# ANNUAL REPORT 2015

Kommunalbanken Norway


PHOTO: Tove Lauluten

## BJØRNSLETTA SCHOOL

Bjørnsletta is a primary and lower secondary school with a multipurpose facilities hall. It is the first school building in Oslo municipality built according to the passive house standard satisfying environmental requirements. In many ways the school sets the future building standard for schools. To the city of Oslo KBN is a substantial source of financing.

# TABLE OF CONTENTS

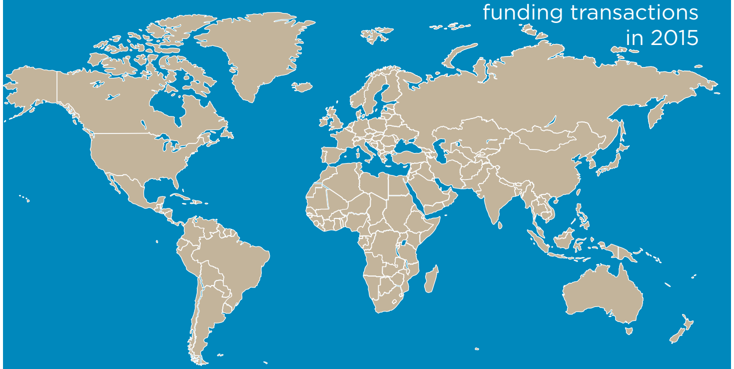
# HIGHLIGHTS 2015

FUNDING FROM
AROUND THE WORLD...

AAA
Highest
possible rating

Norway's third
largest financial
institution

309
funding transactions
in 2015



591
new loans
granted in
2015

98%
of Norwegian
municipalities
are KBN
customers


... OFFERING LONG-TERM FLEXIBLE
FINANCING SOLUTIONS ON
ATTRACTIVE TERMS

Stable

Cost efficient

Long-term

STATE OWNED AGENCY
WITH COST EFFECTIVE OBJECTIVES

Owned by the State
since 1927

KBN's operations cost
three øre in administra-
tion for every hundred
kroner we manage

The KBN staff

Share of
women
46%

Mean
age
42

Other
citizenship
than
Norwegian
8%

# KEY FIGURES

(Amounts in NOK 1 000 000)

| | 2015 | 2014 |
|---|---|---|
| **RESULTS** | | |
| Net interest income | 1 642 | 1 515 |
| Core earnings[1] | 1 043 | 1 026 |
| Profit before tax | 2 583 | 673 |
| Profit for the year | 1 870 | 491 |
| | | |
| Return on equity after tax[2] | 20.84 % | 6.13 % |
| Return on equity after tax (core earnings)[2] | 11.70 % | 12.82 % |
| Return on assets after tax[2] | 0.42 % | 0.12 % |
| Return on assets after tax (core earnings)[2] | 0.23 % | 0.26 % |
| **LENDING** | | |
| New disbursements | 46 757 | 42 680 |
| Outstanding loans[3] | 254 421 | 247 116 |
| **LIQUIDITY PORTFOLIO**[3] | 146 611 | 155 305 |
| **BORROWINGS** | | |
| New long-term borrowings | 68 644 | 116 739 |
| Repurchase of own debt | 2 979 | 1 753 |
| Redemptions | 110 604 | 108 080 |
| Total borrowings[3] | 400 894 | 391 285 |
| **TOTAL ASSETS** | 449 361 | 455 466 |
| **EQUITY** | 12 202 | 8 336 |
| Total capital adequacy ratio | 18.81 % | 14.53 % |
| Tier 1 capital adequacy ratio | 16.53 % | 12.26 % |
| Common equity Tier 1 capital adequacy ratio | 15.09 % | 12.26 % |

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

# CEO'S FOREWORD

## KBN ended 2015 with a sound profit and a significantly improved capital position. This is crucial to KBN's ability to be a long-term partner to the Norwegian local government sector.

"The future is not what it once was" read some graffiti in white capital letters on an apartment block in Oslo. Despite having committed an act of civil disobedience, the graffiti artist had made a valid point. With a few notable exceptions, the outlook for Norway has been stable so far this century. There are now signs that we are entering choppier waters, and we need to prepare for changes ahead.

The rate of growth forecast for the Norwegian economy has been revised down. The low oil price has had a negative impact on petroleum-related industries. At the same time, the weaker Norwegian krone has given a boost to traditional export industries. The divide in the Norwegian economy is increasingly clear.

Norway's population continues to grow more quickly than that of most other European countries. In 2015 the Confederation of Norwegian Enterprise called its annual conference «#7million» to draw attention to how many Norwegians there will be in scarcely a generation. 2015 was also the year in which it really became clear that the flow of refugees to Norway will require significant resources in the future. The need for welfare services increases the more Norwegians there are and the longer we all live.

Municipal reform is coming. In 2016 the main features of the structure of the local government sector will fall into place and we will see a new map featuring fewer municipalities and county authorities start to take shape.

At the same time, Norway is in the process of becoming a low-carbon society. Although this will bring great environmental gains, getting there will require significant investment.

Putting all these factors together, it is clear that the local government sector will continue to have sizeable investment needs in the future. Fortunately we live in a country that has significant room to manoeuvre financially and where economic and monetary policy are actively used to counteract the effects of tougher times. At the same time, the fall in the oil price has brought forward the time when the state's oil revenues are less than the oil money spent as part of the National Budget. With less room for manoeuvre, we need to work smarter. KBN's task is to ensure the local government sector is able to access financing when it needs it at the lowest possible cost. This enables the state to deliver the best possible welfare services for the amount it invests in KBN, and means municipalities can deliver the welfare services that they are legally required to provide.

KBN is committed to prudent financial management at the municipal level as part of our corporate social responsibility. It is for this reason that long-term loans are our main product. The maturity of a loan should be reasonably similar to the lifetime of the investment it finances. More and more municipalities and county authorities are choosing to use the capital markets to finance some of their investments. The capital markets are an important supplement to an instrument of the state such as KBN, but they expose municipalities to greater refinancing risk. Short-maturity loans have to be refinanced often, and changes in the liquidity situation can make borrowers vulnerable to turmoil in the capital markets. In the second half of 2015 the spreads on certificate loans issued by the local government sector widened sharply and quickly.

Despite financial turmoil, both in Norway and the rest of the world, KBN recorded a much better than expected profit in 2015. This shows that our model works well.

A sound profit is important to KBN building its capacity to meet the local government sector's future borrowing requirements. At a time when the banking sector is facing higher capital requirements, strong profits build the equity that KBN needs. Another alternative would be for us to reduce the extent of our lending considerably. In view of the investment needs of the local government sector in the future, this is not a viable course of action.

We finance the welfare services that the local government sector is legally required to provide, and our customer group consists of extremely safe borrowers. However, we are subject to the same regulations as commercial banks, even though they have a completely different risk profile. This is puzzling and means that Norway differs in this respect from many other countries in Europe.

More and more countries in Europe as well as elsewhere in the world are setting up specialised lending institutions for the local government sector because of its need for access to financing on stable and reasonable terms. Banks' own return requirements and the equity requirements set by the authorities mean that traditional banks no longer regard low-margin customers in the local government sector as attractive borrowers. This has led to the borrowing market for municipalities and county authorities becoming dominated ever since the financial crisis by publicly-owned specialist institutions with sectoral policy mandates. In order to differentiate this type of lender that exclusively provides loans to the local government sector from traditional banks in regulatory terms, the authorities in countries such as Finland and the Netherlands have opted to define their institutions that lend to the local government sector as 'promotional banks'. Just like KBN, such promotional banks are 100% publically owned by the authorities in their respective countries, and their lending activities are therefore deemed to be public sector self-financing activities according to the European Commission's interpretation that regulatory adaptations for such banks are not affected by the prohibition against unlawful state aid. The status of promotional banks means such institutions are subject to different regulation, and the result is their customers – the local government sector – can borrow more cheaply.

Kristine Falkgård
President & CEO


Lagunen
211


## THE BERGEN LIGHT RAIL

Since 2010 KBN has helped finance the light rail's three construction stages. The rail, the climate friendly backbone of Bergen's public transport system, has replaced heavy bus lines tempting more inhabitants to leave the car at home.

PHOTO: Paul Sigve Amundsen

# WE FINANCE WELFARE SERVICES

In a world of continuing social change, climate change and reforms, the local government sector will face a continuing requirement for new investment spending financed by borrowing in the years ahead. KBN is committed to continuing its 88-year history of supporting the local government sector by providing long-term financing.

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

KBN IS ABLE TO OFFER FINANCING ON REASONABLE TERMS FOR BOTH SMALL AND LARGE PROJECTS AT SHORT NOTICE.

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 be financed on a long-term basis. Instalment loans with long maturities are therefore KBN's core product. Some municipalities choose instead to arrange financing with much shorter maturities 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.

THE FACTORS DRIVING continued 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. The population composition of Norway is changing. 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 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.

KOMMUNAL RAPPORT, the local government sector's newspaper, reports that 200 of Norway's 428 municipalities were involved in negotiations regarding their future structure at the end of 2015. The 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 on their sources of financing. KBN has always adapted its activities in pace with changes in the local government sector's responsibilities and requirements. This will continue to be the case in the future.


PHOTO: Fullriggeren Sørlandet

## THE TALL SHIP SØRLANDET

«SS Sørlandet» is the world's oldest working tall ship. The 65 meter long three-master was built in 1927 offering maritime skill training. Since then tens of thousands of youths have received their training on board the ship.

Today the tall ship offers a secondary school education. During two years the students will visit 22 countries while at the same time preparing for entrance into the best post-secondary universities and colleges in the world.

Owing to new regulatory requirements, the tall ship's restoration was financed through loans from KBN.

# FUNDING FROM AROUND THE WORLD

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.

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 in the international markets. Its highest possible credit rating (Aaa/AAA) from Moody's and Standard & Poor's creates strong demand for KBN's bonds and ensures that KBN achieves low funding costs.

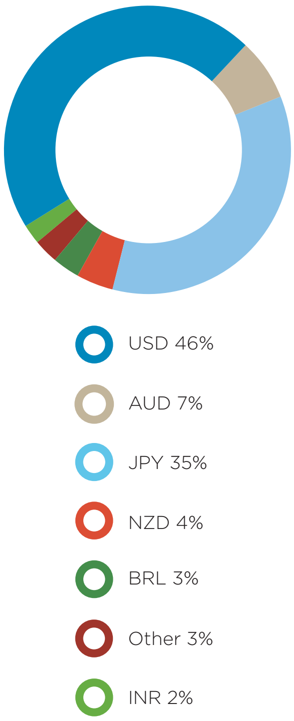
In order to be a stable source of financing for the local government sector, KBN needs to ensure it is not dependent on market conditions in any particular market. KBN's funding program spreads its activities across all continents and between different types of investors - everything from national central banks through to private investors.

KBN has historically raised most of its funding in Japanese yen, US dollars and a range of other currencies.

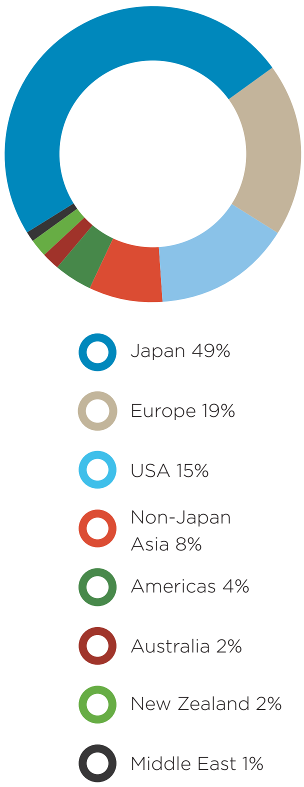
## GREEN BONDS

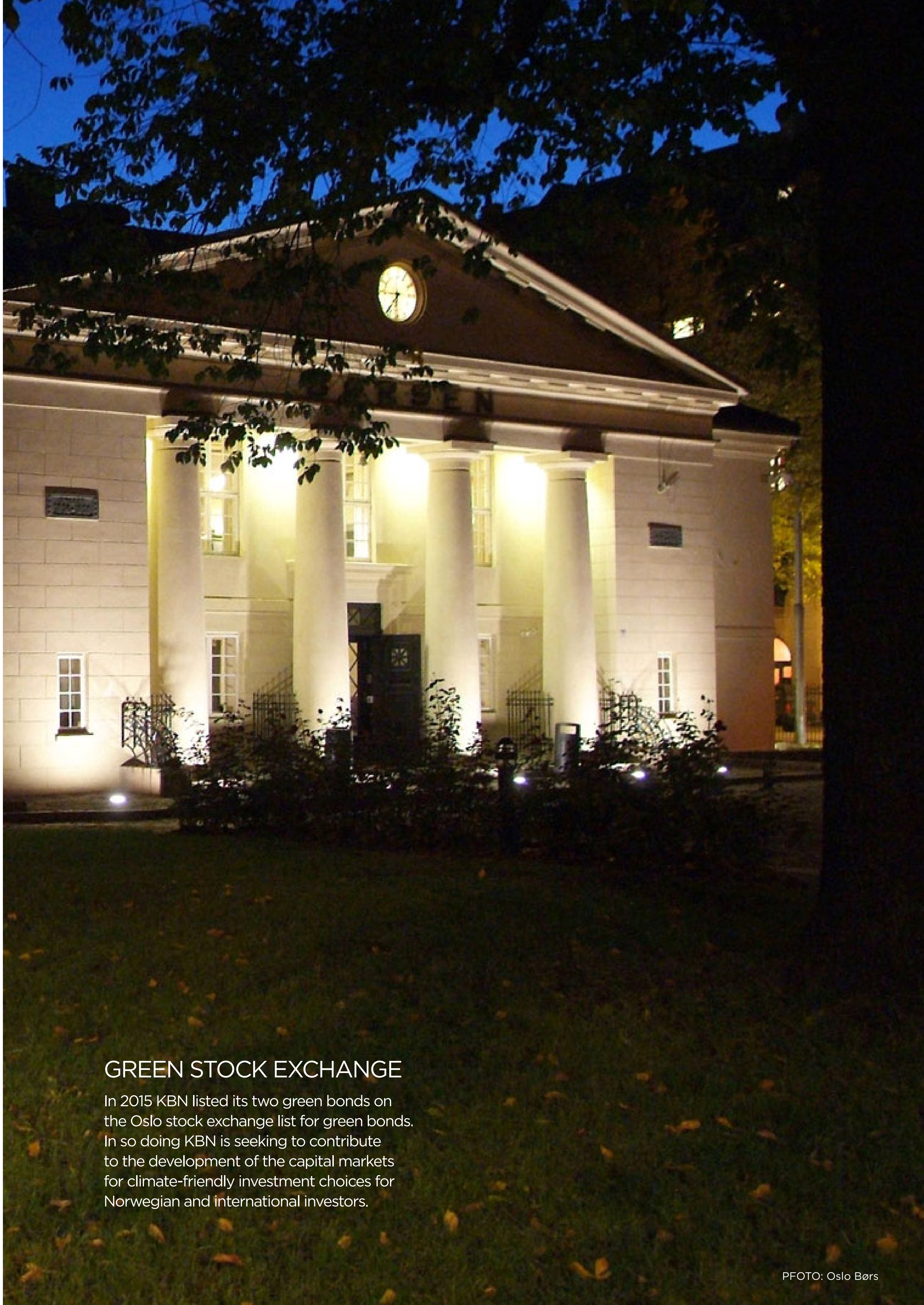
KBN has raised green funding since 2010. In the first couple of years, KBN's green funding targeted Japanese private investors through the Uridashi market. In 2013 KBN became the first Norwegian issuer of green bonds with a USD 500 million issue of 3-year bonds. KBN carried out its second green bond issue in 2015 with a USD 500 million issue of 10-year bonds, and its ambition is to issue green bonds on a regular basis in the years ahead. KBN listed two green bonds on the Oslo stock exchange list for green bonds in 2015. In so doing KBN hopes to contribute to the development of the capital markets for climate-friendly investment choices for Norwegian and international investors.

TOTAL BORROWING 2015
by currencies




TOTAL BORROWING 2015
by investor geography





## GREEN STOCK EXCHANGE

In 2015 KBN listed its two green bonds on the Oslo stock exchange list for green bonds. In so doing KBN is seeking to contribute to the development of the capital markets for climate-friendly investment choices for Norwegian and international investors.

PFOTO: Oslo Børs

FOTO: Torunn Brånå

## ØDEGÅRDEN KINDERGARTEN

Last year some of Oppegård municipality's most recent inhabitants moved into the municipality's most recent building: Ødegården kindergarten. The brick building looks stark from the street, but it contains solutions bringing the building of the future considerable steps closer: The source of warmth and cooling is an energy well in the ground. Through water-borne floor heating and a balanced ventilation system, the energy is distributed in the building.

# THE NORWEGIAN LOCAL GOVERNMENT SECTOR FROM AN INVESTMENT PERSPECTIVE

With the funding it receives as part of one of the richest countries in the world, the Norwegian local government sector is characterised as extremely low risk from an investment perspective. Norwegian municipalities have the resilience to cope with economic downturns as they are able to access stable financing regardless of economic cycles and are subject to strict guidelines on borrowing.

The economic slowdown resulting from the fall in the oil price has therefore so far had little impact on the finances of the Norwegian local government sector. In its role as a provider of financing, KBN contributes to Norwegian municipalities' ability to invest in and deliver important welfare objectives such as schools, health and care services, water and wastewater projects, roads, cultural activities and nurseries.

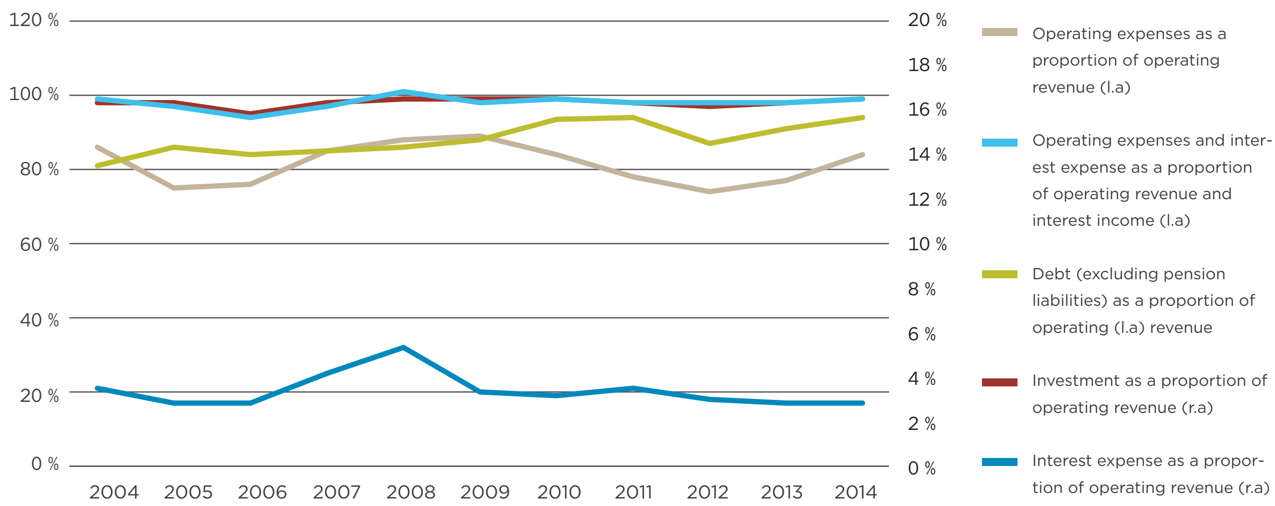
### THE LOCAL GOVERNMENT SECTOR IS SAFE FOR INVESTORS

Norwegian municipalities are extremely low risk from an investment perspective thanks to the funding they receive as part of one of the richest countries in the world. Municipalities have to comply with strict budgetary, accounting and borrowing requirements, which are regulated by the Local Government Act. There are also requirements for what municipalities can finance through borrowing, with this limited primarily to delivering central welfare services, such as education, nurseries and care homes.

