not rated	
Sovereigns and central banks	0	7 292	0	0	0	0	3 059	2 112	0	12 462
Regional authorities <sup>1</sup>	0	14 603	22 628	0	0	0	11 398	10 340	223 512	282 481
Multilateral development banks	0	9 241	0	0	0	0	673	13 126	0	23 040
Financial institutions	0	11 898	0	0	0	143	799	0	0	12 840
Securitisation	0	128	0	0	0	0	0	0	0	128
Covered bond	0	10 021	0	0	0	0	0	3 837	0	13 858
<b>Total</b>	<b>0</b>	<b>53 184</b>	<b>22 628</b>	<b>0</b>	<b>0</b>	<b>143</b>	<b>15 929</b>	<b>29 414</b>	<b>223 512</b>	<b>344 810</b>

<sup>1</sup> Including loans to municipal sector of NOK 243.1 billion.

Undisbursed loan commitments amount to NOK 7.38 bn as at 31 December 2013.

## Credit exposure by country

### 2013

Time to maturity	< 1 year			> 1 year						Total
	A-3	A-1/A-1+	Not rated	BBB	A-	A	AA	AAA	Not rated	
Australia	0	230	0	0	0	0	578	0	0	808
Belgium	0	959	0	0	0	0	0	0	0	959
Canada	0	649	0	0	0	0	41	0	0	691
Denmark	0	4 208	81	0	0	0	0	3 361	0	7 650
Finland	0	1 366	420	0	0	0	0	456	253	2 495
France	0	9 320	0	0	0	0	3 059	0	0	12 378
Japan	0	419	0	0	0	0	0	0	0	419
Netherlands	0	2 659	0	0	0	0	0	0	0	2 659
Norway	0	2 638	21 672	0	0	143	0	923	221 442	246 818
Austria	0	544	0	0	0	0	0	0	0	544
Spain	0	17	0	0	0	0	0	0	0	17
Supranational	0	9 241	0	0	0	0	673	13 126	0	23 040
Sweden	0	3 074	0	0	0	0	1 133	576	144	4 926
Germany	0	15 080	455	0	0	0	10 445	7 822	1 673	35 475
United Kingdom	0	2 780	0	0	0	0	0	3 150	0	5 931
<b>Total</b>	<b>0</b>	<b>53 183</b>	<b>22 628</b>	<b>0</b>	<b>0</b>	<b>143</b>	<b>15 929</b>	<b>29 414</b>	<b>223 512</b>	<b>344 810</b>

## NOTE 26

### INTEREST RATE RISK

(Amounts in NOK 1 000 000)

Interest rate risk arises as a result of KBN's lending and borrowing activities. The interest rate risk results from differences in the interest rate periods for assets and liabilities, and the fact that cash payments in and out are due at different times. As a part of interest rate risk management, KBN actively buys and sells highly rated securities issued by sovereigns, local authorities, multilateral development banks and financial institutions, and enters into derivatives contracts, mainly FRA contracts and interest rate swaps.

KBN has bond debt and investments in several currencies,

however, all interest rate risk is fully hedged for all currencies except NOK, USD and EUR. The interest rate risk for these three currencies is hedged using interest rate swaps, such that KBN only has remaining exposure to changes in 3 month money market interest rates. Interest rate sensitivity is measured as the change in fair value of assets and liabilities based on a 100 basis point change in interest rates (parallel shift).

The Board has adopted a limit for interest rate risk of NOK 12 million. The interest rate sensitivity is measured assuming 50 days to an adjustment of the floating rate on the lending portfolio. The interest rate sensitivity in the main currencies is presented in the table below:

Effect of 100 bp change in interest rate	Net interest rate risk	Gross interest rate risk
NOK	1.0	1.0
USD	1.2	1.2
EUR	(6.2)	6.2
<b>Total</b>	<b>(4.0)</b>	<b>8.4</b>

The table shows the total effect in the income statement related to the assumed change in interest rates. This comes from a combination of a value change based on fair value measurement, and an effect on Net interest income. For the latter part the interest rate change will impact the Net interest income during the three month period following the rate change.

