ANNUAL REPORT 2017

Kommunalbanken Norway

KBN Kommunalbanken Norway

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KEY FIGURES

(Amounts in NOK 1 000 000)

	2017	2016
RESULTS		
Net interest income	2 162	2 087
Core earnings[1]	1 517	1 400
Profit before tax	1 783	919
Profit for the year	1 429	689
Return on equity after tax[2]	12.72%	6.27%
Return on equity after tax (core earnings)[2]	13.51%	12.74%
Return on assets after tax[2]	0.34%	0.16%
Return on assets after tax (core earnings)[2]	0.36%	0.33%
LENDING		
New disbursements	55 021	48 117
Outstanding loans[3]	281 706	266 558
LIQUIDITY PORTFOLIO[3]	107 484	116 413
BORROWINGS		
New long-term borrowings	118 509	82 752
Repurchase of own debt	837	1 159
Redemptions	112 555	93 926
Total borrowings[3]	373 816	376 785
TOTAL ASSETS	412 854	418 327
EQUITY	14 667	12 452
Total capital adequacy ratio	24.61%	21.45%
Tier 1 capital adequacy ratio	21.65%	18.39%
Common equity Tier 1 capital adequacy ratio	18.41%	16.86%
Leverage ratio	3.68%	2.65%
LIQUIDITY COVERAGE RATIO (LCR)[4]		
Total	570%	1 116%
NOK	2 052%	1 848%
EUR	233%	558%
USD	308%	471%
AUD	Infinite	Infinite
JPY	185%	852%

*1 Profit after tax adjusted for unrealised gain/(loss) on financial instruments after tax (NOK 1 429 million + (0.75*NOK 163 million) - NOK 34million). This result measure is included to give relevant information about the company's underlying operations.*

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

3 Principal amounts

4 Liquidity coverage ratio (LCR) is a measure for the regulatory liquidity reserve. LCR is defined as liquid assets as a percentage of net payments in a given stress period of 30 days ahead.

90 YEARS OF BUILDING A BETTER SOCIETY

CEO's foreword

In 2017 we celebrated the 90th anniversary of KBN's role in financing welfare service provision by the Norwegian local government sector. Through our lending to municipalities and county authorities, we helped to finance the construction of power stations before and after World War II, the construction of schools in the 50s and 60s, and the investments needed for a range of reforms such as the Nursery Reform. KBN and its customers have played a central role in the creation and development of the Norwegian welfare state.

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. Our credit rating, AAA/Aaa, ensures that we have stable access to funding on favourable terms and are able to offer the lowest possible interest rates on lending. The low interest rates offered by KBN ensure investing in welfare services does not constitute a greater burden on municipalities' budgets than necessary. Our profits are returned to society through the dividends we pay to the state as our owner.

KBN will continue to play an important role in the decades ahead as the task of financing the welfare state becomes more challenging. The proportion of the population actively engaged in the labour market will continue to fall, but the working population will have to support the increasing costs associated with an ageing population. These demographic changes will place greater demands on the welfare services provided by the local government sector. Moreover, it is likely that these changes will coincide with a decline in the country's income from the Norwegian continental shelf. The Productivity Commission describes this as a shift from a resource-based economy to a knowledge-based economy. This will in turn increase the need for expertise and skills. The way in which municipalities and county authorities invest in good schools, automation and digitalisation may prove to be key factors for our success as a society. In addition, the shift towards a low-emission society will also need very significant investment spending. KBN's objective is to be a long-term partner for the efficient provision of welfare services, a good standard of local welfare and a greener society.

KBN plays an important role in Norwegian society as the largest provider of financing for local government investments. We are committed to taking a long-term and responsible approach to our role, and to helping the local government sector to find good financial solutions. Our role in society brings with it the expectation that we shall be open and transparent, maintain high ethical standards and play a driving role in the development of corporate social responsibility. An important part of KBN's corporate social responsibility is helping our customers maintain a sustainable financial position and exercise strong financial and debt management. Key concepts for this work in 2017 were digitalisation, better information and tools to support financial decision-making, and close collaboration with our customers.

2017 was a good year for KBN's financial performance. We achieved some increase in our market share as a result of greater demand for long-term loans. KBN's standard interest rate was reduced on 1 August from what was already a low level. The proportion of lending that is provided for environmental and climate-friendly projects increased.

We intend to work hard in 2018 to accelerate the growth of our green lending. The welfare investments for which KBN provides financing today will last well into the low-carbon society. Our obligations in respect of the climate and climate risk therefore need to be part of the basis on which we make decisions today. We want to help to increase our customers' awareness of climate risk. KBN is committed to taking a leading role in the development of green finance both in Norway and internationally. In 2017 KBN was elected to the Executive Committee of Green Bond Principles, which is the leading international standards authority for green bonds. KBN also collaborated in 2016 and 2017 with nine other Nordic issuers of green bonds to produce a joint reporting framework.

The #Metoo campaign started in the USA in autumn 2017 and quickly reached Norway. The campaign has created extensive debate and awareness of the issue of unwanted sexual attention, and a number of high profile individuals in politics, business and the media have lost their jobs and positions as a result of victims of misconduct speaking out about their experiences. This campaign seems likely to represent a turning point in work on gender equality.

KBN is committed to diversity and equality, and has an overall gender balance that complies with its 40% target. Our employees represent many languages and nationalities. This has a positive effect on our corporate culture, attitudes, working environment and expertise. It is essential for us to attract the best minds and the best expertise. This means that KBN must be recognised as an attractive and inclusive place to work. In addition to our internal work on diversity and equality, we also expect our suppliers and partners to work systematically on these issues both in their own organisations and with their own suppliers and subcontractors.