The Local Government Act stipulates that municipalities cannot declare themselves insolvent, and if any municipality experiences financial difficulties this is addressed by running a budgeted deficit under close supervision by the state authorities acting through the Ministry of Local Government and Modernisation. This means municipalities are extremely unlikely to experience difficulties in meeting their liabilities. KBN has not incurred a single loss on its lending to the local government sector at any time in the 90 years that it has been in existence. It is consequently difficult to estimate the actual level of risk. What can be said, however, is that the risk of missed payments is extremely low, and on a level comparable to that associated with the safest of government bonds.

Because local government in Norway

KEY FINANCIAL METRICS FOR NORWEGIAN MUNICIPALITIES, 2004-2014.
Source: Statistics Norway



is largely a sheltered sector, with direct transfers from the state forming approximately 60% of its revenues, the sector has so far been little affected by the economic slowdown. So far the sector has been compensated for the reduction in income tax receipts caused by higher unemployment through the direct transfers provided for in the National Budget.

In addition, as the third largest financial institution in Norway by total assets, KBN has been judged to be of systemic importance in Norway and is therefore subject to additional strict capital adequacy requirements. KBN's observance of these capital adequacy requirements serves as an additional buffer between the local government sector's borrowing and KBN's creditors in the capital markets. This reduces the risk associated with the Norwegian local government sector from an investment perspective even further, and the risk of a third party incurring losses as a consequence of loans issued to the local government sector in Norway can consequently be regarded as virtually non-existent. In other terms, there are few safer areas in which to invest.

### ORGANISATION STRUCTURE OF NORWEGIAN MUNICIPALITIES

Municipalities represent the part of public administration that is responsible for taking care of the population's needs at a local level. The level of activity in the local government sector is largely managed by the revenue allocation the Norwegian Parliament sets each year in the National Budget, and the state has to ensure that the responsibilities delegated to municipalities are consistent with the resources they have available. The scope of existing legislation and regulation means that municipalities are themselves responsible for ensuring an effective balance between resource use and service production, subject to the revenue allocation they have available.

The local government sector is responsible for delivering a significant proportion of welfare services in Norway, and the areas for which it is responsible are steadily increasing. Municipalities finance key public welfare schemes such as nurseries, primary schools, primary healthcare services and care for the elderly. The local government sector is therefore a sizeable employer, and in terms of employee numbers accounts for slightly under 20% of workers currently employed in Norway.

The Norwegian government has launched a municipal reform process with the objective of introducing greater delegation of authority and facilitating the creation of stronger municipalities. Norway currently has more comprehensive centralised control of local government authorities than is the case in many other European countries. There has been a trend over many years for this centralised control to become ever more detailed, while at the same time municipalities have taken on significantly more responsibility for welfare services. The government's municipal reforms will enable it to transfer more power and responsibility to municipalities. The purpose of this is to make municipalities more able to meet individual challenges and to promote more efficient resource use so that municipalities can further develop the range of services they offer.

*The article is written by Menon Business Economics for Kommunalbanken.*

## DEVELOPMENTS IN THE LOCAL GOVERNMENT ECONOMY

Norwegian local government authorities have seen annual revenue grow by around 2.6% a year in real terms between 2005 and 2014. This is partly due to strong population growth, which has increased local government tax revenues.

In terms of their proportion of mainland Norway GDP, local government sector revenues have been relatively stable in recent years, and the level of activity has increased in line with increases in revenue. According to the National Budget for 2016, the local government sector's revenue grew in real terms by NOK 9 billion or 2.2% in 2015. Revenue is expected to be NOK 7.3 billion higher again in real terms in 2016. The level of activity in the local government sector has increased at approximately the same rate as its revenue has grown over time. Further revenue growth is expected going forwards, with this helping the local government sector to develop its service offering further.

The level of investment by the local government sector is high as a proportion of its revenue, and investment has increased in real terms over the last two years. Net investment by the local government sector amounted to approximately 14% of the sector's revenue in 2015, with investment in the first six months 1.7% higher than in the same period in 2014. Employee numbers in the local government sector were stable in 2015 relative to 2014.

The Association of Consulting Engineers' 'State of Norway in 2015' report found that there is a significant investment backlog in relation to the local government sector's building stocks. In view of this and the expectation that Norway's population will continue to grow strongly, there are grounds to believe that investment by the local government sector will continue to grow going forwards.

## NORWEGIAN MUNICIPALITIES AND COUNTIES

• Norway is divided into 19 counties (fylker), which are split up into 428 municipalities (kommuner).

• Many municipalities are relatively small. More than half the municipalities (287) are home to fewer than 5,000 people. 12 municipalities have over 50,000 residents.

• The total revenue of the local government sector in 2015 was slightly over NOK 400 billion, up 2.2% in real terms from 2014.

• The local government sector employs approximately one fifth of Norway's workforce.

• The local government sector is responsible for welfare services such as health and care services, education, transport and infrastructure.

• Municipalities and counties are subject to strict central government control, regulation and supervision.

• Municipalities and counties cannot declare themselves insolvent.

# AN UPDATE ON NORWEGIAN ECONOMY

The divide in Norway between the mainland economy on the one hand and petroleum-related industries on the other became increasingly pronounced in 2015. The low oil price had a negative impact on petroleum-related industries, but at the same time contributed to the Norwegian krone weakening significantly. This benefits more traditional export industries such as seafood and manufacturing.

However, due to the central importance of the petroleum industry to the economy, Norway's overall economic performance in 2015 was disappointing, with growth lower and unemployment higher. Yet, despite the weaker performance seen in 2015, the outlook is not entirely bleak. The Norwegian economy is characterised by the country's strong public finances, and expansive fiscal and monetary policy will lessen the negative effects. Higher exports from traditional industries are also creating the expectation that there will be higher investment in the mainland economy going forwards, and many economists are forecasting an upturn from the end of 2016 continuing throughout 2017.

Moderate global economic growth and a low oil price acted as a drag on economic growth in Norway in 2015. In contrast to the trend in recent years, it is now the petroleum-dominated industries that are struggling. The Southern and Eastern Norway regions are now particularly struggling because of this, while more diversified regions that are home to traditional industries are finding market conditions to be more favourable than before.

## UNEMPLOYMENT IS INCREASING, BUT WITH SIZEABLE GEOGRAPHIC DIFFERENCES

The unemployment rate in Norway increased slightly in 2015, moving from an average of 2.8% in 2014 to 3% in 2015. Although unemployment has increased, it continues to be at a significantly lower level than is the case for most of Norway's trading partners. The geographical differences within Norway are now becoming pronounced. The rising unemployment rate is principally due to redundancies and lay-offs in the petroleum sector and related industries, particularly along the coast from the county of Aust-Agder in the south of the country to the county of Møre og Romsdal in the north west. The unemployment rate in other parts of Norway has remained relatively stable, and inland, in Oslo and Northern Norway, unemployment has actually fallen. Many of those who have lost their jobs are highly educated workers who are attractive to other industries. If one compares the number of redundancies and lay-offs with the number of unemployed, the figures indicate that a large proportion quickly find a new job.

## THE NORWEGIAN ECONOMY

Norway is a small, open economy with a highly educated population and extensive natural resources. The Norwegian economy is characterised by long-term stability, and Norway has one of the highest GDP per person in the world.

The Government Pension Fund - Global, commonly known as the Oil Fund, has generated a stable positive return for 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 2.5% of the workforce over the last 10 years. Norway has a high rate of population growth, principally as a result of immigration.

This is benefitting other industries since it is improving their access to a productive, highly skilled workforce. Also, a significant proportion of those losing their jobs are economic migrants who are choosing to return to their country of origin. This reduces the effect of the job losses on the unemployment rate.

## RESIDENTIAL PROPERTY PRICES RISING IN NORWAY , BUT FALLING IN STAVANGER

Residential property prices increased by 5% on average in Norway in 2015. The divide in the Norwegian economy is also affecting residential property price growth. Residential prices rose in Oslo by a full 10% between December 2014 and December 2015. This was partly due to activity levels increasing during this period, but also to underlying structural trends across the country. Norway's population is now rapidly becoming more centralised, and this is coinciding with a low construction rate in many of the areas where demand for housing is the highest. This is putting upward pressure on prices in most metropolitan regions. In contrast, the petroleum-dominated regions are seeing weak or negative growth in residential property prices. Prices fell by over 5% in Stavanger in 2015. Households' lower expectations for the Norwegian economy and their own personal finances will potentially lead to residential property prices growing less strongly going forwards, but lower real interest rates will work in the opposite direction and will potentially generate continued positive price growth.

## GROWTH IN CONSUMPTION

Consumption showed continued growth in 2015, albeit somewhat less strongly during the second half of the year. However, indicators of consumer confidence have fallen, and are now at the same level as during the financial crisis. This, in conjunction with lower real wage growth, means there are grounds to think that the rate of consumption growth will be slower going forwards, but for the moment it is only in the areas around Stavanger that consumption has slowed. The low cost of borrowing will help real disposable household incomes to grow in 2016, which will stimulate consumption growth in Norway.

## WEAK KRONE INCREASING TRADITIONAL EXPORTS

The low oil price has caused the Norwegian krone to weaken, and this has given positive impetus to traditional export industries. One example of this is that the value of fish exports increased markedly in 2015, particularly to European countries. Oil-importing countries are also benefiting from the low oil price. As a result of this, there is increasing demand for more traditional export goods and services from Norway. With the Norwegian krone likely to remain weak going forwards, there is reason to expect that more traditional exports will continue to grow strongly.

## OUTLOOK

The Norwegian economy is adaptable, and is characterised by the country's robust public finances. More expansive fiscal and monetary policy has already provided the economy with some stimulus, and this policy will continue to be actively pursued in the future. The increase in traditional exports is also creating expectations for a higher level of investment in Norway's mainland economy. For these reasons Statistics Norway expects the economic situation to improve towards the end of 2016, with stronger growth in activity and a modest decrease in unemployment.

KEY MACROECONOMIC INDICATORS FOR 2015 AND FORECASTS FOR 2016.
Percentage change from previous year.
Source: Statistics Norway and the Norwegian Labour and Welfare Administration

| | 2015 | 2016 |
|---|---|---|
| Private consumption | 2.3 | 1.5 |
| Public consumption | 2.6 | 3.5 |
| Gross fixed capital formation | -2.7 | 0.6 |
| Mainland Norway | 1.6 | 5.0 |
| Exports | 3.4 | 2.4 |
| Crude oil and natural gas | 2.0 | 0.7 |
| Traditional goods | 5.4 | 4.2 |
| GDP | 1.8 | 1.7 |
| GDP - Mainland Norway | 1.5 | 2.0 |
| Unemployment rate (level as a percentage, Norwegian Labour and Welfare Administration) | 2.8 | 3.0 |
| Consumer Price Index | 2.2 | 2.8 |
| Current account surplus (percentage of GDP) | 8.0 | 7.1 |

# REPORTING ON 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.

KBN bases its corporate social responsibility reporting on the relevant legal requirements, its owner's expectations and an analysis of which areas are of importance.

The Board of Directors of KBN approves KBN's corporate social responsibility report and ensures that all important topics are covered. This includes the associated targets and measures, which are revised annually.

## STAKEHOLDERS

KBN carried out a thorough stakeholder analysis in 2013 in which all managers and employees who are responsible for continuous dialogue with KBN's stakeholders were represented. The analysis was used to map KBN's most important stakeholders, which were identified as its customers, its owner, the authorities, investors and its employees.

Corporate social responsibility was one of several themes considered as part of the Board's assessment of its own work in relation to 2015. The results of this self-assessment led to the Board setting corporate social responsibility as one of four priority areas in KBN's long-term strategy.

KBN presented its strategy and plans for further work in the corporate social responsibility area to its owner in 2015. KBN's plan for 2016 is to further develop and structure KBN's dialogue on corporate social responsibility with its most important stakeholders.

## COLLABORATION PARTNERS

- The International Capital Market Association's (ICMA) Green Bond Principles
- The Municipality of Hurdal, the Sustainable Valley Festival
- Transparency International (TI)
- The Zero Emission Resource Organisation (ZERO)

## PRIORITY AREAS

The Norwegian Accounting Act stipulates that corporate social responsibility reporting is the responsibility of the Board of Directors and that the signed confirmation provided by the Board in relation to the annual report also applies to the corporate social responsibility report. The Norwegian state also expects state-owned companies to "report on their work relating to corporate social responsibility, including significant challenges, objectives and indicators of goal achievement".

The White Paper on Ownership Policy (White Paper No. 27, 2013-2014) sets out the corporate social responsibility reporting duties of state-owned companies in more detail, with the Government expecting state-owned companies to provide information in relation to four key thematic areas: climate and environment, human rights, employee and worker rights, and anti-corruption.

KBN's activities are limited to office operations located in central Oslo.

## KBN'S APPROVED GUIDELINES FOR CORPORATE SOCIAL RESPONSIBILITY

| *Document* | *Approved* | *Approved by* | *Area covered:* |
|---|---|---|---|
| Supplementary Money Laundering Guidelines | 2015 | CEO | Money laundering |
| General Diversity and Equality Guidelines | 2015 | The Board of Directors | Gender balance, manager recruitment, anti-discrimination |
| Code of Conduct | 2011/2014 | The Board of Directors | General principles for ethical conduct, discrimination, harassment, bullying, conflicts of interest, secondary employment, relationships with customers and suppliers, inside information, money laundering, corruption, reporting, whistleblowing, gifts and other benefits, personal trading, substance abuse. |

KBN's corporate social responsibility priority areas are based on its size and the nature of its activities. The Board of Directors decided that the priority areas for KBN's corporate social responsibility efforts for 2015 would be as follows:

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

## CLIMATE AND ENVIRONMENT

KBN's carbon footprint is limited. There is consequently limited potential to improve KBN's emissions and energy consumption. However, due to our funding and lending activities we are well positioned to make a difference in relation to climate change and the environment. Issuing green bonds and providing funding for green projects represent an increasingly important part of KBN's core activities.

KBN offers a separate lending product designed to encourage municipalities to undertake climate-friendly investment projects. The 'green floating interest rate' on this product is lower than KBN's ordinary floating rate. KBN's portfolio of green loans increased from NOK 10.7 billion to NOK 12.2 billion in 2015. KBN worked systematically in 2015 on assessing whether to strengthen its green lending program. As a result of this work we are keen to offer a new, green floating interest rate product to municipalities and to improve our environmental impact reporting activities for investors in 2016.

Our objective is not for the lower rate to be a bonus for projects that have already been planned, but for it to be a tool considered during the design phase. In order to achieve this, municipalities' finance departments and procurement departments need to be aware that green loans are an option. We ran several publicity campaigns advertising the green floating interest rate product in 2015, and have increased the product's visibility on our website. We participated with stands and distributed information on the green lending product at the annual conferences of Norwegian Water and Waste Management Norway. Investment in energy and climate projects by the local government sector was also a theme of the last edition in 2015 of KBN's customer magazine, KBN-dialog, and particular attention was devoted in the edition to projects that qualified for the green floating rate. In addition, we co-organised a breakfast seminar on local government policy with the Zero Emission Resource Organisation (ZERO) at Zerokonferansen, the organisation's annual conference.

KBN became the first Norwegian issuer of green bonds in 2013. KBN carried out its second green bond issue in 2015 with a USD 500 million issue of 10-year bonds. Both issues were listed on the Oslo stock exchange list for green bonds in 2015. KBN hopes this will help raise the profile of climate-friendly investment choices among Norwegian and international investors.

The framework for KBN's green bonds is assessed by CICERO. This framework was revised at the start of 2016. KBN plans to be a regular issuer of green bonds in the future in order to finance municipal climate and energy-related projects, and also intends to provide reporting information to assure investors that when their funds are lent to our customers they are used for climate-friendly investment 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. KBN's office premises provide good opportunities for efficient energy use and scored a 'C' rating for energy efficiency. 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. Sound waste management is a priority and measures to ensure food waste is separated out were implemented in 2015, with KBN now achieving a sorting rate of 76.2%.

KBN is aware of its responsibilities in relation to procurement, and strives to select goods and services with the smallest possible impact on the climate and environment. The proportion of KBN's suppliers that are environmentally certified continued to increase in 2015, and we intend to increase this further in 2016.

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.

## ETHICAL CONDUCT AND ANTI-CORRUPTION

Employees and managers were provided with training in ethical issues in 2015 in order to raise awareness and ensure high ethical standards. An ethics program was run for employees during the course of the year. External speakers focused on the risk of corruption in the local government sector, financial crime in the finance sector, and bribery in Norway. KBN's employees also took part in a half-day workshop on identifying situations throughout the entire value chain of KBN's activities in which there might be a risk of corruption and money laundering. The ethics program concluded with an e-learning course on personal benefits.

In addition to the above, employees were provided with regular dilemma training sessions in relation to ethical problems. KBN also produced and implemented new guidelines in relation to money laundering. KBN's objective for 2016 is to further develop the ethical conduct and anti-corruption area by strengthening its collaboration with Transparency International.

## SOCIETY, DIVERSITY AND EQUALITY

KBN's Board of Directors approved general guidelines on diversity and equality in 2015. The Board is of the view that explicit targets and systematic work to promote diversity and equality help create an attractive workplace and a working environment that is conducive to greater value creation for KBN.

KBN works in a targeted and systematic way on diversity and equality across the organisation, and is following up on its targets with specific measures in its activity plans for 2016. Its work to promote diversity and equality is a fundamental part of its recruitment of new employees, its development of managers and employees, and its succession planning. KBN's objective is to achieve a good gender balance at all levels and within all units, with an overall gender balance target of 40%.

## PERFORMANCE

The table below presents the measures and targets for 2015 as well as information on the extent to which KBN achieved the targets.