## NOTE 27

### CURRENCY RISK

(Amounts in NOK 1 000 000)

Currency risk is defined as the risk of loss due to changes in market values based on fluctuations in FX rates. Currency risk arises due to KBN's borrowing being mainly in foreign currency, while lending is in NOK. The bank's risk policy requires hedging

of all currency risk related to assets and liabilities. However, short term net positions related to income statement items in USD and EUR may occur. Currency risk is hedged at both transaction level and portfolio level. The limit for currency risk is set to NOK 12 million for a 10 percent absolute change in all FX rates.

Currency	2014		2013	
	Net position	10 % change in FX-rate	Net position	10 % change in FX-rate
USD	4.5	0.5	16	1.6
EUR	0.9	0.1	5	0.5
Other currencies	4.4	0.4	4	0.4
<b>Total</b>	<b>9.9</b>	<b>1.0</b>	<b>25</b>	<b>2.5</b>

The table above shows an absolute effect in the income statement of a 10 percent change in FX rates relative to NOK. The amount is calculated based on all net positions in foreign currency as at 31 December 2014 and 2013. The sensitivity analysis assumes zero correlation between FX rates and other market risk factors.

## NOTE 28

### LIQUIDITY RISK

(Amounts in NOK 1 000 000)

Liquidity risk is defined as the risk of KBN not being able to meet its commitments and/or finance lending demand without significant extra costs being incurred in the form of reduction in value of assets that need to be sold, or in the form of more expensive funding. Liquidity risk is monitored and managed through the bank's internal control and finance policy. The policy requires that a portfolio of liquidity holdings should be held amounting to over time a minimum of 12 months' net redemptions, and at any time not below 10 months' net redemptions. This implies that the bank in a given situation may cover all its liabilities/payables,

including that related to the lending activities, during the next 12 months without new borrowing. The liquidity portfolio is managed using a conservative investment policy keeping both credit and market risk low. Surplus liquidity is invested in notes and bonds issued by sovereigns, local authorities, multilateral development banks and highly rated financial institutions. A large part of the portfolio matures within 12 months. Further to this liquidity risk is reduced by matching maturities on assets and liabilities. The bank also has a short term funding programme and a credit line with DNB to manage short-term liquidity.

## 2014

Exposure by time to maturity	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	16 219	16 219	0	0	0	0	0
Instalment loans	247 023	4 001	8 284	16 217	19 807	198 715	0
Notes, bonds and other interest-bearing securities	155 305	22 926	25 577	58 101	48 701	0	0
<b>Total assets</b>	<b>418 547</b>	<b>43 145</b>	<b>33 861</b>	<b>74 318</b>	<b>68 509</b>	<b>198 715</b>	<b>0</b>
Loans from credit institutions	25 135	25 135	0	0	0	0	0
Senior securities issued	392 097	14 271	15 278	47 391	274 892	40 265	0
Other liabilities	515	20	225	209	0	0	61
Subordinated debt	1 760	0	0	0	1 760	0	0
<b>Total liabilities</b>	<b>419 507</b>	<b>39 426</b>	<b>15 503</b>	<b>47 600</b>	<b>276 652</b>	<b>40 265</b>	<b>61</b>
<b>Financial derivatives</b>	<b>9 599</b>	<b>5 949</b>	<b>6 952</b>	<b>4 892</b>	<b>(6 982)</b>	<b>(1 212)</b>	<b>0</b>
<b>Net liquidity exposure</b>	<b>8 639</b>	<b>9 668</b>	<b>25 310</b>	<b>31 609</b>	<b>(215 125)</b>	<b>157 238</b>	<b>(61)</b>