## AREA 1: ETHICAL CONDUCT AND ANTI-CORRUPTION

| *Target* | *Target indicator* | *Measure* | *Achievement status* |
|---|---|---|---|
| Train managers and employees in ethical issues. | Number of participants at workshop.<br><br>Familiarity with Code of Conduct as revealed by questionnaires. | Ethics month with talks and a workshop for all employees.<br><br>Systematic self-reporting of gifts/ other benefits given or received.<br><br>Emphasise KBN's Code of Conduct in the introductory program for new employees. | The 2015 ethics program was carried out, which consisted of:<br>• Talks by external speakers (corruption in the Norwegian local government sector, financial crime in the banking and finance sector, internationally and in Norway).<br>• 88% of KBN employees completed a special e-learning program on ethical issues.<br>• All business areas identified areas where KBN may potentially be exposed to corruption and money laundering.<br><br>Systematic reporting introduced. |
| Continue work to integrate KBN's vision and values into the organisation. | The proportion of employees who think KBN abides by its values: open, responsible and engaging.<br><br>Individual compliance with these values as a KBN employee. | Introduce values as separate criteria for evaluating employees.<br><br>Highlight KBN's values on digital communication platforms.<br><br>Raise profile of KBN's vision.<br><br>Separate hand-out for all employees explaining KBN's corporate values. | The 2015 employee survey revealed that the proportion of employees who think KBN abides by its values increased from 64% in 2014 to 66% in 2015.<br><br>Individual performance targets in relation to values have been defined for all employees. |
| Increase awareness of corruption and minimise the risk of KBN being linked to corruption. | | Run an anti-corruption day for all KBN employees.<br><br>Further develop KBN's collaboration with Transparency International.<br><br>Continue work on mapping the risk of corruption in central business processes.<br><br>Report on anti-corruption and money laundering efforts in activity report submitted to Board. | The 2015 ethics program and several talks addressed anti-corruption and money laundering.<br><br>KBN has altered its guidelines on measures against money laundering and its procedures for carrying out checks on customers.<br><br>Material from Transparency International was used in an internal workshop on corruption. |

## AREA 2: CLIMATE AND ENVIRONMENT

| *Target* | *Target indicator* | *Measure* | *Achievement status* |
|---|---|---|---|
| Separate interest rate product for climate-friendly investments by municipalities. | Proportion of lending portfolio represented by green loans. | Market KBN's green loan product. | Proportion of lending portfolio represented by green loans increased from 4.3% to 4.8% in 2015. |
| Increase knowledge surrounding KBN's green floating interest rate product. | Marketing activities to increase visibility of KBN's green floating interest rate product.<br><br>Participation in conferences and seminars. | More advertising for the green floating interest rate product.<br><br>Attend at least two important Norwegian climate conferences.<br><br>Work more closely with an organisation that holds conferences at which the climate, the environment and sustainable development are central topics. | The advertising budget for the green floating interest rate product increased in 2015.<br><br>KBN started to work more closely with the ZERO environmental foundation in 2015. KBN co-organised a breakfast seminar with ZERO on how the local government sector can contribute to the green shift.<br><br>KBN was also one of the sponsors of a sustainability conference in Hurdal at which it also had a stand and distributed information material. |
| Issue green bonds. | Proportion of funding portfolio represented by green bonds. | New green bond issue in 2015. | KBN carried out a USD 500 million issue of 10-year green bonds.<br><br>KBN's green bonds were listed on the Oslo stock exchange list for green bonds. |

| | | | |
|---|---|---|---|
| Environmentally friendly operations at KBN. | As KBN is Eco-Lighthouse certified, it produces a separate environmental report each year in which it describes its performance on its measurement criteria. | Renew KBN's Eco-Lighthouse certification.<br><br>Targets as described in 2015 environmental report. | KBN again achieved Eco-Lighthouse certification in 2015.<br><br>The proportion of KBN's suppliers that have environmental certification increased in 2015.<br><br>KBN's waste sorting rate was 76.2% following the introduction of a food waste sorting scheme.<br><br>Video conferencing equipment installed and used regularly. Increasing usage depends on how soon KBN's financial counterparties acquire equivalent equipment. |

## AREA 3: SOCIETY, DIVERSITY AND EQUALITY

| *Target* | *Target indicator* | *Measure* | *Achievement status* |
|---|---|---|---|
| Increase awareness of KBN's corporate social responsibility externally and at KBN itself. | Information from the employee survey. | Set up a project in the corporate social responsibility area in 2015. | KBN's executive management selected the criteria for the type of projects KBN can become involved with in the corporate social responsibility area. All employees were invited to propose specific organisations.<br><br>Work has started but was not complete by the end of 2015, so a project in the corporate social responsibility area will be chosen in 2016.<br><br>The 2015 employee survey revealed that there was less awareness of KBN's strategy, including its corporate social responsibility, than is desirable. Measures to communicate KBN's strategy and raise the level of awareness, including a new intranet, were implemented. |
| Have a strategy and measures in place to increase diversity among employees and managers and avoid discrimination on the basis of considerations such as ethnic background, functional disability or gender. | Proportion of employees from non-Nordic backgrounds.<br><br>Gender distribution at management level and on KBN's governing bodies. | Maintain or increase proportion of employees from non-Nordic backgrounds.<br><br>Gender balance target of 40% for all levels of management and on all governing bodies.<br><br>Ensure quality, diversity and equal treatment during recruitment process.<br><br>Specific measures identified and included in KBN's 2016 activity plans. | The Board's work on diversity and equality is expressed through its general guidelines and the measures included in its 2016 activity plans.<br><br>The guidelines stipulate a gender balance requirement of 40% across KBN as a whole and set this as an ambition for all units and levels. The guidelines also prescribe further requirements to be followed in relation to recruitment, personal development and remuneration, and succession planning.<br><br>The proportion of women at KBN in 2015 was: Board 44%; CEO and executive management 43%; Level 3 management 33%; all employees 46%. 8% of employees do not hold Norwegian citizenship and come from a total of six different countries. |
| Have strategies and measures in place in order to recruit, develop and retain talented employees. | | All employees to have a personal development plan. | The KBN Talent program will support employees during the three phases of employment: 1) recruitment, 2) manager and employee development and 3) succession planning.<br><br>From 2016 all employees must have a personal action plan that is an extension of KBN's activity plan. Each action plan must contain a personal development plan for the employee. |

# THE BOARD OF DIRECTORS' ANNUAL REPORT 2015

Kommunalbanken Norway's (KBN's) vision is to be a long-term partner to the local government sector and its financing of local welfare. Thanks to its low borrowing costs and efficient operating base, KBN is able to offer the local government sector long-term flexible financing solutions on attractive terms. KBN granted 591 new loans totalling NOK 46.8 billion in 2015.

KBN's lending grew by 3.0% in 2015, which is in line with 2014. Lending for climate and environment projects increased by 12.0% in 2015.

Profit for the year was NOK 1,870 million in 2015 as compared to NOK 491 million in 2014. Net interest income was stable and satisfactory, and was in line with 2014. KBN's profit for the year was also influenced by unrealised losses of NOK 734 million incurred in 2014 reversing to give a total gain of NOK 1,116 million in 2015. KBN's return on equity after tax was 20.8% as compared to 6.1% in 2014.

KBN's equity increased by NOK 3.9 billion in 2015 due to its better-than-expected profit for the year, a share capital increase and an additional Tier 1 capital instrument issue.

KBN listed two green bonds on the Oslo stock exchange list for green bonds in 2015. In so doing KBN is seeking to contribute to the development of the capital markets for climate-friendly investment choices for Norwegian and international investors.

KBN is Norway's third largest financial institution by total assets. KBN, DNB and Nordea were classified as systemically important financial institutions in 2014 and a special additional capital buffer requirement of 1% was introduced with effect from July 2015, with this increasing to 2% from 1 July 2016.

KBN had total assets of NOK 449.4 billion at 31 December 2015 and its loans to Norwegian municipalities and county authorities totalled NOK 254.4 billion. Its liquidity portfolio is primarily denominated in foreign currencies, and at 31 December 2015 was NOK 146.6 billion, down from NOK 155.3 billion at the end of 2014.

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 2015) 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 2015 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 was NOK 1,870 million in 2015 as compared to NOK 491 million in 2014. Net interest income in 2015 totalled NOK 1,642 million, as compared to NOK 1,515 million in 2014. The margins on KBN's lending portfolio and on its investments in the liquidity portfolio were stable throughout 2015.

Net unrealised gains on financial instruments increased profit before tax by NOK 1,116 million in 2015. In 2014, net unrealised losses on financial instruments reduced profit before tax by NOK 734 million. The gains in 2015 were principally due to increased turmoil in international capital markets and the effect of this on credit spreads. As a result of this KBN has unrealised gains on outstanding senior securities issued with lower credit spreads.

Net trading income (from market transactions such as repurchasing KBN's own bonds and selling securities held in the liquidity portfolio) totalled NOK 6 million in 2015, as compared to NOK 39 million in 2014.

Total operating expenses in 2015 were NOK 151 million as compared to NOK 123 million in 2014. Approximately half the increase is due to non-recurring costs associated with migrating to a new finance system. The other half mainly relates to costs associated with an increase in employee numbers which was required as a consequence of various regulatory requirements, KBN's status as a systemically important financial institution, and increased requirements related to internal control and reporting activities. Total operating expenses represented 0.03% of total assets in 2015.

KBN had total assets at 31 December 2015 of NOK 449.4 billion as compared to NOK 455.5 billion at 31 December 2014. The decrease is due to a reduction in the size of the liquidity portfolio towards the end of 2015.

KBN's total primary capital at 31 December 2015 was NOK 12,950 million, NOK 10,385 million of which is total common equity Tier 1 capital. KBN's Tier 1 capital consists of share capital, retained earnings and additional Tier 1 capital. The common equity Tier 1 capital adequacy ratio at 31 December 2015 was 15.09%, the Tier 1 capital adequacy ratio was 16.53%, and the total capital ratio was 18.81%.

## LENDING

KBN granted 591 new loans in 2015 totalling NOK 46.8 billion. Total lending to the local government sector at the end of 2015 was NOK 254.4 billion. KBN's loan portfolio grew by NOK 7.3 billion in 2015, representing an increase of 3.0% relative to 2014. KBN's market share for the sector was approximately 45%, as compared to 47.5% in 2014.

KBN adapted its lending activities in 2015 to the higher capital requirement that it will have to meet from 1 July 2016. As part of its liquidity and balance sheet management KBN holds a limited portfolio of short-term bonds. The size of this portfolio decreased in 2015.

All Norwegian county authorities and 98% of the country's 428 municipalities, as well as Longyearbyen Local Council, had loans from KBN at the end of 2015. In addition, a range of municipal and inter-municipal companies have loans from KBN. Loans to limited liability companies require municipal or county guarantees, principally in the form of an unconditional guarantee of payment. KBN offers the same interest rate terms to all its borrowers regardless of their size, thereby ensuring all municipalities have equal access to competitive financing terms.

Demographic changes, government initiatives and a maintenance backlog are contributing to the local government sector continuing to have high investment requirements. These factors caused borrowing by the sector to continue to grow in 2015 at approximately the same rate as in previous years. Borrowing by the sector grew by 7.7% in 2015, which is slightly lower than in previous years. A large proportion of the new loans made in 2015 were ultimately used for schools, nurseries, care homes and water, wastewater and sanitation (WWS) projects.

KBN had granted loans totalling NOK 27.8 billion to toll road companies with municipal guarantees by the end of 2015. Lending to toll road companies increased by NOK 2.7 billion in 2015 due to new projects being started and to back-end financing for already finalised projects.

To ensure good customer relations, KBN held a range of customer meetings and regional seminars on topical themes related to local government financing. KBN provides borrowers with electronic tools which provide access to real-time financial information on the internet, direct access to each municipality's own loan portfolio via its website and a loan administration solution that municipalities can use as a tool for liability management. Work on improving the functionality and user-friendliness of these tools was started in 2015, with the launch due to take place in 2016. The new solution will meet customers' increasing reporting requirements and will offer better support for financial management.

As in previous years, KBN experienced no loan losses in 2015. No losses resulting from defaults or problems with payment are expected in 2016.

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 seven such contracts in 2015.

## THE LENDING MARKET

The market in which KBN operates is very competitive in nature, with direct financing from the certificate loan and bond market increasing.

The increasing use of capital market financing implies that the time to maturity of the sector's total debt will decrease over time. Approximately 20% of outstanding local government debt will mature in 2016, and this proportion is increasing. The more the sector uses short-term financing, the more it is vulnerable to imbalances between supply and demand in the capital markets.

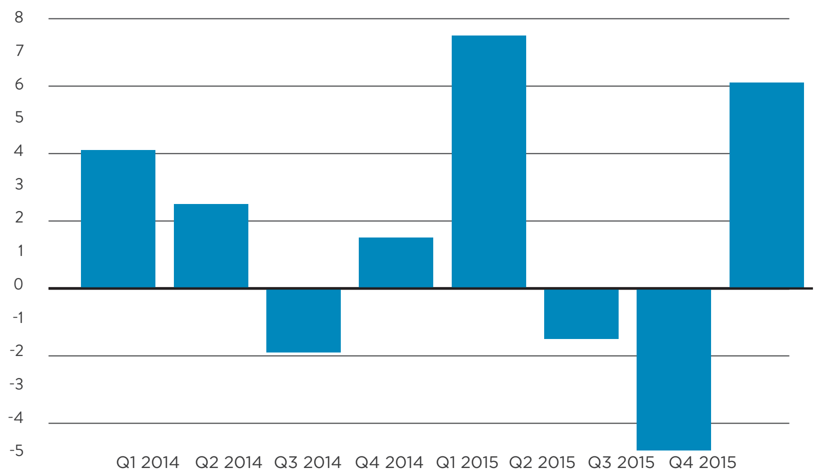
KBN is market-oriented and provides long-term, flexible financing solutions adapted to its customers' demands and requirements. KBN's aim is to contribute to the provision of robust but simple financing solutions and responsible debt management to ensure the sector's borrowing patterns are financially sustainable.

Credit spreads in the capital markets widened in 2015, and the effect of this on local government debt securities was seen particularly in the second half of the year. One major reason for this was the turmoil in the financial markets internationally, which affected borrowers in the capital markets, both in Norway and elsewhere. Marked and sharp increases were occasionally seen in the credit spreads on short-term debt issued by Norwegian municipalities and county authorities. These developments can be regarded as a consequence of the strong increase over a short period of time in the volume of outstanding short-term certificate loans issued by the local government sector.

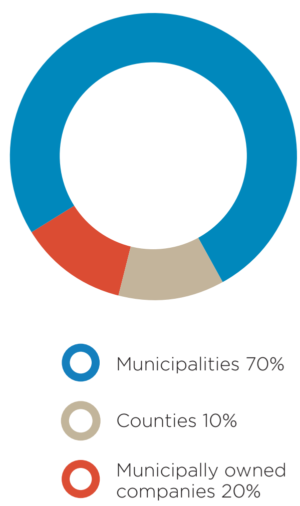
## GREEN LENDING AND GREEN FUNDING

KBN is committed to helping Norwegian municipalities achieve their climate targets. It therefore offers a separate green floating interest rate product specifically to finance

LENDING GROWTH 2014- 2015
(amounts in NOK billion)




LOAN VOLUME 2015
by type of borrower



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 12.0% in 2015, and at the end of 2015 the volume of outstanding loans in this category was NOK 12.2 billion. Investment in the WWS area, energy reduction measures and a drive to increase the use of public transport are examples of projects financed using the green floating interest rate product in 2015.

There is increasing demand globally for socially-responsible investments and projects that benefit the climate. KBN has its own green borrowing program and again issued green bonds in 2015. In order to reassure investors that KBN's green bonds finance climate-friendly investments, the Center for International Climate and Environmental Research – Oslo (CICERO) independently assesses KBN's policy framework for green lending. KBN will develop its green lending framework going forward to include a specific measure of the carbon footprint of each project. KBN will also include emission reduction information when reporting on our green bonds.

In 2015 Oslo stock exchange became the first stock exchange in the world to launch a separate list for green bonds. KBN listed two green bonds on the Oslo stock exchange list for green bonds in 2015. In so doing KBN is seeking to contribute to the development of the capital markets for climate-friendly investment choices for Norwegian and international investors.

## FUNDING

KBN has the highest possible credit ratings of AAA/Aaa. KBN's high creditworthiness is a result of its long-term state ownership, its sectoral-policy role as an instrument of the state, Norway's solid fiscal position, the low risk of lending to the Norwegian local government sector and KBN's low financial risk.

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 68.6 billion in 2015, which is NOK 48.1 billion less than in 2014. KBN's liquidity was satisfactory throughout 2015, and it therefore had less need to raise funding. KBN's access to funding is well diversified, with KBN borrowing more in the Japanese market than in any other single market. KBN issued bonds in 11 currencies in 2015, including two benchmark bonds totalling USD 2.0 billion.

KBN's total borrowings increased in 2015 from NOK 391.3 billion to NOK 400.9 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.

KBN's liquidity portfolio is primarily held in foreign currencies. Following the continued weakening of the Norwegian krone in 2015, the value of the liquidity portfolio at 31 December 2015 was NOK 146.6 billion, down from NOK 155.3 billion at the end of 2014.

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 both 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. KBN had a liquidity coverage ratio (LCR) of 1,418% at the end of 2015.

## 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. KBN is organised as a limited liability company 100%-owned by the Norwegian state. In its White Paper on Ownership Policy[1], the Government classified KBN as a 'Category 3' entity, which is to say an entity with commercial objectives and other specifically defined objectives that define the purpose of the state's ownership of it.

In the State Ownership Report 2014, KBN's sectoral-policy function is described as follows:

*«KBN offers long-term cost-efficient financing of municipal welfare investments with the same interest rate terms, independent of the size of the loan or the municipality. This is an expression of the institution's sectoral-policy function and is the core of KBN's corporate social responsibility.»*

According to KBN's Articles of Association, its 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»*. Changes to KBN's Articles of Association are decided by the Annual General Meeting and must be approved by the Financial Supervisory Authority of Norway (Finanstilsynet).

As owner, the state determines KBN's capital structure, the size of dividends paid and the target capital return for KBN.

The objective of the state's ownership of KBN is to facilitate the availability of financing for the local government sector, and at the same time KBN is to target a satisfactory return on paid in capital for the state[2]. The target return is set in the National Budget for a three-year period, with the return for the 2016-2018 period having been set at 8%.

The objectives set for KBN state that its important functions include ensuring the markets used to finance the local government sector are efficient, compensating for any effects of market deficiencies and ensuring that municipalities have access to financing even when market turmoil reduces the capacity available in the capital markets. KBN offers long-term cost-efficient financing for municipal welfare investments with the same interest rate terms regardless of the size of the loan or municipality, and this is an expression of KBN's sectoral-policy function.

KBN's governing bodies are organised in accordance with the provisions of the Norwegian Public Limited Liability Companies Act and the Financial Enterprises 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

1 Diverse and Value-Creating Ownership (White Paper No. 27 2013-2014)

2 Prop. 1 S(2015-2016) i.e. the National Budget Proposition No. 1 (2015-2016)

made, and it also appoints a state-authorised public accountant to act as auditor and approves the mandate for the Control Committee. The Control Committee's role is to supervise KBN's activities, including the work of the Board of Directors.

The Board of Directors is responsible for the management of KBN's activities, which includes appointing the CEO, approving the mandate for the CEO, decisions on borrowing 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 and whose members are elected by and from amongst its own members, namely the Audit Committee, the Risk Management Committee, and the Remuneration Committee.

The CEO is responsible for running KBN on a day-to-day basis in accordance with the mandate issued by the Board of Directors and approved by the Supervisory Board. The Risk Management department has overall responsibility for risk management at KBN. The Chief Risk Officer reports to the CEO, but has a direct reporting line to the Board of Directors in accordance with Section 47.3 of the Norwegian Capital Requirements Regulations. The Staff and Support department is responsible for internal control and compliance. The Head of Compliance has a direct reporting line to the CEO and also to the Board of Directors for material breaches of compliance.

## THE BOARD OF DIRECTORS' STATEMENT ON EXECUTIVE REMUNERATION

The Board of Directors produces a statement and proposed guidelines on the remuneration of senior executives for the Annual General Meeting. The statement and information on the remuneration paid to each senior executive are provided in Note 6 of KBN's financial statements on page 50 in this annual report.