## 2014

Exposure by time to interest rate reset	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	16 219	16 219	0	0	0	0	0
Instalment loans	247 023	101 054	89 770	21 438	26 574	8 188	0
Notes, bonds and other interest-bearing securities	155 305	37 656	44 352	35 377	37 920	0	0
<b>Total assets</b>	<b>418 547</b>	<b>154 929</b>	<b>134 121</b>	<b>56 815</b>	<b>64 493</b>	<b>8 188</b>	<b>0</b>
Loans from credit institutions	25 135	25 135	0	0	0	0	0
Senior securities issued	392 097	46 558	82 444	68 811	168 052	26 233	0
Other liabilities	515	20	225	209	0	0	61
Subordinated debt	1 760	0	0	0	1 760	0	0
<b>Total liabilities</b>	<b>419 507</b>	<b>71 713</b>	<b>82 669</b>	<b>69 020</b>	<b>169 812</b>	<b>26 233</b>	<b>61</b>
<b>Financial derivatives</b>	<b>9 599</b>	<b>(64 020)</b>	<b>(62 117)</b>	<b>12 330</b>	<b>106 180</b>	<b>17 226</b>	<b>0</b>
<b>Net liquidity exposure</b>	<b>8 639</b>	<b>19 196</b>	<b>(10 664)</b>	<b>125</b>	<b>862</b>	<b>(819)</b>	<b>(61)</b>

## 2013

Exposure by time to maturity	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	5 257	5 257	0	0	0	0	0
Instalment loans	240 863	3 701	10 577	6 511	18 446	201 627	0
Notes, bonds and other interest-bearing securities	100 616	7 543	17 530	28 410	47 133	0	0
<b>Total assets</b>	<b>346 736</b>	<b>16 501</b>	<b>28 107</b>	<b>34 922</b>	<b>65 579</b>	<b>201 627</b>	<b>0</b>
Loans from credit institutions	3 656	3 656	0	0	0	0	0
Senior securities issued	326 473	844	24 495	44 653	219 703	36 777	0
Other liabilities	662	7	244	225	139	0	48
Subordinated debt	1 569	0	0	0	1 569	0	0
<b>Total liabilities</b>	<b>332 360</b>	<b>4 507</b>	<b>24 739</b>	<b>44 878</b>	<b>221 410</b>	<b>36 777</b>	<b>48</b>
<b>Financial derivatives</b>	<b>(6 354)</b>	<b>743</b>	<b>(814)</b>	<b>(376)</b>	<b>(7 093)</b>	<b>1 185</b>	<b>0</b>
<b>Net liquidity exposure</b>	<b>8 022</b>	<b>12 737</b>	<b>2 555</b>	<b>(10 332)</b>	<b>(162 925)</b>	<b>166 035</b>	<b>(48)</b>

## 2013

Exposure by time to interest rate reset	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	5 257	5 257	0	0	0	0	0
Instalment loans	240 863	90 928	98 527	17 634	27 053	6 721	0
Notes, bonds and other interest-bearing securities	100 616	18 013	36 059	21 973	24 571	0	0
<b>Total assets</b>	<b>346 736</b>	<b>114 198</b>	<b>134 586</b>	<b>39 607</b>	<b>51 624</b>	<b>6 721</b>	<b>0</b>
Loans from credit institutions	3 656	3 656	0	0	0	0	0
Senior securities issued	326 473	26 262	86 800	53 649	139 972	19 790	0
Other liabilities	662	7	244	225	139	0	48
Subordinated debt	1 569	0	0	0	1 569	0	0
<b>Total liabilities</b>	<b>332 360</b>	<b>29 924</b>	<b>87 044</b>	<b>53 874</b>	<b>141 680</b>	<b>19 790</b>	<b>48</b>
<b>Financial derivatives</b>	<b>(6 354)</b>	<b>(63 843)</b>	<b>(69 159)</b>	<b>22 852</b>	<b>90 307</b>	<b>13 490</b>	<b>0</b>
<b>Net liquidity exposure</b>	<b>8 022</b>	<b>20 431</b>	<b>(21 618)</b>	<b>8 585</b>	<b>251</b>	<b>421</b>	<b>(48)</b>

## NOTE 29

### CAPITAL ADEQUACY AND CAPITAL MANAGEMENT

(Amounts in NOK 1 000 000)