## RISK MANAGEMENT AND INTERNAL CONTROL

The purpose of risk management is to ensure that KBN manages its assets and liabilities responsibly as well as maintaining the highest possible credit rating. The Board of Directors has established a risk appetite and risk tolerance framework for KBN and within this framework sets financial policies and risk limits each year, including policies and limits relating to KBN's operational 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.

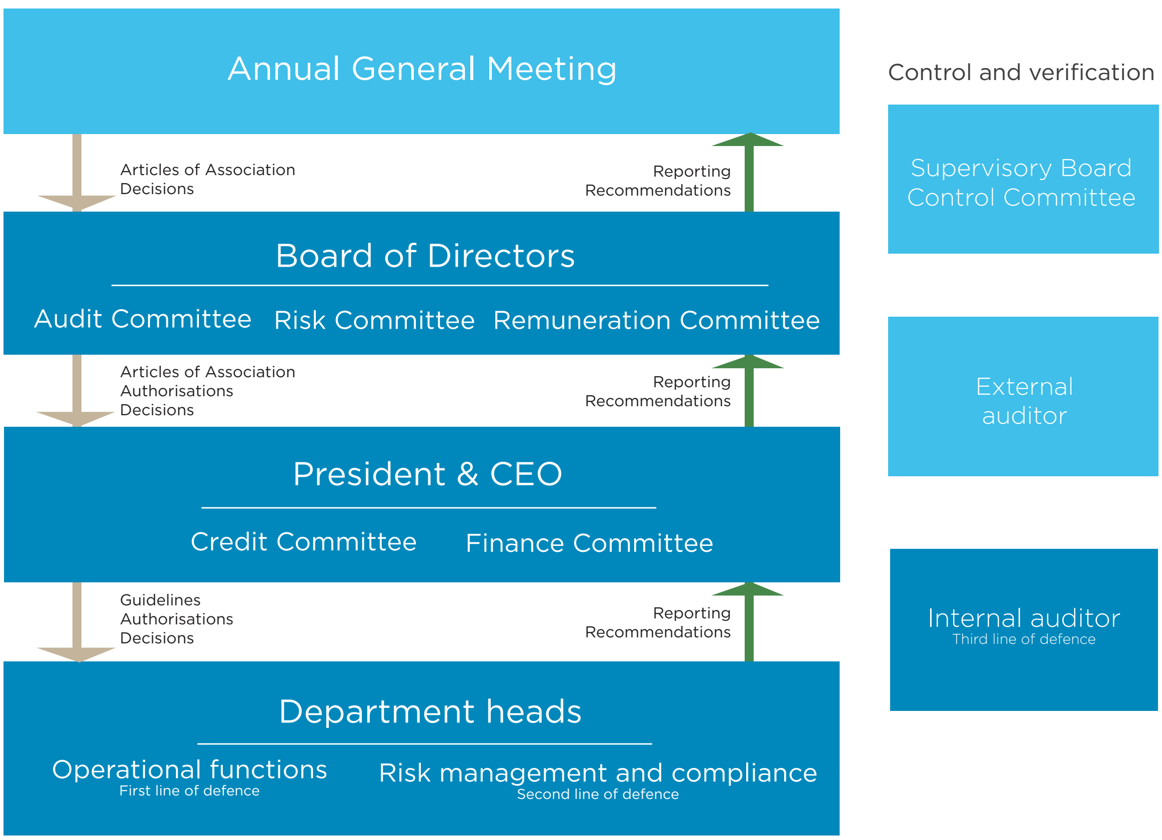
The Board of Directors is regularly informed of KBN's activities, financial position and earnings situation. The Board considers the management's assessment of risk and adverse events on a quarterly basis, with this forming an integral part of KBN's activity reporting processes.

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 and advising the Board on them.

The Risk Management Committee's role is to help the Board of Directors oversee and manage the overall level of risk at KBN by preparing issues related to this area and advising the Board accordingly. The Board sets KBN's risk appetite and defines quantitative limits for the various types of risk in the policies it sets.

The Remuneration Committee's role is to prepare issues related to remuneration and to advise the Board. Its overall function is to independently assess the

## KBN GOVERNING BODIES



company's remuneration schemes and to improve the Board's management of all matters related to remuneration.

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.

Risk management and internal control offer three lines of defence. KBN's operational activities represent the first line of defence and are responsible for monitoring and controlling whether KBN's activities are carried out within the approved limits. The risk management and compliance functions represent the second line of defence, with both serving to support the first line of defence by assisting with advice and facilitating appropriate methodology. They also, however, are independent control functions to monitor compliance with the approved risk limits and whether internal control at KBN is functioning satisfactorily. The internal auditor represents the third line of defence, and serves to provide independent confirmation to the Board.

*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 Board has a very limited risk appetite with regard to liquidity management, the purpose of which is to ensure sufficient liquid assets to cover KBN's ongoing liabilities at any point, including to meet all liabilities arising during a subsequent 12-month period without new borrowing. The liquidity portfolio is subject to requirements in respect of the minimum ratings, concentration, range of instruments and maturities permitted. Furthermore, liquidity management is designed with an emphasis on compliance with capital adequacy requirements, including liquidity coverage ratio requirements.

*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. Hedging transactions are entered into to avoid interest rate and currency risk, and KBN is only willing to accept low credit risk in relation to counterparties to derivatives transactions.

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 by the activity reports and extended market updates that it receives.

*Operational risk* is managed 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, monthly adverse event reports and annual assessments of internal control.

## CORPORATE COMMUNICATIONS 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. The Government has expressed its policy on ownership in White Paper No. 27 (2013–2014) «Diverse and Value-Creating Ownership», and this forms part of the Government's expectations for KBN.

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. In 2015 KBN particularly emphasised the importance of a prudent approach to borrowing by the local government sector in its external communications.

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 2015, some independently and some in partnership with other parties that work in the local government sector.

KBN held its annual conference in April 2015, the theme of which was the future of welfare. How future welfare services will be financed was also the theme of a panel discussion that KBN hosted at the Arendalsuka conference in August 2015. The main target audience for the events KBN arranged was, in addition to customers for KBN's lending products, 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 for the local government sector. Increasing KBN's visibility in digital media was a priority area in 2015. The purpose of this was to improve the level of contact KBN has with its target audiences, increase the level of understanding of the role KBN plays in society, and to drive more traffic to its website. The number of users of KBN's website increased in 2015 to 100,000 from fewer than 50,000.

## ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

Principle 10 of the Government's White Paper No. 27 on Ownership Policy (2013-2014) states that state-owned companies *«shall work systematically to fulfil their corporate social responsibility»*. With a market share for loans to the local government sector of around 45%, KBN plays an important role in society. KBN's role is to be a long-term financing partner to municipalities, county authorities and municipal companies in order to help them achieve their welfare objectives. To be a long-term partner, KBN has to conduct itself responsibly and help to promote sustainable development for the benefit of society as a whole.

KBN worked on producing its own guidelines for its corporate social responsibility work in 2015. These will be approved in 2016 in connection with a thorough review of its efforts and reporting in the area. Corporate social responsibility work is being designed into KBN's strategy work and the process for developing its activity plans, as this will ensure corporate social responsibility becomes an integral part of KBN's ordinary activities.

The starting point for reporting on corporate social responsibility at KBN is an analysis of which areas are of importance. KBN decided to prioritise the following areas for its work on corporate social responsibility in 2015:

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

Managers and employees received training on ethical issues throughout 2015 through seminars and a dedicated e-learning programme. New guidelines for measures against money laundering were implemented into KBN's activities and workshops were held for all employees to enable them to identify situations in which there might be a risk of corruption or money laundering.

KBN has worked actively to put climate change and the environment on the agenda by being a pioneering provider of green funding and a relatively sizeable issuer of green bonds. KBN's work in the area of climate change and the environment was carried out in accordance with a separate action plan. KBN is also Eco-Lighthouse certified.

The Board approved general guidelines on diversity and equality in 2015. The Board is of the view that explicit targets and systematic work to promote diversity and equality help create an attractive workplace and a working environment that is conducive to greater value creation for KBN.

KBN's reporting on corporate social responsibility for 2015 and information about the measures and targets for 2016 can be found on page 22 of this annual report.

## ORGANISATION AND EMPLOYEES

KBN is dependent on skilled employees to carry out everyday activities that range from participating in global financial markets to 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 development of KBN and its managers and employees is conducted in accordance with the strategy and targets set by the Board in the activity plan. The priority areas for 2015 were (i) strengthening KBN's specialist teams and their capacity in order to reduce key person risk, (ii) increasing the efficiency of work processes, (iii) management development, (iv) systematic and targeted work on diversity and equality, and (v) increasing students' awareness of KBN at relevant universities.

### CAPACITY, EXPERTISE AND ORGANISATIONAL STRUCTURE

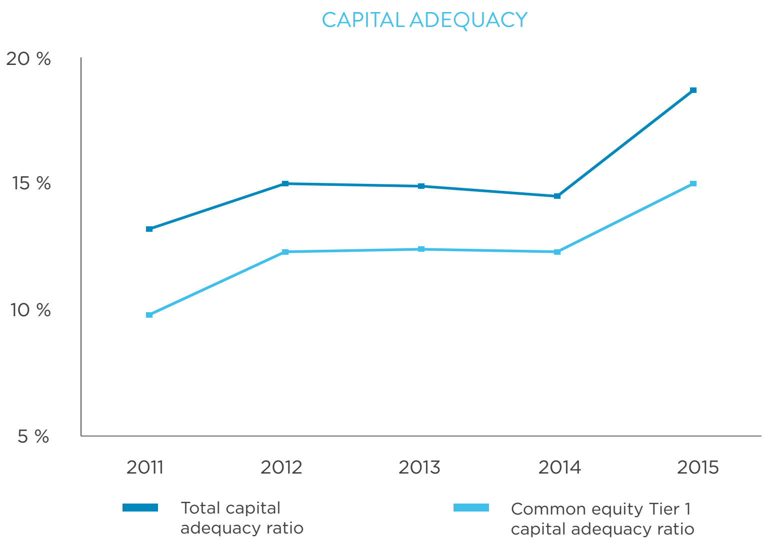
KBN had 72 employees at the end of 2015 equating to 68.9 full-time employees. 63 employees hold permanent positions. KBN had the equivalent of seven more full-time employees at the end of 2015 than at the end of 2014, representing an increase of 12.5%. The additions were principally in staff and support functions, including in risk management, compliance and the finance department, due to KBN being subject to new regulations and additional internal control and reporting requirements as a result of having been designated as one of three systemically important financial institutions in Norway. To further strengthen KBN's customer focus, its lending activities have been separated out into a dedicated department that reports directly to the CEO. In order to strengthen how KBN responds to, monitors and implements changes to financial regulation and improve efficiency in this area, a separate organisational unit was set up with effect from 2015 in the risk management department. The new members of this unit strengthen KBN's level of expertise and make it less vulnerable to key-person risk and to risks associated with succession planning.

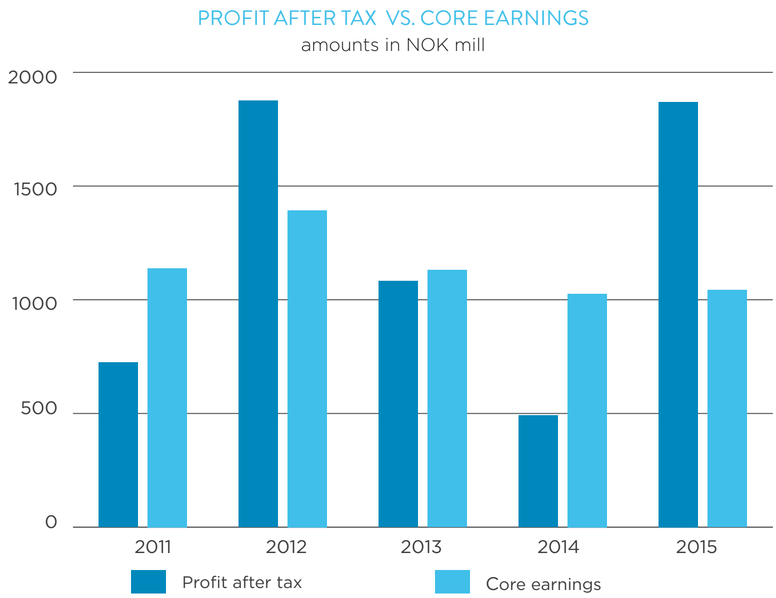
KBN has strengthened the activities it carries out at selected educational institutions in the form of business presentations and participation in career days in order to increase the level of awareness of KBN at business schools and universities. Approximately 10% of KBN's permanent employees have enrolled in further education courses.

The level of expertise across KBN has increased as a result of the implementation and adoption of a new finance system involving approximately 25% of employees. The system entered operation in the fourth quarter of 2015 and is intended to help ensure KBN's activities are managed efficiently and prudently with a satisfactory level of

### CORPORATE DIVERSITY IN KBN AS OF 31.12.2015

| | | | | |
|---|---|---|---|---|
| Share of women | Board of Directors | Employees | CEO and management | Next management level |
| | 44% | 46% | 43% | 33% |
| Age | Mean age men | Mean age women | Employees 30 years or younger | Employees over the age of 50 |
| | 40 | 43 | 14 | 19 |
| International | Other citizenships than Norwegian | Nationalities | International work experience, more than one year | Education abroad, more than one year |
| | 8% | 6 | 15% | 39% |




risk. KBN depends on having an efficient and flexible management system that is suited to its role as a systemically important financial institution and is adapted to future regulatory requirements. The new accounting and finance system creates opportunities for important work processes to be automated and will contribute to a higher level of efficiency and lower operational risk.

As a follow-up to the management development programme run in 2014, an 'ideal manager template' has been developed against which all managers with reporting staff will be measured. Managers have to comply with KBN's values, motivate employees and lead the way during restructurings, take overall responsibility, be efficient at attaining objectives and achieving results, and be good role models. Monthly meetings are held for all managers, and further management development work will take place in 2016 in the form of a continuation programme.

DIVERSITY AND EQUALITY

KBN strives to work in a systematic and targeted way on diversity and equality across the organisation and to follow up targets with specific measures in its activity plans. Its work to promote diversity and equality is a fundamental part of its recruitment of new employees, its development of managers and employees, and its succession planning. KBN's objective is to achieve a good gender balance at all levels and within all units, with an overall gender balance target of 40%.

When recruiting for or making changes to the composition of its management teams and organisational units, KBN accords particular weight to the gender balance and requires that the most qualified woman or man is identified before any decision is taken. No consideration is given to gender, disability, age, or cultural or geographic background when candidates' professional and personal qualifications are being assessed.

All employees are treated equally and have access to the same opportunities with regard to personal and professional development and promotion. Employees who do not speak Norwegian are provided with training in Norwegian, and diversity and equality work is part of management development. Flexible working hours are offered to facilitate arrangements for employees who have care responsibilities at home.

The target for succession planning for management positions and critical roles is for internal candidates of both genders to be considered.

At the end of 2015 the proportion of women on the Board of Directors was 44.4%, while the equivalent proportions for the CEO's management team and for all employees (permanent and temporary) were 42.8% and 45.8% respectively. The average age of KBN employees was a little over 40, and there are approximately as many employees under 30 as there are employees over 50. 8% of employees do not hold Norwegian citizenship.

HEALTH, SAFETY AND THE WORKING 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 has held regular meetings and has carried out safety inspections and risk assessments in relation to health, safety and environment issues. Regular health-promoting and social activities, including exercise facilities and health checks, were offered for all employees in collaboration with KBN's various activity groups. The annual employee satisfaction survey led to concrete measures being taken, including setting up a new intranet and extending the management development programme. 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 or from work or for work purposes. No accidents or injuries were reported to the Norwegian Labour Inspection Authority. Near-miss incidents at KBN's office premises involving the property owner's building workforce are dealt with by the property owner.

The sickness rate was 4.4% in 2015 as compared to 3.6% in 2014. The sickness rate for men was 3.4% and 5.4% for women. The increase is due to long-term sick leave[3], which in total represents 3.1%. KBN works actively on health, safety and the working environment, 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 2015 financial year: NOK 417 million is to be paid to KBN's owner as a dividend, NOK 11 million is to be paid in interest on the additional Tier 1 capital instruments, and NOK 1,454 million is to be transferred to retained earnings.

## FUTURE PROSPECTS

The outlook for the world economy affects Norway as a small, open economy. Lower oil prices mean that the level of activity in the oil sector has declined after many years of high activity. A weaker Norwegian krone has to a certain extent served as a buffer to this and contributed to growth in exports by mainland Norway. 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 robust economy that is able and willing to make active use of budgetary measures to address economic downturns. In light of Norway's high population growth, demographic changes and a large maintenance backlog in relation to infrastructure and building stocks, the level of investment by the local government sector is expected to remain high going forward.

Over the last few years, local government borrowing has grown by around 8%. Some of the local government sector's borrowing relates to self-cost investments or areas where the state provides interest cost subsidies, reducing the sector's overall interest rate exposure.

The capital markets are of increasing importance to local government borrowing. The proportion of municipalities choosing to finance some of their investments using the capital markets is increasing. Municipalities expose themselves to refinancing risk by choosing to raise short-term financing in the capital markets. Short-term loans have to be refinanced regularly and can make municipalities more vulnerable to turmoil in the capital markets. In the second half of 2015 the spreads on local government certificate loans widened quickly and significantly. Municipalities that use the capital markets for a high proportion of their financing requirements need to have a high level of expertise in this area.

Undesirable volatility and price fluctuations on local government debt may lead to increased demand for more traditional financing with longer maturities. KBN plays a central role in ensuring that stable and long-term financing on attractive terms is available regardless of sudden market fluctuations and economic cycles. KBN's market share increased following the financial crisis as part of the counter-cyclical policies implemented by the authorities.

The Norwegian Ministry of Finance has classified KBN as one of three systemically important financial institutions. The consequences of this include KBN being subject to higher capital requirements and closer monitoring by the authorities. KBN will organise its activities so as to ensure it is capitalised in accordance with all regulatory requirements as in force at any time. After adjusting for the dividend expected to be paid for 2015, KBN's equity increased by approximately NOK 3.4 billion in 2015 due to its strong profit for the year, a share capital increase and an additional Tier 1 capital instrument issue (NOK 3.9 billion before the dividend). This provides the basis for KBN's lending to grow in 2016 at the same rate as in 2015. KBN's activities will in the coming years be affected by developments in the regulatory framework, and its ability to meet increased demand for financing from the local government sector will be defined by its available equity. Predictability with regard to the long-term framework in which KBN operates is important to ensuring KBN is able to maintain a steady level of activity.

A lower return target has been set for KBN in the National Budget for 2016. The return target proposed for the 2016-2018 period is 8% of value-adjusted equity, and it is projected that for this period dividends will account for half the return requirement. The reduction in the return target relates to KBN's higher equity ratio and unchanged risk profile helping to reduce the risk associated with its activities, and to the risk-free rate of return having fallen in recent years.

3 Long-term sick leave is defined as absence for more than 17 consecutive days due to ill health.

The accounts for 2015 show that KBN achieved results that are satisfactory given the current market conditions and the regulatory framework within which it operates. KBN's aim is 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 2015
29 March 2016

The Board of Directors of Kommunalbanken AS

Else Bugge Fougner
*Chair*

Martin Skancke
*Vice Chair*

Rune Midtgaard
*Board member*

Martha Takvam
*Board member*

Nanna Egidius
*Board member*

Rune Sollie
*Board member*

Petter Steen Jr.
*Board member*

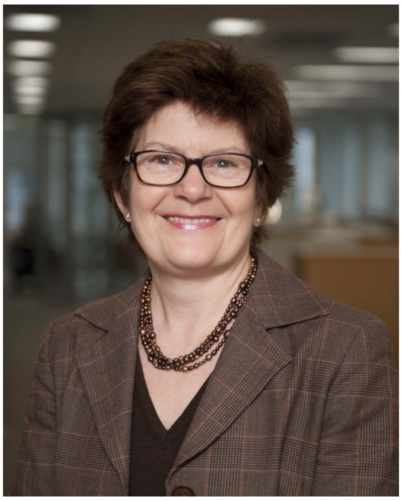
Marit Urmo Harstad
*Employee representative*

Jarle Byre
*Employee representative*

Kristine Falkgård
*President & CEO*

# THE BOARD OF DIRECTORS






ELSE BUGGE FOUGNER

*Chair since 1999*

Lawyer.

Chair, KBN Remuneration 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.

MARTIN SKANCKE

*Vice Chair since 2015*

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.

RUNE MIDTGAARD

*Member of the Board since 2014*

Master of Business and Authorised Financial Analyst (AFA).

Member, KBN Remuneration 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.

PETTER STEEN JR.

*Member of the Board since 2015*

Schoolmaster.

Advisor, former Mayor of Haugesund.

Vice chair in the Board of Directors at Haugaland Kraft AS.

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.

JARLE BYRE

*Employee representative since 2015*

Master of Business and Economics.

Senior Relationship Manager, KBN.

Member, KBN Remuneration Committee.

Personal alternate is Andreas Aleström.

# FINANCIAL STATEMENTS 2015



## NOTES TO THE FINANCIAL STATEMENTS

### Income statements



### Balance



### Risk management

## INCOME STATEMENT

| (Amounts in NOK 1 000 000) | Note | 2015 | 2014 |
|---|---|---|---|
| Interest income | | 5 496 | 6 011 |
| Interest expense | | 3 854 | 4 496 |
| **Net interest income** | **1** | **1 642** | **1 515** |
| Fees and commission expenses | **2** | 30 | 24 |
| Net unrealised gain/(loss) on financial instruments | **3** | 1 116 | (734) |
| Net trading income | **4** | 6 | 39 |
| **Total other operating income** | | **1 092** | **(719)** |
| Salaries and administrative expenses | **5,6,7** | 115 | 93 |
| Depreciation on fixed assets | | 5 | 3 |
| Other expenses | **9** | 30 | 27 |
| **Total operating expenses** | | **151** | **123** |
| | | | |
| **Profit before tax** | | **2 583** | **673** |
| Income tax | **8** | 713 | 182 |
| **Profit for the year** | | **1 870** | **491** |
| Portion allocated to shareholder | | 1 859 | 491 |
| Portion allocated to owners of additional Tier 1 capital | | 11 | 0 |

## STATEMENT OF COMPREHENSIVE INCOME

| (Amounts in NOK 1 000 000) | Note | 2015 | 2014 |
|---|---|---|---|
| Profit for the year | | 1 870 | 491 |
| **Other comprehensive income** | | | |
| *Items which will not be reclassified in profit or loss* | | | |
| Actuarial gain/(loss) on defined benefit plan | | 16 | (18) |
| Of which is tax | | 4 | (5) |
| **Total other comprehensive income** | | **12** | **(13)** |
| **Total comprehensive income for the year** | | **1 882** | **478** |

## STATEMENT OF FINANCIAL POSITION

| *(Amounts in NOK 1 000 000)* | Note | 2015 | 2014 |
|---|---|---|---|
| **Assets** | | | |
| Deposits with credit institutions | **10,11,12,14,21** | 19 428 | 16 219 |
| Instalment loans | **10,11,12,15** | 256 815 | 249 928 |
| Notes, bonds and other interest-bearing securities | **10,11,12,13,16** | 149 944 | 157 364 |
| Financial derivatives | **10,12,13,20** | 22 831 | 31 776 |
| Deferred tax asset | **8** | 201 | 86 |
| Other assets | **17** | 142 | 93 |
| **Total assets** | | **449 361** | **455 466** |
| **Liabilities and equity** | | | |
| Loans from credit institutions | **10,12,18,21** | 7 167 | 25 135 |
| Senior securities issued | **10,11,12,13,19** | 390 107 | 398 669 |
| Financial derivatives | **10,12,13,20** | 37 207 | 20 919 |
| Other liabilities | | 36 | 47 |
| Current tax liabilities | **8** | 829 | 404 |
| Pension liabilities | **7** | 49 | 61 |
| Subordinated debt | **10,12,22** | 1 764 | 1 895 |
| **Total liabilities** | | **437 159** | **447 130** |
| Share capital | **23** | 3 145 | 2 145 |
| Additional Tier 1 capital | **24** | 994 | 0 |
| Retained earnings | | 8 063 | 6 191 |
| **Total equity** | | **12 202** | **8 336** |
| **Total liabilities and equity** | | **449 361** | **455 466** |

# STATEMENT OF CHANGES IN EQUITY

**2015**

| *(Amounts in NOK 1 000 000)* | **Note** | **Share capital** | **Additional Tier 1 capital** | **Retained earnings** | **Total equity** |
|---|---|---|---|---|---|
| Equity as of 1 January 2015 | | 2 145 | 0 | 6 191 | 8 336 |
| Profit for the year | | 0 | 0 | 1 870 | 1 870 |
| Total other comprehensive income | | 0 | 0 | 12 | 12 |
| Interest paid on Tier 1 capital | **24** | 0 | 0 | (10) | (10) |
| Issued additional Tier 1 capital | **24** | 0 | 994 | 0 | 994 |
| Issue of share capital | | 1 000 | 0 | 0 | 1 000 |
| Dividends for 2014 | | 0 | 0 | 0 | 0 |
| **Equity as of 31 December 2015** | **23** | **3 145** | **994** | **8 063** | **12 202** |

**2014**

| *(Amounts in NOK 1 000 000)* | **Note** | **Share capital** | **Additional Tier 1 capital** | **Retained earnings** | **Total equity** |
|---|---|---|---|---|---|
| Equity as of 1 January 2014 | | 2 145 | 0 | 6 071 | 8 216 |
| Profit for the year | | 0 | 0 | 491 | 491 |
| Total other comprehensive income | | 0 | 0 | (13) | (13) |
| Dividends for 2013 | | 0 | 0 | (357) | (357) |
| **Equity as of 31 December 2014** | **23** | **2 145** | **0** | **6 191** | **8 336** |

## STATEMENT OF CASH FLOWS

| (Amounts in NOK 1 000 000) | Note | 2015 | 2014 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Interest received | | 5 616 | 5 977 |
| Interest paid | | (3 175) | (4 390) |
| Fees and commissions paid | | (30) | (25) |
| Receipts from repurchase of issued securities | | 6 | 39 |
| Cash payments to employees and suppliers | | (146) | (120) |
| Income taxes paid | | (404) | (437) |
| Net disbursement of loans to customers | | (7 298) | (6 209) |
| Net (increase)/decrease in deposits with credit institutions | | (20 789) | 11 015 |
| Net (increase)/decrease in notes, bonds and other interest-bearing securities | | 19 049 | (45 046) |
| Net (increase)/decrease in other assets | | (123) | 0 |
| Net increase/(decrease) in other liabilities | | (7) | 6 |
| **NET CASH FLOWS FROM OPERATING ACTIVITIES** | | **(7 302)** | **(39 189)** |
| | | | |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Net (purchase)/sales of property and equipment | | 69 | (50) |
| **NET CASH FLOWS FROM INVESTING ACTIVITIES** | | **69** | **(50)** |
| | | | |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Proceeds from issuance of commercial paper | | 3 758 | 0 |
| Repayment of commercial paper | | (3 855) | 0 |
| Proceeds from issuance of debt securities | | 68 644 | 116 690 |
| Repayment of debt securities | | (116 443) | (109 570) |
| Proceeds from issuance of additional Tier 1 capital | | 994 | 0 |
| Interest paid on Tier 1 capital | | (14) | 0 |
| Dividends paid | | 0 | (357) |
| Proceeds from issuance of share capital | | 1 000 | 0 |
| **NET CASH FLOWS FROM FINANCING ACTIVITIES** | | **(45 917)** | **6 763** |
| | | | |
| **NET CASH FLOWS** | | **(53 149)** | **(32 476)** |
| | | | |
| Effects of foreign exchange differences | | 53 163 | 32 468 |
| **NET CASH FLOWS AFTER FOREIGN EXCHANGE DIFFERENCES** | | **13** | **(9)** |
| | | | |
| Cash and cash equivalents at 1 January | | 21 | 29 |
| Net change in cash and cash equivalents | | 13 | (9) |
| **Cash and cash equivalents at 31 December** | | **34** | **21** |
| | | | |
| *Deposits with credit institutions without agreed time to maturity* | **14** | *34* | *21* |
| *Loans from credit institutions without agreed time to maturity* | **18** | *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 VIIs gate 5B, Oslo. The financial statements for the year ended 31 December 2015 were approved by the Board of Directors on 29 March 2016.

## 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

## 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. The majority of 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 where quoted prices in an active market are not available, 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, fair value is determined using valuation techniques where significant input is based 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 comprise 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. For items measured at fair value including interest rate derivatives, interest is recognised as it accrues either as income or expense. 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 the 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 was deployed in November 2015 and is also classified as an intangible asset. The acquisition cost is 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 27 per cent to 25 per cent effective from 1 January 2016, and the new tax rate is used in the calculation of deferred tax for 2015.

## EQUITY

The Company's equity consists of share capital, additional Tier 1 capital that fulfils the requirements of equity, and retained earnings. Dividends are classified as equity until approved by the Annual General Meeting. The additional Tier 1 capital is measured at cost and paid interest is subtracted from retained earnings in the same way as dividends.

## 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 2015.

## CHANGES IN ACCOUNTING POLICIES

The accounting standards applied to the financial statements are consistent with those used in the previous year. Changes in standards with effective date 1 January 2015 have not lead to material changes in 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). Endorsement by the EU is expected in the second half of 2016. This standard replaces IAS 39 *Financial instruments: Recognition and Measurement*. KBN will in 2016 assess the effect of the changes for its financial statements, and will consider early adoption, i.e. from 1 January 2017. It is expected that the new rules may give some effects for the Company's loan loss provisioning (impairment) for loans and bond investments measured at amortised cost, based on the new standard using an expected loss method, while the current standard uses an incurred loss method. Assessments have been started regarding whether debtors that may not go bankrupt, for example Norwegian municipalities, may give rise to impairment charges in an expected loss model as it is designed in IFRS 9. The new standard also includes a new model for hedge accounting, and hence the adoption may entail adjustments to KBN's approach to hedge accounting. It will be assessed whether further economic hedges that are not today hedge accounted may be given such treatment in the new model. Finally the new IFRS 9 has changed the model for classification and measurement. KBN will also look into whether this has an effect for the Company, but does not expect material changes to the financial statements based on this.

## NOTE 1

**NET INTEREST INCOME**

*(Amounts in NOK 1 000 000)*

| 2015 | Total | At fair value through profit or loss | | | | | |
|---|---|---|---|---|---|---|---|
| | | Fair value option | Held for trading | Fair value hedge | Held to maturity | Loans and receivables | Other liabilities |
| Deposits with credit institutions | **5** | 4 | 0 | 0 | 0 | 0 | 0 |
| Instalment loans | **5 117** | 3 348 | 0 | 0 | 0 | 1 768 | 0 |
| Notes, bonds and other interest-bearing securities | **1 884** | 1 670 | 0 | 0 | 0 | 214 | 0 |
| Financial derivatives | **(1 509)** | 0 | (1 398) | (111) | 0 | 0 | 0 |
| **Total interest income** | **5 496** | **5 022** | **(1 398)** | **(111)** | **0** | **1 983** | **0** |
| | | | | | | | |
| Loans from credit institutions | **7** | 7 | 0 | 0 | 0 | 0 | 0 |
| Senior securities issued | **9 415** | 6 706 | 0 | 0 | 0 | 0 | 2 710 |
| Financial derivatives | **(5 595)** | 0 | (3 775) | (1 821) | 0 | 0 | 0 |
| Subordinated debt | **27** | 27 | 0 | 0 | 0 | 0 | 0 |
| **Total interest expenses** | **3 854** | **6 740** | **(3 775)** | **(1 821)** | **0** | **0** | **2 710** |
| **Net interest income** | **1 642** | **(1 717)** | **2 377** | **1 709** | **0** | **1 983** | **(2 710)** |

| 2014 | Total | At fair value through profit or loss | | | | | |
|---|---|---|---|---|---|---|---|
| | | Fair value option | Held for trading | Fair value hedge | Held to maturity | Loans and receivables | Other liabilities |
| 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 |
| **Total interest income** | **6 011** | **5 571** | **(1 925)** | **(211)** | **2** | **2 574** | **0** |
| | | | | | | | |
| 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 | **23** | 23 | 0 | 0 | 0 | 0 | 0 |
| **Total interest expenses** | **4 496** | **6 515** | **(2 648)** | **(1 509)** | **0** | **0** | **2 138** |
| **Net interest income** | **1 515** | **(944)** | **723** | **1 298** | **2** | **2 574** | **(2 138)** |

## NOTE 2

**FEES AND COMMISSION EXPENSES**

*(Amounts in NOK 1 000 000)*

| | 2015 | 2014 |
|---|---|---|
| Expenses of banking services | 19 | 14 |
| Other transaction costs | 11 | 10 |
| **Total fees and commission expenses** | **30** | **24** |

## NOTE 3

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

*(Amounts in NOK 1 000 000)*

| **2015** | **Total** | **At fair value through profit or loss** | | | **Loans and** | **Other** |
|---|---|---|---|---|---|---|
| | | **Fair value option** | **Held for trading** | **Fair value hedge** | **receivables** | **liabilities** |
| Instalment loans | **(271)** | (271) | 0 | 0 | 0 | 0 |
| Notes, bonds and other interest-bearing securities | **(331)** | (222) | 0 | 0 | (109) | 0 |
| Financial derivatives | **(17 172)** | 0 | (16 959) | (213) | 0 | 0 |
| Loans from credit institutions | **0** | 0 | 0 | 0 | 0 | 0 |
| Senior securities issued | **18 775** | 18 439 | 0 | 0 | 0 | 336 |
| Subordinated debt | **115** | 115 | 0 | 0 | 0 | 0 |
| **Net unrealised gain/(loss) on financial instruments** | **1 116** | **18 061** | **(16 959)** | **(213)** | **(109)** | **336** |

| **2014** | **Total** | **At fair value through profit or loss** | | | **Loans and** | **Other** |
|---|---|---|---|---|---|---|
| | | **Fair value option** | **Held for trading** | **Fair value hedge** | **receivables** | **liabilities** |
| 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 | **(21)** | (21) | 0 | 0 | 0 | 0 |
| **Net unrealised gain/(loss) on financial instruments** | **(734)** | **(3 413)** | **2 653** | **151** | **(89)** | **(36)** |

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. As KBN takes very limited currency and interest rate risk, the changes in relevant parameters will mostly be symmetric on the asset and liabilities sides of the Statement of financial position and therefore to a small extent give rise to net effects in the income statement. Changes in credit spreads for investments in the liquidity portfolio and for issued bonds may on the other hand lead to significant income statement effects, as may changes in basis swap spreads.

Net unrealised gains in 2015 amounting to NOK 1.1 billion primarily come from Senior securities issued and financial derivatives related to these, and are the result of increased credit spreads in fixed income markets and changes in swap spreads. In total credit spread changes give rise to gains of NOK 600 million in 2015, while reduction in USD-NOK swap spreads have lead to gains of NOK 500 million.

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 and are presented in the column Fair value hedge in the table above. The related hedged items comprise NOK 3.2 billion in "Notes, bonds and other interest-bearing securities" and NOK 158.8 billion in "Senior securities issued", that are classified as Loans and receivables and Other liabilities and are initially measured at amortised cost. In addition changes in value for the bond that is attributable to the hedged risk (interest rate and currency risk) are recognised in the income statement as "Net unrealised gain/(loss) on financial instruments". These value changes are presented in the columns Loans and receivables and Other liabilities in the above table.

## NOTE 4

**NET TRADING INCOME**

*(Amounts in NOK 1 000 000)*

| | **2015** | **2014** |
|---|---|---|
| Gain/(loss) from repurchase of securities issued | 25 | 13 |
| Gain/(loss) from sales of bond investments and derivatives terminations | (19) | 26 |
| **Net trading income** | **6** | **39** |

## NOTE 5

**SALARIES AND ADMINISTRATIVE EXPENSES**

*(Amounts in NOK 1 000 000)*

| | **2015** | **2014** |
|---|---|---|
| Salaries | 66 | 57 |
| Employer contributions | 9 | 7 |
| Pension costs | 12 | 4 |
| Other personnel benefits | 2 | 2 |
| Administrative expenses | 26 | 23 |
| **Total salaries and administrative expenses** | **115** | **93** |
| *Average number of man-years* | *62* | *54* |

## NOTE 6

**REMUNERATION**

*(Amounts in NOK 1 000)*

The Board of Directors will submit the following statement on the salary and other remuneration of senior executives to the Annual General Meeting:

THE REMUNERATION SCHEME FOR SENIOR EXECUTIVES
KBN's remuneration policy for senior executives is anchored in the Company's value proposition and its personnel policy, and is in line with its owner's expectations of the Company and its guidelines for the remuneration of senior executives. The central principles observed when determining the salaries of senior executives are that overall remuneration should be competitive but not market-leading when compared with equivalent companies in the banking and finance sector.

KBN's remuneration scheme for senior executives complies with the provisions of the Financial Enterprises Act 1), the Regulation on remuneration schemes at financial institutions 2), the circular on this Regulation issued by the Financial Supervisory Authority of Norway 3), and the Norwegian Government's Guidelines for remuneration of senior executives in companies with state ownership 4).

Remuneration for all employees, including senior executives, consists of a fixed salary, variable salary payments, pensions and other benefits, including personnel insurance, newspapers, mobile telephone and a residential mortgage scheme. KBN does not operate share-based remuneration programs or options. Fixed salary is the main element of remuneration received. The Board of Directors sets quantitative criteria each year for variable salary payments for the next financial year and can award payments to all employees in the following financial year of up to 1.5 times one month's salary.

All employees' fixed salaries are adjusted each year with effect from 1 January on the basis of a combined assessment of KBN's results, their contribution to the attainment of shared targets and their adherence to the bank's values, with leadership skills also forming part of the assessment for managers with reporting staff.

Senior executives are defined as the President & Chief Executive Officer (the "CEO") and the CEO's leader group, comprising 7 persons.

GOVERNANCE SYSTEM AND DECISION-MAKING PROCESS
The Board of Directors has appointed an advisory committee - the Remuneration Committee - which carries out preparatory work on the principles applicable to remuneration, guidelines for variable salary, and guidelines for the remuneration of senior executives and for the remuneration of the CEO. The Board has issued a mandate for the work of the Remuneration Committee. Minutes of the meetings of the Remuneration Committee are circulated to the Board. The Remuneration Committee has three members, who are appointed annually by and from among the members of the Board.