KBN's capital consists of share capital, retained earnings, hybrid Tier 1 capital and supplementary capital/subordinated debt. A satisfactory level of capital is seen as necessary for maintaining the AAA-rating and to ensure efficient market competition. The Board assesses the capital level on an ongoing basis and approves KBN's principles for capital management. KBN is subject to the capital adequacy regulations and shall have a sufficient capital level based on its risk profile and the market conditions. The capital management target is operationalised through the Tier 1 capital adequacy ratio and total capital adequacy ratio - the level of Tier 1 and total capital relative to risk weighted assets. KBN's capital status is assessed against risk in a normal market situation and using stress tests. Regulatory requirements for common equity Tier 1 capital adequacy has been set at 10 percent including buffer

requirements. KBN is compliant with all regulatory capital requirements as at 31 December 2014. In order to maintain a sufficient capital level, KBN can, depending on market conditions, reduce or increase its total assets or enter into a dialogue with the owner regarding changing its capital structure by changes in dividend policy or issue of share capital. The common equity Tier 1 capital requirement including buffers increased from 9 to 10 percent from 1 July 2014, and will increase further to 12 percent 1 July 2015, and 13 percent from 1 July 2016. Corresponding to this, total capital requirements including buffers increased from 12.5 to 13.5 percent 1 July 2014, and will increase further to 15.5 percent 1 July 2015 and 16.5 percent 1 July 2016. In addition the countercyclical capital buffer requirement may increase and would in such case affect KBN's capital requirements. The minimum requirements regarding common equity Tier 1 capital and total capital are 4.5 and 8.0 percent respectively. KBN is well capitalised on the reporting date, and is adapting its capital structure to new capital requirements.



	2014			2013		
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Carrying amount	Risk-weighted assets	Minimum capital requirements
<b>Credit risk</b>						
Sovereigns and central banks	14 797	426	34	6 797	218	20
Regional governments and local authorities	307 713	51 105	4 088	287 672	52 485	4 724
<i>Of which are Norwegian municipalities</i>	249 880	51 100	4 088	243 061	52 122	4 691
Public sector entities	16 236	95	8	6 300	30	3
Multilateral development banks	27 114	0	0	23 040	0	0
Financial institutions	65 987	9 869	790	27 789	4 917	443
<i>Of which counterparty exposure on derivatives</i>	27 598	1 857	149	8 153	990	89
Corporates	0	0	0	0	0	0
Claims secured by residential property	48	48	4	53	53	5
Covered bonds	24 438	2 444	196	13 858	1 386	125
Other assets	14	14	1	11	11	1
Securitisation	113	42	3	128	48	4
Credit Valuation Adjustment	160	2 005	160	0	0	0
<b>Total credit risk</b>	<b>456 618</b>	<b>66 047</b>	<b>5 284</b>	<b>365 647</b>	<b>59 147</b>	<b>5 323</b>
<b>Market risk</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Operational risk—Basic Indicator Approach</b>		<b>3 184</b>	<b>255</b>		<b>3 207</b>	<b>289</b>
<b>Minimum capital requirements</b>		<b>69 231</b>	<b>5 538</b>		<b>62 354</b>	<b>5 612</b>
<b>Total capital ratio</b>			<b>14.53 %</b>			<b>14.91 %</b>
<b>Common equity Tier 1 capital adequacy ratio</b>			<b>12.26 %</b>			<b>12.39 %</b>
<b>Tier 1 capital adequacy ratio</b>			<b>12.26 %</b>			<b>12.39 %</b>

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

	2014	2013
<i>Common equity Tier 1 capital</i>		
Share capital	2 145	2 145
Retained earnings previous years	5 700	4 988
Retained earnings current year	491	1 083
Pension funds above pension commitments	0	0
Deferred tax asset*	0	0
Intangible assets	(78)	(34)
Dividends payable	0	(357)
Adjustments in common equity Tier 1 capital based on regulatory filters	232	(97)
<b>Total common equity Tier 1 capital</b>	<b>8 490</b>	<b>7 727</b>
Other approved Tier 1 capital	0	0
<b>Total Tier 1 capital</b>	<b>8 490</b>	<b>7 727</b>
<i>Supplementary capital</i>		
Ordinary subordinated debt	1 571	1 571
<b>Total supplementary capital</b>	<b>1 571</b>	<b>1 571</b>
<b>Total primary capital</b>	<b>10 061</b>	<b>9 299</b>

\*Only non reversing deferred tax asset to be deducted here.