The Board approves guidelines each year for the remuneration of senior executives and for variable salary payments. KBN carries out an annual review of the practical implementation of the variable element of remuneration in the form of a written report that is reviewed by the internal auditor in accordance with the remuneration regulation.

The Board determines the remuneration of the CEO following preparatory work on this matter carried out by the Remuneration Committee.

The CEO determines the remuneration of the other senior executives within the limits set by the Board's guidelines and after consulting the Board. The CEO's decisions on the remuneration of senior executives are subsequently submitted to the Board for information.

REMUNERATION OF KBN'S SENIOR EXECUTIVES IN 2015
*Pension benefits*
Senior executives are members of KBN's defined benefit pension scheme administered by KLP for salaries up to 12 times the National Insurance base amount. Members of the scheme are entitled to a life expectancy-adjusted retirement pension upon the completion of 30 years of service equivalent to 66% of base salary at the time of leaving KBN's employment. KBN previously provided supplemental pension schemes for salaries in excess of 12 times the National Insurance base amount ("12G"), but these schemes were discontinued with effect from 1 November 2015. Senior executives who were members of the defined benefit scheme funded from operations retained their entitlement to the rights accrued in this scheme up to 31 October 2015. Senior executives who were contractually entitled to a defined contribution scheme for salaries in excess of 12 times the National Insurance base amount received the accumulated fund value up until 31 October 2015 as a one-off salary payment in November 2015. The individuals affected by the closure of the schemes received compensation for future fund accumulation in the form of an increase in salary with effect from 1 November 2015. The CEO was compensated to the extent of 20% of salary in excess of 12 times the base amount, while other senior executives were compensated to the extent of 15%.

*Fixed salary*
Fixed salary payable in 2015 included the normal annual salary increase, a non-recurring payment in respect of the accumulated pension value in the contractual defined contribution supplemental pension scheme for salaries in excess of 12 times the National Insurance base amount and compensation for the discontinuation of the supplemental pension schemes. The Chief Risk Officer, Håvard Thorstad, was not included in the compensation arrangements.

*Variable salary*
Guidelines for variable salary in respect of the 2015 financial year, including the criteria for variable salary for all KBN employees, were approved by the Board in December 2014, and resulted in all employees receiving variable salary equivalent to 1.5 times one month's salary.

*Other benefits*

Senior executives are entitled to other benefits such as insurance arrangements, mobile phone, newspaper subscription etc. on the same terms and conditions as apply to other employees. The insurance arrangements relate to various forms of personnel insurance including health insurance and travel insurance, as well as disability insurance and life insurance up to the current level of fixed salary.

The CEO, the Chief Financial Markets Officer and the Chief Lending Officer are entitled to a fixed annual car benefit of NOK 130,000, NOK 80,000 and NOK 50,000 respectively.

The CEO has a contractual entitlement, subject to certain conditions, to severance pay equivalent to one year's fixed salary.

1) The Financial Enterprises Act (LOV-2015-12-04-96)

2) Regulation on remuneration schemes at financial institutions, investment firms and fund management companies (FOR-2010-12-01-1507)

3) The Financial Supervisory Authority of Norway: Circular 15/2014

4) Guidelines for remuneration of senior executives in companies with state ownership, adopted by the Norwegian Ministry of Trade, Industry and Fisheries with effect from 13 February 2015.

**2015**

| **Remuneration to senior executives** | **Fixed salary before one-off payment** | **One-off payment above 12G from 01.01.15** | **Variable salary accrued in the period*** | **Other benefits** | **Pension costs** |
|---|---|---|---|---|---|
| Kristine Falkgård (President & CEO) | 2 551 | 1 266 | 351 | 159 | 175 |
| Martin Spillum (Chief Financial Markets Officer) | 2 319 | 28 | 294 | 116 | 161 |
| Jannicke Trumpy Granquist (CFO) | 1 647 | 119 | 217 | 20 | 142 |
| Tor Ole Steinsland (CCO) | 1 197 | 62 | 150 | 31 | 148 |
| Håvard Thorstad (CRO from 01.11.15) | 275 | 0 | 34 | 4 | 0 |
| Frank Øvrebø (CRO until 30.10.15) | 1 355 | 113 | 169 | 19 | 155 |
| Ilse Margarete Bache (Chief of Staff) | 1 355 | 81 | 172 | 23 | 144 |
| Lars Strøm Prestvik (Chief Lending Officer from 01.07.15) | 1 343 | 68 | 182 | 69 | 141 |
| **Total remuneration to senior executives** | **12 042** | **1 737** | **1 569** | **441** | **1 066** |
| **Total remuneration to employees whose professional activities affect the risk position of the institution** | **16 827** | **91** | **2 178** | **644** | **2 256** |
| **Total remuneration to the employees in the independent control functions** | **16 907** | **0** | **2 231** | **416** | **2 236** |

*Paid out in the following year

**2014**

| **Remuneration to senior executives** | **Fixed salary** | **One-off payment above 12G** | **Variable salary accrued in the period** | **Other benefits** | **Pension costs** |
|---|---|---|---|---|---|
| Kristine Falkgård (President & CEO) | 2 474 | 0 | 306 | 143 | 199 |
| Martin Spillum (Chief Financial Markets Officer) | 2 816 | 0 | 269 | 111 | 441 |
| Karina Folvik (CFO until 30.04.14) | 808 | 0 | 0 | 14 | 87 |
| Jannicke Trumpy Granquist (CFO from 04.08.14) | 661 | 0 | 83 | 11 | 55 |
| Tor Ole Steinsland (CCO) | 1 180 | 0 | 144 | 26 | 146 |
| Frank Øvrebø (CRO) | 1 354 | 0 | 161 | 13 | 163 |
| Ilse Margarete Bache (Chief of Staff from 01.01.14) | 1 210 | 0 | 163 | 18 | 136 |
| **Total remuneration to senior executives** | **10 503** | **0** | **1 126** | **336** | **1 225** |
| **Total remuneration to employees whose professional activities affect the risk position of the institution** | **15 039** | **0** | **1 796** | **548** | **2 399** |
| **Total remuneration to the employees in the independent control functions** | **11 878** | **0** | **1 619** | **349** | **2 024** |

| Remuneration to Board of Directors | 2015 | 2014 |
|---|---|---|
| Chairman Else Bugge Fougner [1)3)] | 386 | 282 |
| Vice-chairman Nils R. Sandal (until 05.06.15) | 70 | 143 |
| Vice-chairman Martin Skancke (vice-chairman from 05.06.15) [3)] | 273 | 105 |
| Board member Frode Berge (until 17.06.14) | 0 | 68 |
| Board member Nanna Egidius [2)] | 178 | 158 |
| Board member Martha Takvam [2)3)] | 304 | 185 |
| Board member Rune Sollie [2)] | 178 | 184 |
| Board member Rune Midtgaard (from 17.06.14) [1)] | 155 | 59 |
| Board member Petter Steen jr (from 05.06.15) | 70 | 0 |
| Board member employees' representative Trine Tafjord (until 17.06.14) | 0 | 52 |
| Board member employees' representative Roald Fischer (until 05.06.15) | 54 | 105 |
| Board member employees' representative Jarle Byre (from 05.06.15) [1)] | 90 | 0 |
| Board member employees' representative Marit Urmo Harstad (from 17.06.14) | 123 | 59 |
| Alternate Board member employees' representative Trine Tafjord (17.06.14 - 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 (until 05.06.15) | 32 | 5 |
| **Total remuneration to Board of Directors** | **1 913** | **1 405** |

[1]Member of remuneration committee

[2]Member of audit committee

[3]Member of risk committee

| Remuneration to Control Committee | 2015 | 2014 |
|---|---|---|
| Chairman Britt Lund (until 17.06.14) | 0 | 27 |
| Chairman Kjell Inge Skaldebø (from 17.06.14) | 57 | 45 |
| Committee member Anne-Ma Tostrup Smith | 35 | 34 |
| Committee member Ole Rødal (from 17.06.14) | 35 | 17 |
| Committee alternate member Roy Jevard | 35 | 34 |
| **Total remuneration to Control Committee** | **162** | **157** |

| Remuneration to Supervisory Board | 2015 | 2014 |
|---|---|---|
| Chairman Elin Eidsvik (until 17.06.14) | 0 | 11 |
| Chairman Svein Ludvigsen (from 17.06.14) | 23 | 14 |
| Board members | 67 | 66 |
| **Total remuneration to Supervisory Board** | **90** | **91** |

| Fees to the statutory auditor | 2015 | 2014 |
|---|---|---|
| Statutory audit fees | 1 098 | 935 |
| Other financial audit and attestation services | 822 | 1 119 |
| Tax services | 77 | 0 |
| Other services not related to audit | 7 | 15 |
| **Total fees excl. VAT** | **2 004** | **2 069** |

## 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.

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, and was terminated in 2015 for current employees that were part of the plan. For further information about the unwinding of pension above 12xBase amount, see Note 6.

Employer's contributions are included in pension costs and liabilities.

| **Economic estimates used in calculation of pension costs and defined benefit obligation** | **31.12.2015** | **31.12.2014** |
|---|---|---|
| Discount rate | 2.70 % | 2.30 % |
| Estimated wage growth | 2.50 % | 2.75 % |
| Estimated growth in Base amount | 2.25 % | 2.50 % |
| Expected growth in benefit levels | 1.48 % | 1.73 % |

KBN has used Norwegian covered bonds as input when determining the discount rate for 2015 and 2014. The actuarial assumptions are based on standard assumptions related to demographic factors recommended by the Norwegian Accounting Standards Board. For 2015 changes in estimates lead to an actuarial gain in Other comprehensive income amounting to NOK 12.2 million for the funded plan and NOK 3.9 million for the unfunded plan.

| **Pension costs** | | **Funded plan** | | **Unfunded plan** |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Net periodic pension cost | 8 191 | 6 530 | 635 | 695 |
| Net interest | 1 099 | 1 250 | 450 | 525 |
| Service cost | 224 | 192 | 0 | 0 |
| Employer contributions | 1 342 | 1 124 | 153 | 172 |
| Pension costs recognised in income statement incl. employer contributions and service costs | 0 | (6 996) | 0 | (1 431) |
| **Total pension cost recognised in income statement** | **10 856** | **2 101** | **1 238** | **(39)** |
| Actuarial gain/(loss) recognised in other comprehensive income | (12 208) | 12 002 | (3 889) | 6 302 |
| **Net pension costs** | **(1 352)** | **14 102** | **(2 651)** | **6 263** |

| **Pension liabilities** | | **Funded plan** | | **Unfunded plan** |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Defined benefit obligation | 94 813 | 92 546 | 16 512 | 19 068 |
| Plan assets | (68 608) | (58 340) | 0 | 0 |
| Employer contributions | 3 695 | 4 823 | 2 328 | 2 689 |
| **Net pension liabilities** | **29 900** | **39 029** | **18 840** | **21 757** |

| **Movement in pension liabilities** | | **Funded plan** | | **Unfunded plan** |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Net pension liabilities as of 1 January | 39 029 | 32 229 | 21 757 | 15 747 |
| Net pension costs | (1 352) | 14 102 | (2 651) | 6 263 |
| Contribution to the pension scheme | (7 778) | (7 302) | (266) | (254) |
| **Net pension liabilities as of 31 December** | **29 900** | **39 029** | **18 840** | **21 757** |

| Movement in the fair value of plan assets | Funded plan | | Unfunded plan | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Fair value of plan assets as of 1 January | 58 340 | 47 658 | 0 | 0 |
| Net interest | 1 207 | 1 784 | 0 | 0 |
| Actuarial gain/(loss) | 3 424 | 3 600 | 0 | 0 |
| Service cost | (224) | (192) | 0 | 0 |
| Contribution to the pension scheme | 6 816 | 6 400 | 233 | 222 |
| Benefits paid | (955) | (909) | (233) | (222) |
| **Fair value of plan assets as of 31 December** | **68 608** | **58 340** | **0** | **0** |

## NOTE 8

### TAX

*(Amounts in NOK 1 000 000)*

The corporate income tax rate has been reduced from 27 percent to 25 percent from 1 January 2016.

| | 2015 | 2014 |
|---|---|---|
| Current taxes | 832 | 404 |
| Change in deferred tax | (119) | (220) |
| Too low/high expense previous years | 0 | (3) |
| **Total income tax** | **713** | **182** |

| Current taxes | 2015 | 2014 |
|---|---|---|
| Current tax payable | 832 | 404 |
| Current taxes payable on items recognised in other comprehensive income | (4) | 0 |
| **Total current taxes** | **829** | **404** |

| Reconciliation of effective income tax rate | 2015 | 2014 |
|---|---|---|
| Profit before tax | 2 583 | 673 |
| Calculated income tax (27 %) | 697 | 182 |
| Effect of change in tax rate | 16 | 0 |
| **Tax expense** | **713** | **182** |
| Effective income tax rate | 27.6 % | 27.0 % |

| Deferred tax liability/(asset) | 2015 | 2014 |
|---|---|---|
| Deferred tax liability/(asset) as at 1 January | (86) | 139 |
| Change in deferred tax | (119) | (220) |
| Changes in deferred tax on items recognised in other comprehensive income | 5 | (5) |
| **Deferred tax liability/(asset) as at 31 December (27%)** | **(201)** | **(86)** |

| Temporary differences | 2015 | 2014 |
|---|---|---|
| Fixed assets | (1) | 0 |
| Pension liabilities | (33) | (42) |
| Provisions | (11) | (18) |
| Financial derivatives | 157 | 323 |
| Premiums/discounts on bonds | (1 465) | 0 |
| Unrealised gain/loss on financial instruments | 563 | (554) |
| **Total temporary differences in the income statement** | **(791)** | **(291)** |
| Actuarial gain/(loss) recognised in other comprehensive income | (13) | (29) |
| **Total temporary differences** | **(803)** | **(319)** |
| **Deferred tax liability/(asset)** | **(201)** | **(86)** |

## NOTE 9

**LEASES**

*(Amounts in NOK 1 000 000)*

| Future minimum lease payments | 2015 | 2014 |
|---|---|---|
| Under 1 year | 6 | 6 |
| 1-5 years | 23 | 24 |
| Over 5 years | 0 | 5 |
| **Total future minimum lease payments** | **29** | **35** |

| Lease payments recognised as an expense in the period | 7 | 7 |
|---|---|---|

Property rental in Haakon VIIs 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)*

| 2015 | Total | At fair value through profit or loss | | | Held to | Loans and | Other |
|---|---|---|---|---|---|---|---|
| | | Fair value option | Held for trading | Fair value hedge | maturity | receivables | liabilities |
| Deposits with credit institutions | **19 428** | 2 190 | 0 | 0 | 0 | 17 238 | 0 |
| Instalment loans | **256 815** | 159 525 | 0 | 0 | 0 | 97 289 | 0 |
| Notes, bonds and other interest-bearing securities | **149 944** | 146 687 | 0 | 0 | 69 | 3 188 | 0 |
| Financial derivatives | **22 831** | 0 | 21 016 | 1 815 | 0 | 0 | 0 |
| **Total financial assets** | **449 018** | **308 402** | **21 016** | **1 815** | **69** | **117 716** | **0** |
| | | | | | | | |
| Loans from credit institutions | **7 167** | 0 | 0 | 0 | 0 | 0 | 7 167 |
| Senior securities issued | **390 107** | 231 332 | 0 | 0 | 0 | 0 | 158 775 |
| Financial derivatives | **37 207** | 0 | 36 435 | 772 | 0 | 0 | 0 |
| Subordinated debt | **1 764** | 1 764 | 0 | 0 | 0 | 0 | 0 |
| **Total financial liabilities** | **436 245** | **233 096** | **36 435** | **772** | **0** | **0** | **165 942** |

| 2014 | Total | At fair value through profit or loss | | | Held to | Loans and | Other |
|---|---|---|---|---|---|---|---|
| | | Fair value option | Held for trading | Fair value hedge | maturity | receivables | liabilities |
| 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 |
| **Total financial assets** | **455 287** | **303 909** | **29 598** | **2 178** | **113** | **119 489** | **0** |
| | | | | | | | |
| Loans from credit institutions | **25 135** | 0 | 0 | 0 | 0 | 0 | 25 135 |
| 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 |
| **Total financial liabilities** | **446 618** | **255 465** | **19 826** | **1 093** | **0** | **0** | **170 234** |

## NOTE 11

**FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE**

*(Amounts in NOK 1 000 000)*

| 2015 | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Deposits with credit institutions | 0 | 2 190 | 0 | **2 190** |
| Instalment loans | 0 | 100 695 | 58 830 | **159 525** |
| Notes, bonds and other interest-bearing securities | 84 660 | 56 060 | 5 967 | **146 687** |
| Financial derivatives | 0 | 20 572 | 2 259 | **22 831** |
| **Total financial assets measured at fair value** | **84 660** | **179 517** | **67 056** | **331 233** |
| Loans from credit institutions | 0 | 7 167 | 0 | **7 167** |
| Senior securities issued | 0 | 158 630 | 72 702 | **231 332** |
| Financial derivatives | 0 | 7 527 | 29 680 | **37 207** |
| Subordinated debt | 0 | 0 | 1 764 | **1 764** |
| **Total financial liabilities measured at fair value** | **0** | **173 324** | **104 146** | **277 470** |

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

| 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** |
| **Total financial assets measured at fair value** | **82 882** | **201 043** | **51 761** | **335 686** |
| 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** |
| **Total financial liabilities measured at fair value** | **0** | **173 410** | **102 974** | **276 384** |

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

**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 are recognised in the income statement as “Net unrealised gain/(loss) on financial instruments”.

*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. Loans from a shorter period of time up until the reporting date are used in determining the credit spread to ensure a fair value that reflects market conditions on the reporting date.

*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 are 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.

| **Reconciliation of movements in Level 3** | **2014** | **Additions** | **Disposals** | **Gain/(loss)** | **Transfers** | **2015** |
|---|---|---|---|---|---|---|
| Instalment loans | 46 456 | 25 442 | (14 177) | 2 383 | (1 274) | 58 830 |
| Notes, bonds and other interest-bearing securities | 4 193 | 2 795 | (1 510) | 29 | 460 | 5 967 |
| Financial derivatives | 1 112 | 38 | (446) | 1 555 | 0 | 2 259 |
| **Total financial assets at fair value in Level 3** | **51 761** | **28 275** | **(16 133)** | **3 967** | **(814)** | **67 056** |
| Senior securities issued | 89 562 | 17 809 | (33 648) | (1 021) | 0 | 72 702 |
| Financial derivatives | 11 517 | 4 092 | (1 576) | 15 647 | 0 | 29 680 |
| Subordinated debt | 1 895 | 0 | 0 | (131) | 0 | 1 764 |
| **Total financial liabilities at fair value in Level 3** | **102 974** | **21 901** | **(35 224)** | **14 495** | **0** | **104 146** |

| | **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 |
| **Total financial assets at fair value in Level 3** | **51 713** | **27 565** | **(28 446)** | **735** | **194** | **51 761** |
| 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 |
| **Total financial liabilities at fair value in Level 3** | **112 138** | **33 105** | **(56 795)** | **14 526** | **0** | **102 974** |

*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 2015 vary from –20 bp to +88 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 –32 bp to + 61 bp for notes and bonds. Other significant unobservable inputs include volatilities within option pricing models, used for instruments with embedded options or option elements.

Notes, bonds and other interest-bearing securities amounting to NOK 460 million were in 2015 transferred from Level 2 or 1 based on very little market activity with little observable data for these securities. For Instalment loans the transfer out of Level 3 is due to customers ending a period of fixed interest, i.e. a product change.

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” below.

| Impact of changes in key assumptions | 2015 | | 2014 | |
|---|---|---|---|---|
| | Carrying amount | Impact of changes in key assumptions | Carrying amount | Impact of changes in key assumptions |
| Instalment loans | 58 830 | (249) | 46 456 | (151) |
| Notes, bonds and other interest-bearing securities | 5 967 | (81) | 4 193 | (7) |
| Financial derivatives | (27 421) | (58) | (10 405) | (24) |
| Senior securities issued | 72 702 | 18 | 89 562 | 217 |
| Subordinated debt | 1 764 | 1 | 1 895 | 3 |
| **Total** | **111 842** | **(369)** | **131 701** | **38** |

*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.*

An increase in the discount rate used for measuring Instalment loans in Level 3 of 10 bp across all maturities for example leads to a reduction in value for these loans of NOK 249 million. Such an increase in the discount rate could be caused by an increase in the credit spread across all maturities. Similarly an increase in the discount rate of 10 bp for Notes, bonds and other interest-bearing securities allocated to Level 3 would lead to a reduction in value of NOK 81 million; this could be caused by either an increase in credit spreads for relevant bonds, or increased liquidity risk in financial markets. For Senior securities issued allocated to Level 3 an increase in the discount rate of 10 bp would lead to a reduction in value of NOK 18 million. Again this could be caused by an increase in the credit spread, in this case for KBN, or it could be due to changes in parameters used in option pricing models, for instance FX rates or volatilities. The table above assumes the same change across all maturities on the yield curve, different changes for different maturities may also be envisaged.

## NOTE 12

### FINANCIAL INSTRUMENTS MEASURED AT AMORTISED COST

*(Amounts in NOK 1 000 000)*

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | **Carrying amount** | **Fair value** | **Carrying amount** | **Fair value** |
| Deposits with credit institutions | 17 238 | 17 238 | 6 600 | 6 600 |
| Instalment loans | 97 289 | 97 264 | 99 600 | 99 549 |
| Notes, bonds and other interest-bearing securities classified as Loans and receivables | 3 188 | 3 209 | 13 289 | 13 238 |
| Notes, bonds and other interest-bearing securities classified as Held to maturity | 69 | 63 | 113 | 113 |
| **Total financial assets measured at amortised cost** | **117 784** | **117 773** | **119 602** | **119 500** |
| | | | | |
| Loans from credit institutions | 7 167 | 7 167 | 25 135 | 25 135 |
| Senior securities issued | 158 775 | 158 436 | 145 099 | 145 138 |
| **Total financial liabilities measured at amortised cost** | **165 942** | **165 603** | **170 234** | **170 273** |

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

| **2015** | **Level 1** | **Level 2** | **Level 3** | **Total** |
|---|---|---|---|---|
| Instalment loans | 0 | 81 505 | 15 759 | **97 264** |
| Notes, bonds and other interest-bearing securities classified as Loans and receivables | 0 | 2 465 | 745 | **3 209** |
| Notes, bonds and other interest-bearing securities classified as Held to maturity | 0 | 63 | 0 | **63** |
| **Total financial assets measured at fair value** | **0** | **84 033** | **16 502** | **100 535** |
| | | | | |
| Senior securities issued | 150 400 | 8 036 | 0 | **158 436** |
| **Total financial liabilities measured at fair value** | **150 400** | **8 036** | **0** | **158 436** |

| **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** |
| **Total financial assets measured at fair value** | **0** | **97 018** | **15 882** | **112 900** |
| | | | | |
| Senior securities issued | 137 565 | 7 182 | 391 | **145 138** |
| **Total financial liabilities measured at fair value** | **137 565** | **7 182** | **391** | **145 138** |

### 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 mainly of USD or Euro benchmark loans and loans in public niche markets.

## NOTE 13

### HEDGE ACCOUNTING

*(Amounts in NOK 1 000 000)*

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

| Carrying amount of financial instruments in fair value hedges | 2015 | 2014 |
|---|---|---|
| Notes, bonds and other interest-bearing securities | 3 188 | 13 289 |
| Senior securities issued | 158 775 | 145 099 |
| Financial derivatives | 1 043 | 1 085 |
| **Total** | **163 006** | **159 473** |

| Fair value changes on financial instruments in fair value hedges | 2015 | 2014 |
|---|---|---|
| Notes, bonds and other interest-bearing securities | (109) | (89) |
| Senior securities issued | 336 | (36) |
| Financial derivatives | (213) | 151 |
| **Total** | **14** | **26** |

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)*

| | 2015 | 2014 |
|---|---|---|
| Deposits with credit institutions without agreed time to maturity | 34 | 21 |
| Deposits with credit institutions with agreed time to maturity | 2 190 | 9 619 |
| Cash collateral pledged | 17 204 | 6 579 |
| **Total deposits with credit institutions** | **19 428** | **16 219** |

## NOTE 15

**INSTALMENT LOANS**

*(Amounts in NOK 1 000 000)*

| | 2015 | 2014 |
|---|---|---|
| Principal amount | 254 376 | 247 067 |
| Accrued interest | 945 | 1 092 |
| Fair value adjustment | 1 448 | 1 720 |
| **Total loans to customers** | **256 769** | **249 879** |
| Other loans | 46 | 49 |
| **Total instalment loans** | **256 815** | **249 928** |

| **Geographic distribution** | **2015** | **2014** |
|---|---|---|
| Østfold | 10 913 | 10 998 |
| Akershus | 22 401 | 21 593 |
| Oslo | 6 944 | 4 415 |
| Hedmark | 11 093 | 10 515 |
| Oppland | 8 034 | 8 042 |
| Buskerud | 29 877 | 28 648 |
| Vestfold | 8 569 | 8 334 |
| Telemark | 9 479 | 8 302 |
| Aust-Agder | 5 850 | 5 924 |
| Vest-Agder | 11 618 | 12 420 |
| Rogaland | 19 740 | 20 080 |
| Hordaland | 28 817 | 29 213 |
| Sogn og Fjordane | 8 054 | 7 640 |
| Møre og Romsdal | 16 417 | 15 553 |
| Sør-Trøndelag | 12 491 | 12 133 |
| Nord-Trøndelag | 9 234 | 9 669 |
| Nordland | 16 819 | 16 111 |
| Troms | 11 082 | 10 961 |
| Finnmark | 6 843 | 6 462 |
| Svalbard | 100 | 54 |
| **Loans to customers, principal amount** | **254 376** | **247 067** |

## NOTE 16

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

*(Amounts in NOK 1 000 000)*

| **Notes, bonds and other interest-bearing securities by type of issuer** | **2015** | **2014** |
|---|---|---|
| Domestic | | |
| Issued by other borrowers | 14 754 | 6 748 |
| Foreign | | |
| Issued by public bodies[1] | 87 978 | 108 762 |
| Issued by other borrowers | 47 212 | 41 853 |
| **Total notes, bonds and other interest-bearing securities** | **149 944** | **157 364** |

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

| **Notes, bonds and other interest-bearing securities by time to maturity** | **2015** | **2014** |
|---|---|---|
| Under 1 year | 81 576 | 107 399 |
| 1-5 years | 68 368 | 49 965 |
| **Total notes, bonds and other interest-bearing securities** | **149 944** | **157 364** |

## NOTE 17

### OTHER ASSETS

*(Amounts in NOK 1 000 000)*

| | 2015 | 2014 |
|---|---|---|
| Intangible assets | 125 | 80 |
| Fixed assets | 13 | 9 |
| Other assets | 2 | 1 |
| Prepaid, non-accrued expenses and accrued income | 2 | 3 |
| **Total other assets** | **142** | **93** |

Intangible assets mainly consist of a new portfolio system. The system was brought into use in 2015 and is amortised over its expected life.

### OTHER LIABILITIES

*(Amounts in NOK 1 000 000)*

| | 2015 | 2014 |
|---|---|---|
| Accounts payable | 4 | 3 |
| Public fees | 9 | 5 |
| Other short term liabilities | 11 | 20 |
| Accrued expenses and received, not yet accrued interest | 12 | 21 |
| **Total other liabilities** | **36** | **47** |

## NOTE 18

### LOANS FROM CREDIT INSTITUTIONS

*(Amounts in NOK 1 000 000)*

| | 2015 | 2014 |
|---|---|---|
| Cash collateral received | 7 167 | 25 135 |
| **Total loans from credit institutions** | **7 167** | **25 135** |

## NOTE 19

### SENIOR SECURITIES ISSUED

*(Amounts in NOK 1 000 000)*

| | 2015 | 2014 |
|---|---|---|
| **Senior securities issued (nominal amounts) as at 1 January** | **391 285** | **326 470** |
| New issuance | 68 644 | 116 739 |
| Redemptions* | (113 583) | (109 833) |
| Amortisation | (2 860) | 264 |
| Translation differences | 57 408 | 57 646 |
| **Senior securities issued (nominal amounts) as at 31 December** | **400 894** | **391 285** |
| Accrued interest | 3 017 | 2 419 |
| Fair value adjustment | (13 805) | 4 966 |
| **Total senior securities issued** | **390 107** | **398 669** |
| *Of which gain/(loss) from fair value adjustment that is due to changes in own credit risk* | *343* | *(305)* |

* Redemptions in 2015 includes buybacks of 2 979 million NOK.

There was no breach in debt covenants as of 31 December 2015.

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.

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | **Notional amount** | **Positive market values - assets** | **Negative market values - liabilities** | **Notional amount** | **Positive market values - assets** | **Negative market values - liabilities** |
| **Held for trading:** | | | | | | |
| Interest rate derivatives | 103 209 | 648 | 2 195 | 118 295 | 978 | 2 396 |
| Currency derivatives | 513 298 | 20 331 | 32 121 | 409 353 | 28 571 | 15 837 |
| Equity-related derivatives | 11 186 | 37 | 2 119 | 15 182 | 49 | 1 560 |
| Commodity-related derivatives | 0 | 0 | 0 | 180 | 0 | 33 |
| | **627 693** | **21 016** | **36 435** | **543 011** | **29 598** | **19 826** |
| **Fair value hedges:** | | | | | | |
| Interest rate derivatives | 155 101 | 776 | 609 | 114 706 | 1 058 | 737 |
| Currency derivatives | 6 471 | 1 039 | 162 | 12 841 | 1 120 | 356 |
| | **161 572** | **1 815** | **772** | **127 547** | **2 178** | **1 093** |
| **Total financial derivatives** | **789 266** | **22 831** | **37 207** | **670 557** | **31 776** | **20 919** |

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)*

KBN has entered into ISDA agreements with all derivatives counterparties. This implies that all exposures vs the counterparty may be netted in the event of default. The ISDA agreements contain agreements regarding the exchange of collateral in the form of Credit Support Annex (CSA) related to financial derivatives exposures.  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. See Note 20 for additional information about financial derivatives.

| | 2015 | 2014 |
|---|---|---|
| Cash collateral received | 7 167 | 25 135 |
| Cash collateral pledged | (17 204) | (6 579) |
| **Total cash collateral** | **(10 037)** | **18 555** |

### Effect of offsetting and collateral

The table below shows items in the Statement of Financial Position that are subject to legally binding netting agreements and related collateral to reduce counterparty risk. In KBN this comprises the item Financial derivatives (assets and liabilities). The column Gross fair value presents the total market value for contracts with positive and negative market value. The same amounts are presented in the column Carrying amount, to make it clear that these items are presented gross in the Statement of Financial Position, based on the ISDA agreements not fulfilling the requirements for offsetting. In the column Netting effect for counterparties with both assets and liabilities items the effect of having many counterparties with both positive and negative market value positions is shown, such that it is reflected how much the gross value may be reduced by netting per counterparty. The column Amounts after netting and collateral shows net exposure after the netting effect and received cash collateral for counterparties with positive market values and pledged cash collateral for counterparties with negative market value.

*(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 | | |
|---|---|---|---|---|---|---|
| **2015** | **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** | **Cash collateral** | **Amounts after netting and collateral** |
| **Assets** | | | | | | |
| Financial derivatives | 22 831 | 0 | 22 831 | 13 345 | 7 167 | 2 318 |
| **Liabilities** | | | | | | |
| Financial derivatives | 37 207 | 0 | 37 207 | 13 345 | 17 204 | 6 658 |

| | | | | 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** | **Cash collateral** | **Amounts after netting and collateral** |
| **Assets** | | | | | | |
| Financial derivatives | 31 776 | 0 | 31 776 | 10 958 | 20 818 | 0 |
| **Liabilities** | | | | | | |
| Financial derivatives | 20 919 | 0 | 20 919 | 10 958 | 6 579 | 3 381 |

## NOTE 22

### SUBORDINATED DEBT

| *(Amounts in NOK 1 000 000)* | Currency | Nominal amount in CCY | Redemption right | Coupon | Nominal amount in NOK 2015* | 2014* |
|---|---|---|---|---|---|---|
| Ordinary subordinated loan capital | CAD | 275 million | 2016 | 3.74% | 1 743 | 1 760 |
| **Total subordinated debt** | | | | | **1 743** | **1 760** |

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

## NOTE 23

### SHARE CAPITAL

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Number of shares | Share in % | Number of shares | Share in % |
| The Kingdom of Norway | 3 144 625 | 100 | 2 144 625 | 100 |

KBN received NOK 1 billion in share capital in 2015, in the form of the issue of 1 million shares with notional amount of NOK 1 000. This is in order to allow for the fulfilling of increased capital requirements in 2015 and the coming years.

## NOTE 24

### ADDITIONAL TIER 1 CAPITAL

| *(Amounts in NOK 1 000 000)* | Currency | Nominal amount in CCY | Redemption right | Coupon | Carrying amount 2015 | 2014 |
|---|---|---|---|---|---|---|
| Additional Tier 1 capital | NOK | 1 000 | 2020 | 3 month NIBOR +1.5% | 994 | 0 |
| **Total additional Tier 1 capital** | | | | | **994** | **0** |

KBN issued additional Tier 1 capital in the form of a subordinated bond in June 2015. The bond forms part of KBN's Tier 1 capital, see Note 30. Based on KBN having a one-sided right to not pay interest and notional amount to the investors the bond does not qualify as a liability under IAS 32 and is therefore classified as equity in the Statement of Financial Position. The interest expenses are not presented on the line Interest expense in the income statement, but rather as a reduction of Retained earnings. The expenses are recognised when paid, see the Statement of changes in equity. In 2015 interest in the amount of NOK 10.3 million (after tax) has been paid. In addition, NOK 0.8 million had accrued at year end, such that in total NOK 11 million of profit after tax in 2015 is attributed to the additional Tier 1 capital holders, see the income statement.

## NOTE 25

### RISK MANAGEMENT

State ownership, customer group and sector political role imply that KBN maintains a low risk profile.

Risk management and internal control are an integral part of KBN's strategy and business processes, and are adapted to the nature, scope and complexity of the risk exposure.

Robust internal control is carried out as an integral part of the business processes of the bank. Risk management is established in a structure based on three lines of defence that shall ensure systematic identification, assessment and monitoring of the risk in all parts of KBN's activities.

### ORGANISATION OF RISK MANAGEMENT

*Board of Directors.* The Board of Directors has the overall responsibility for the risk management and sets the risk appetite of KBN in line with requirements from the owner and the authorities. The risk appetite reflects KBN's capacity to bear risk and the tolerance for fluctuations in profits and capital. The risk appetite is implemented through the determination of risk limits.

*Risk committee of the Board.* The risk committee is a preparatory and advisory body to the Board. Its three members are appointed annually from and by the members of the Board. The main function of the committee is to assist the Board in making decision on risk capacity, including development of limits for risk tolerance. Furthermore it shall assist the Board in the monitoring and management of KBN's total risk.

*President & CEO.* 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.

*Three lines of defence.* KBN's first line of defence within risk management and internal control comprises the Lending department, the Financial Markets department that performs funding and liquidity management, and the back office and lending administration functions. The second line of defence monitors, guides and contributes to improving the first line controls, and performs comprehensive risk measurement, the Risk Management department has the overall responsibility for

KBN's total risk management. The CRO reports to the President & CEO, but has a direct reporting line to the Board in accordance with Section 47.3 of the Norwegian Capital Requirements Regulation. The third line of defence is carried out by the internal auditor KPMG, reporting directly to the Board.

### 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 assessment*. 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 2015. 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 at least 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 15.09 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 primary/total 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

KBN has very low tolerance for operational risk. Operational risk arises in all functions and is minimised by effective internal control, high professional and competency level, focus on ethical behaviour internally and versus business relations, and robustness in critical functions. Management reports to the Board on the operational risk and incidents.

## NOTE 26

**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 2015, and neither is there any evidence of default as at 31 December 2015. KBN does not issue financial guarantees.

The table below includes exposures on the Statement of Financial Position lines Deposits with credit institutions, Instalment loans and Notes, bonds and other interest-bearing securities.

*Amounts in the table below represent actual credit exposure*

**2015**

| Time to maturity | < 1 year | | | > 1 year | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Risk class** | **A-3** | **A-1/A-1+** | **Not rated** | **BBB** | **A-** | **A** | **AA** | **AAA** | **Not rated** | **Total** |
| Sovereigns and central banks | 0 | 20 872 | 0 | 0 | 0 | 0 | 4 617 | 7 869 | 0 | **33 358** |
| Regional authorities [1] | 0 | 22 697 | 21 104 | 0 | 0 | 796 | 13 453 | 8 743 | 240 438 | **307 231** |
| Multilateral development banks | 0 | 9 307 | 0 | 0 | 0 | 0 | 26 | 11 062 | 0 | **20 395** |
| Financial institutions | 14 506 | 7 544 | 0 | 0 | 0 | 0 | 174 | 71 | 0 | **22 295** |
| Securitisation | 0 | 0 | 0 | 14 | 9 | 5 | 2 | 40 | 0 | **69** |
| Covered bond | 0 | 23 825 | 1 875 | 0 | 0 | 0 | 2 364 | 14 775 | 0 | **42 839** |
| **Total** | **14 506** | **84 245** | **22 979** | **14** | **9** | **801** | **20 637** | **42 559** | **240 438** | **426 187** |

[1] Including loans to municipal sector of NOK 256.8 billion.

Undisbursed loan commitments amount to NOK 3.9 billion as at 31 December 2015.