Primary capital has been calculated under the Regulation on the calculation of primary capital for financial institutions. Unrealised gain/(loss) on liabilities that is due to changes in own credit risk include both non-derivative and derivative liabilities.

# 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 2014.

The Control Committee recommends that the annual report and accounts presented be approved as Kommunalbanken's accounts for 2014 and that the application of profits is adopted by the Annual Shareholders' Meeting in accordance with the Board of Directors' proposals.

Oslo, 26 March 2015  
Control Committee for Kommunalbanken AS

Kjell Inge Skaldebo  
*Chair*

Anne-Ma Tostrup Smith  
*Vice Chair*

Ole Rødal

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 2014 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 477,685,593 is adopted by the Annual Shareholders' Meeting.

With reference to KBN's good 2014 results, the Supervisory Board would like to thank KBN management and employees for a job well done.

Oslo, 15 April 2015  
Supervisory Board for Kommunalbanken AS

Svein Ludvigsen  
*Chair*

# AUDITOR'S REPORT

## To the Annual Shareholders' Meeting of 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 2014, the income statement, the statements of comprehensive income, changes in equity and cash flows 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 2014 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 on the statement on corporate social responsibility*

Based on our audit of the financial statements as described above, it is our opinion that the information presented in the Directors' report and in the statement on corporate social responsibility 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, 20 March 2015  
ERNST & YOUNG AS

Eirik Tandrevold  
State Authorised Public Accountant (Norway)

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

# ARTICLES OF ASSOCIATION

The Articles of Association were last changed by the Annual General Meeting 17 June 2014 and approved by the Financial Supervisory Authority of Norway 9 July 2014.

## 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.

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. 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 procuracionem

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, or the vice-chairman of the Board jointly with one of the Board members or the managing director 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 Modernisation 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 Modernisation 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, inter-municipal 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

As of 31.12.2014

## BOARD OF DIRECTORS

Else Bugge Fougner, Chair  
Nils R. Sandal, Vice Chair  
Rune Midtgaard, member (from 17 June 2014)  
Martha Takvam, member  
Nanna Egidius, member  
Rune Sollie, member  
Martin Skancke, member  
Roald Fischer, employee representative  
Marit Urmo Harstad, employee representative (from 17 June 2014)

### *Alternates to the employee representatives*

Jarle Byre  
Kristine Henriksen Lien (from 17 June 2014)

## BOARD PREPARATORY COMMITTEES

### *Audit Committee*

Martha Takvam, Chair  
Nanna Egidius  
Rune Sollie

### *Risk Committee*

Martin Skancke, Chair  
Martha Takvam  
Else Bugge Fougner

### *Compensation Committee*

Else Bugge Fougner, Chair  
Nils R. Sandal  
Rune Midtgaard

## SUPERVISORY BOARD

Svein Ludvigsen, Chair  
Berit Flåmo, Vice Chair  
Alfred Bjørlo, member (from 17 June 2014)  
Rigmor Brøste, member (from 17 June 2014)  
Karen Marie Hjelmeseter, member  
Arne Johansen, member  
Anita Orlund, member  
Bjørn Ropstad, member  
Tore Sirnes, member  
Bjørn Skjelstad, member  
Lene Conradi, member  
Bjørn Ove Nyvik, employee representative

### *Alternates to the supervisory board*

Berit Koht  
Hans Seierstad  
Cecilie Hansen  
Johnny Stiansen  
Torger Magnus Jonassen, employee representative

### *Observers to the Supervisory Board*

Sølvé Monica Steffensen, Director General,  
Ministry of Local Government and Modernisation  
Thor Bernstrøm, Deputy Director General,  
Ministry of Local Government and Modernisation

## CONTROL COMMITTEE

Kjell Inge Skaldebø, Chair  
Anne-Ma Tostrup Smith, Vice Chair  
Ole Rødal, member (from 17 June 2014)

### *Alternates to the control committee*

Roy Jevard

## AUDITOR

Ernst & Young AS  
Eirik Tandrevold, State Authorised Public Accountant

## INTERNAL AUDITOR

KPMG AS  
Are Jansrud, State Authorised Public Accountant

# ORGANISATION

As of 31.12.2014