**Credit exposure by country**

**2015**

| Time to maturity | < 1 year | | | > 1 year | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Risk class** | **A-3** | **A-1/A-1+** | **Not rated** | **BBB** | **A-** | **A** | **AA** | **AAA** | **Not rated** | **Total** |
| Australia | 0 | 460 | 0 | 0 | 9 | 5 | 74 | 15 | 0 | **562** |
| Austria | 0 | 240 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **240** |
| Belgium | 0 | 1 757 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **1 757** |
| Canada | 0 | 2 743 | 0 | 0 | 0 | 796 | 82 | 1 242 | 0 | **4 864** |
| Denmark | 0 | 13 189 | 0 | 0 | 0 | 0 | 0 | 3 416 | 0 | **16 605** |
| Finland | 0 | 890 | 0 | 0 | 0 | 0 | 1 978 | 69 | 1 164 | **4 100** |
| France | 0 | 10 938 | 0 | 0 | 0 | 0 | 1 806 | 204 | 0 | **12 947** |
| Japan | 0 | 2 553 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **2 553** |
| Netherlands | 8 285 | 3 981 | 0 | 0 | 0 | 0 | 0 | 295 | 1 093 | **13 654** |
| New Zealand | 0 | 23 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **23** |
| Norway | 0 | 5 420 | 21 932 | 0 | 0 | 0 | 424 | 7 496 | 236 330 | **271 603** |
| Spain | 0 | 48 | 0 | 14 | 0 | 0 | 0 | 0 | 0 | **62** |
| Supranational | 0 | 9 373 | 0 | 0 | 0 | 0 | 26 | 11 062 | 0 | **20 461** |
| Sweden | 0 | 15 998 | 156 | 0 | 0 | 0 | 1 689 | 3 895 | 365 | **22 103** |
| Switzerland | 0 | 1 333 | 0 | 0 | 0 | 0 | 0 | 538 | 0 | **1 871** |
| Germany | 5 859 | 10 180 | 463 | 0 | 0 | 0 | 14 558 | 11 708 | 1 486 | **44 253** |
| United Kingdom | 0 | 5 120 | 428 | 0 | 0 | 0 | 0 | 2 621 | 0 | **8 169** |
| United States | 362 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | **362** |
| **Total** | **14 506** | **84 245** | **22 979** | **14** | **9** | **801** | **20 637** | **42 559** | **240 438** | **426 187** |

**2014**

| Time to maturity | | < 1 year | | | | > 1 year | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Risk class** | **A-3** | **A-1/A-1+** | **Not rated** | **BBB** | **A-** | **A** | **AA** | **AAA** | **Not rated** | **Total** |
| Sovereigns and central banks | 0 | 4 840 | 0 | 0 | 0 | 2 131 | 8 339 | 9 950 | 0 | **25 261** |
| Regional authorities [1] | 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** |
| **Total** | **0** | **53 292** | **32 871** | **16** | **11** | **27 128** | **38 423** | **49 818** | **221 953** | **423 511** |

[1] 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 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **Risk class** | **A-3** | **A-1/A-1+** | **Not rated** | **BBB** | **A-** | **A** | **AA** | **AAA** | **Not rated** | **Total** |
| 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** |
| **Total** | **0** | **53 292** | **32 871** | **16** | **11** | **27 128** | **38 423** | **49 818** | **221 953** | **423 511** |

## NOTE 27

**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 NOK interest rate risk depends on the ability to regulate the floating rate on instalment loans.

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 | (4.5) | 4.5 |
| USD | 0.5 | 0.5 |
| EUR | 2.2 | 2.2 |
| **Total** | **(1.8)** | **7.2** |

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. Net interest rate risk takes into account the direction of the effect in the income statement per currency, while Gross interest rate risk is the total of the absolute values of the calculated effect per currency.

## NOTE 28

### 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.

| | 2015 | | 2014 | |
|---|---|---|---|---|
| **Currency** | **Net position** | **10% change in FX-rate** | **Net position** | **10% change in FX-rate** |
| USD | 83.1 | 8.3 | 4.5 | 0.5 |
| EUR | 3.1 | 0.3 | 0.9 | 0.1 |
| Other currencies | 10.7 | 1.1 | 4.4 | 0.4 |
| **Total** | **96.9** | **9.7** | **9.9** | **1.0** |

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 2015 and 2014. The sensitivity analysis assumes zero correlation between FX rates and other market risk factors.

## NOTE 29

### 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 liquidity policy set by the Board of Directors.

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.

A large part of the portfolio matures within 12 months. Further to this liquidity risk is reduced by matching maturities on assets and liabilities up to 3 months. The bank also has a short term funding programme and a credit line with DNB to manage short-term liquidity.

The Board of Directors decided in 2015 that a portfolio of very liquid securities shall be created in 2016. These holdings shall be transferrable to cash without significant losses for KBN under severely stressed market conditions, either through direct sales or through the use of repurchase agreements in a recognised repurchase market.

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.

**2015**

| 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 | **19 428** | 19 428 | 0 | 0 | 0 | 0 | 0 |
| Instalment loans | **254 361** | 2 642 | 9 213 | 8 188 | 28 163 | 206 155 | 0 |
| Notes, bonds and other interest-bearing securities | **146 841** | 17 474 | 23 390 | 39 862 | 65 828 | 286 | 0 |
| **Total assets** | **420 630** | **39 544** | **32 603** | **48 050** | **93 991** | **206 441** | **0** |
| | | | | | | | |
| Loans from credit institutions | **7 167** | 7 167 | 0 | 0 | 0 | 0 | 0 |
| Senior securities issued | **403 410** | 19 386 | 22 786 | 44 360 | 264 426 | 52 452 | 0 |
| Other liabilities | **779** | 15 | 708 | 7 | 0 | 0 | 49 |
| Subordinated debt | **1 743** | 0 | 0 | 1 743 | 0 | 0 | 0 |
| Additional Tier 1 capital | **1 000** | 0 | 0 | 0 | 1 000 | 0 | 0 |
| **Total liabilities** | **414 099** | **26 568** | **23 494** | **46 110** | **265 426** | **52 452** | **49** |
| **Financial derivatives** | **4 314** | **5 006** | **1 890** | **(2 044)** | **(1 167)** | **629** | **0** |
| **Net liquidity exposure** | **10 845** | **17 982** | **10 999** | **(104)** | **(172 602)** | **154 618** | **(49)** |

**2015**

| 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 | **19 428** | 19 428 | 0 | 0 | 0 | 0 | 0 |
| Instalment loans | **254 361** | 98 686 | 91 887 | 16 563 | 32 064 | 15 161 | 0 |
| Notes, bonds and other interest-bearing securities | **146 841** | 25 203 | 44 018 | 29 255 | 48 148 | 217 | 0 |
| **Total assets** | **420 630** | **143 317** | **135 905** | **45 818** | **80 212** | **15 378** | **0** |
| | | | | | | | |
| Loans from credit institutions | **7 167** | 7 167 | 0 | 0 | 0 | 0 | 0 |
| Senior securities issued | **403 410** | 48 286 | 80 887 | 44 808 | 182 960 | 46 470 | 0 |
| Other liabilities | **779** | 15 | 708 | 7 | 0 | 0 | 49 |
| Subordinated debt | **1 743** | 1 743 | 0 | 0 | 0 | 0 | 0 |
| Additional Tier 1 capital | **1 000** | 1 000 | 0 | 0 | 0 | 0 | 0 |
| **Total liabilities** | **414 099** | **58 211** | **81 595** | **44 815** | **182 960** | **46 470** | **49** |
| **Financial derivatives** | **4 314** | **(32 555)** | **(96 578)** | **3 308** | **100 229** | **29 910** | **0** |
| **Net liquidity exposure** | **10 845** | **52 552** | **(42 268)** | **4 311** | **(2 519)** | **(1 182)** | **(49)** |

**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 |
| **Total assets** | **418 547** | **43 145** | **33 861** | **74 318** | **68 509** | **198 715** | **0** |
| | | | | | | | |
| 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 |
| **Total liabilities** | **419 507** | **39 426** | **15 503** | **47 600** | **276 652** | **40 265** | **61** |
| **Financial derivatives** | **9 599** | **5 949** | **6 952** | **4 892** | **(6 982)** | **(1 212)** | **0** |
| **Net liquidity exposure** | **8 639** | **9 668** | **25 310** | **31 609** | **(215 125)** | **157 238** | **(61)** |

**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 |
| **Total assets** | **418 547** | **154 929** | **134 121** | **56 815** | **64 493** | **8 188** | **0** |
| | | | | | | | |
| 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 |
| **Total liabilities** | **419 507** | **71 713** | **82 669** | **69 020** | **169 812** | **26 233** | **61** |
| **Financial derivatives** | **9 599** | **(64 020)** | **(62 117)** | **12 330** | **106 180** | **17 226** | **0** |
| **Net liquidity exposure** | **8 639** | **19 196** | **(10 664)** | **125** | **862** | **(819)** | **(61)** |

## NOTE 30

### 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 12 percent including buffer requirements as at 31 December 2015. KBN is compliant with all regulatory capital requirements as at 31 December 2015.

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 10 to 12 percent from 1 July 2015, and will increase further to 13.5 percent from 1 July 2016. Corresponding to this, total capital requirements including buffers increased from 13.5 to 15.5 percent from 1 July 2015, and will increase further to 17 percent from 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.

| | 2015 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Carrying amount | Risk-weighted assets | Minimum capital requirements | Carrying amount | Risk-weighted assets | Minimum capital requirements |
| **Credit risk** | | | | | | |
| Sovereigns and central banks | 20 413 | 0 | 0 | 14 797 | 426 | 34 |
| Regional governments and local authorities | 311 119 | 52 443 | 4 195 | 307 713 | 51 105 | 4 088 |
| *Of which are Norwegian municipalities* | *256 769* | *52 298* | *4 184* | *249 880* | *51 000* | *4 088* |
| Public sector entities | 12 944 | 0 | 0 | 16 236 | 95 | 8 |
| Multilateral development banks | 20 395 | 0 | 0 | 27 114 | 0 | 0 |
| Financial institutions | 36 922 | 7 015 | 561 | 65 987 | 9 869 | 790 |
| *Of which counterparty exposure on derivatives* | *14 627* | *2 542* | *203* | *27 598* | *1 857* | *149* |
| Claims secured by residential property | 46 | 46 | 4 | 48 | 48 | 4 |
| Covered bonds | 42 839 | 4 284 | 343 | 24 438 | 2 444 | 196 |
| Other assets | 17 | 17 | 1 | 14 | 14 | 1 |
| Securitisation | 69 | 29 | 2 | 113 | 42 | 3 |
| Credit Valuation Adjustment | 175 | 2 193 | 175 | 160 | 2 005 | 160 |
| **Total credit risk** | **444 940** | **66 026** | **5 282** | **456 618** | **66 047** | **5 284** |
| **Market risk** | **0** | **0** | **0** | **0** | **0** | **0** |
| **Operational risk—Basic Indicator Approach** | | **2 814** | **225** | | **3 184** | **255** |
| **Minimum capital requirements** | | **68 840** | **5 507** | | **69 231** | **5 538** |
| **Total capital ratio** | | | **18.81 %** | | | **14.53 %** |
| **Tier 1 capital adequacy ratio** | | | **16.53 %** | | | **12.26 %** |
| **Common equity Tier 1 capital adequacy ratio** | | | **15.09 %** | | | **12.26 %** |

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:

| | 2015 | 2014 |
|---|---|---|
| *Common equity Tier 1 capital* | | |
| Share capital | 3 145 | 2 145 |
| Retained earnings previous years | 6 193 | 5 700 |
| Profit for the year included in Tier 1 capital | 1 870 | 491 |
| Pension funds above pension commitments | 0 | 0 |
| Deferred tax asset* | 0 | 0 |
| Intangible assets | (124) | (78) |
| Dividends payable | (417) | 0 |
| Adjustments in common equity Tier 1 capital based on regulatory filters | (281) | 232 |
| Share of nulled unamortised estimate differences | 0 | 0 |
| **Total common equity Tier 1 capital** | **10 385** | **8 490** |
| Other approved Tier 1 capital | 994 | 0 |
| **Total Tier 1 capital** | **11 379** | **8 490** |
| *Supplementary capital* | | |
| Ordinary subordinated debt | 1 571 | 1 571 |
| **Total supplementary capital** | **1 571** | **1 571** |
| **Total primary capital** | **12 950** | **10 061** |

*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 2015.

The Control Committee recommends that the annual report and accounts presented be approved as Kommunalbanken's accounts for 2015 and that the application of profits is adopted by the Annual Shareholders' Meeting in accordance with the Board of Directors' proposals.

Oslo, 30 March 2016
Control Committee for Kommunalbanken AS

Kjell Inge Skaldebø
*Chair*

Anne-Ma Tostrup Smith
*Vice Chair*

Ole Rødal

Roy Jevard

## SUPERVISORY BOARD'S STATEMENT

*To the Annual Shareholders' Meeting of Kommunalbanken AS*
In accordance with §15 in Kommunalbanken's Articles of Association, the annual accounts for 2015 have been examined by the Supervisory Board.

The Supervisory Board recommends that the Board of Directors' proposals for the income statement and the statement of financial position as well as the application of profit, NOK 1,881,281,272 is adopted by the Annual Shareholders' Meeting.

Oslo, 14 April 2016
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 2015, income statement, statement of comprehensive income, cash flows and changes in equity for the year then ended, a summary of significant accounting policies and other explanatory information.

*The Board of Directors' and President & CEO's responsibility for the financial statements*

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

*Auditor's responsibility*

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

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

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

*Opinion*

In our opinion, the financial statements of Kommunalbanken AS have been prepared in accordance with laws and regulations and present fairly, in all material respects, the financial position of the Company as at 31 December 2015 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 Chief Executive Officer 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, 29 March 2016
ERNST & YOUNG AS

Einar Hersvik
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 5 June 2015 and approved by the Financial Supervisory Authority of Norway 10 July 2015.

## 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 3,144,625,000 (three billion, one hundred and forty-four million, six hundred and twenty five thousand Norwegian kroner) divided into 3,144,625 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 procurationem
5. Present the annual accounts and directors' report to the Annual General Meeting
6. Make recommendations to the Annual General Meeting with respect to alterations to the Articles of Association
7. Appoint the managing director
8. Fix the managing director's salary
9. Prepare statements on remuneration policy.

§ 11 The chairman of the Board, 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.

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, intermunicipal companies and other companies which carry out local government tasks against either a municipal guarantee, government guarantee or other satisfactory security. The Company can also undertake other tasks appropriate to the Company's business.

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

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

## CHAPTER IX - ANNUAL REPORT AND ACCOUNTS

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

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

The annual accounts shall be placed at the disposal of the auditor at least one month prior to the ordinary Annual General Meeting.

The audited annual report and accounts shall be scrutinised by the Control Committee and Supervisory Board before being laid before the Annual General Meeting.

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

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

## CHAPTER X - AGE OF RETIREMENT

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

## CHAPTER XI - ENTRY INTO FORCE

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

## CHAPTER XII - ALTERATIONS TO THE ARTICLES OF ASSOCIATION

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

# GOVERNING BODIES

As of 31.12.2015

## BOARD OF DIRECTORS

Else Bugge Fougner, Chair
Martin Skancke, Vice Chair
Nanna Egidius
Rune Midtgaard
Rune Sollie
Martha Takvam
Petter Steen jr.
Marit Urmo Harstad, employee representative
Jarle Byre, employee representative

*Alternates to the employee representatives*
Kristine Henriksen Lien
Andreas Aleström

## BOARD PREPARATORY COMMITTEES

*Audit Commitee*
Martha Takvam, Chair
Nanna Egidius
Rune Sollie

*Risk Commitee*
Martin Skancke, Chair
Martha Takvam
Else Bugge Fougner

*Remuneration Commitee*
Else Bugge Fougner, Chair
Rune Midtgaard
Jarle Byre

## SUPERVISORY BOARD

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

*Alternates to the Supervisory Board*
Berit Koht
Hans Seierstad
Cecilie Hansen
Johnny Stiansen
Torger Magnus Jonasen, employee representative

*Observers to the Supervisory Board*
Sølve 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

*Alternates to the Control Committee*
Roy Jevard

## AUDITOR

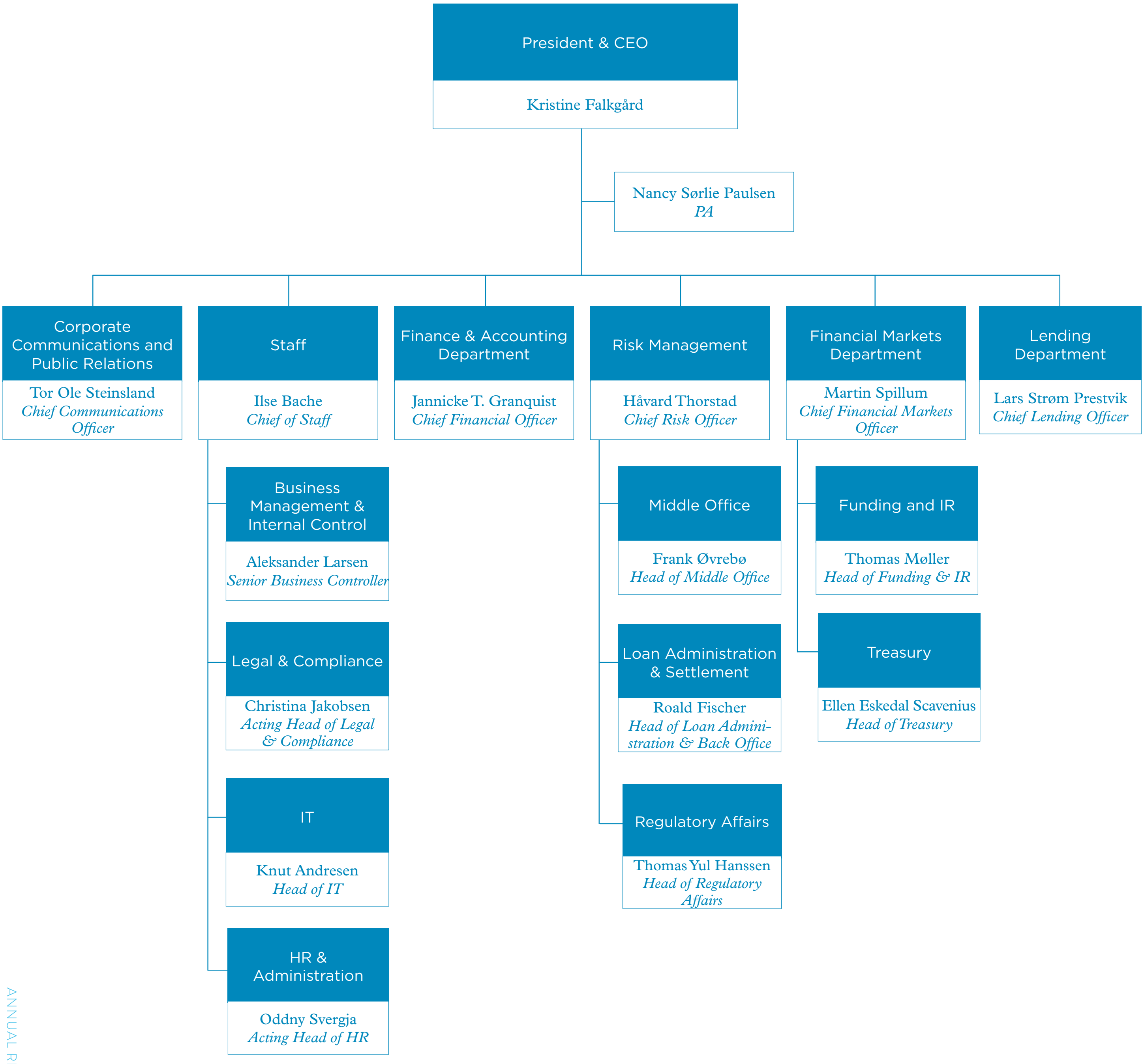
Ernst & Young AS
Einar Hersvik, State Authorised Public Accountant

## INTERNAL AUDITOR

KPMG AS
Are Jansrud, State Authorised Public Accountant

# ORGANISATION

As of 15.03.2016



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