KBN is committed to working closely with its customers to create financially and environmentally sustainable municipalities and county authorities that deliver a high standard of local welfare.

FUNDING IN 2017:

118.5 NOK bill.

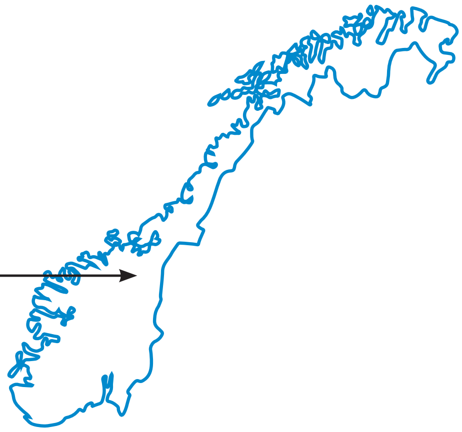
Kommunalbanken Norway

WE BORROW MONEY FROM ACROSS THE WORLD...

...AND LEND IT OUT ON ATTRACTIVE TERMS TO NORWEGIAN MUNICIPALITIES AND COUNTY AUTHORITIES

TOTAL LENDING:

281.7 NOK bill.



AAA/Aaa

Highest possible credit rating from Standard & Poor's and Moody's

14.6

NOK billion lending to climate-friendly municipal projects

55

NOK billion in new loans was granted in 2017

SATISFIED CUSTOMERS

Approximately half of Norway's municipalities and 70% of its county authorities responded to the 2017 customer satisfaction survey. With regard to the statement:

"I am satisfied with KBN"

progress was made relative to the 2016 level, which was already very high. The average of the scores given by respondents when asked to rate on a scale from 1 to 6 (where 6 is the best) how strongly they agreed with the statement was 5.26.

5.26 out of 6

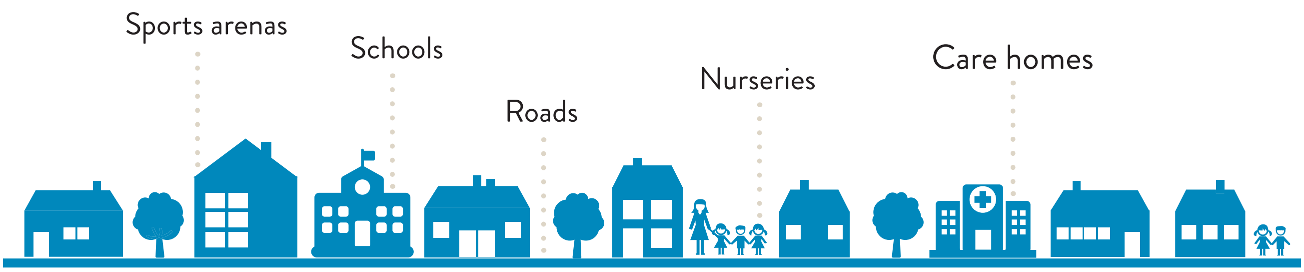
This is 0.12 points higher than in 2016.

100%

of the country's municipalities are KBN customers and

46%

of municipal debt is financed through KBN.



The Board of Directors' Annual Report 2017

Kommunalbanken Norway (KBN) is the largest provider of investment financing for the welfare services provided by Norwegian municipalities and county authorities, and offers attractive and long-term debt financing regardless of economic conditions. In 2017 KBN granted 646 new loans totalling NOK 55 billion. Municipalities, county authorities and intermunicipal companies have used these loans to finance projects including schools, health and care facilities, the water and wastewater area, and measures to prevent and adapt to the effects of climate change. KBN's robust financial results and efficient operating model demonstrate that it is fulfilling its role in society successfully.

KBN's lending grew by 5.7% in 2017, which is a slightly larger increase than in previous years. Long-term instalment loans showed good growth in 2017. Lending for climate and environment projects increased by 7% in 2017.

Profit for the year was NOK 1,429 million in 2017 as compared to NOK 689 million in 2016. Net interest income was higher than in 2016, and this was due to a combination of favourable funding conditions through large parts of 2017 and strong lending growth early in the year. KBN's profit for the year was reduced somewhat by unrealised losses of NOK 163 million stemming from losses on KBN's borrowings and exchange rate swap agreements used to convert non-NOK denominated borrowings into Norwegian kroner. For comparison, KBN had unrealised losses of NOK 974 million in 2016 as a consequence of losses on fixed rate loans and hedging derivatives. KBN's return on equity after tax was 12.7% as compared to 6.3% in 2016.

KBN's total common equity Tier 1 capital increased by NOK 1,440 million. KBN's equity increased by a total of NOK 2,215 million in 2017, partly due to issuance of subordinated debt in June 2017.

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 2017) 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 2017 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 1,429 million in 2017 as compared to NOK 689 million in 2016. Net interest income in 2017 totalled NOK 2,162 million as compared to NOK 2,087 million in 2016. Having been high in the first part of the year, KBN's lending margins decreased somewhat in the second half of 2017. This related to KBN decreasing its lending rate with effect from 1 August 2017 and also to generally lower credit spreads in the market.

Net unrealised losses on financial instruments reduced KBN's profit before tax by NOK 163 million in 2017. Net unrealised losses in 2016 totalled NOK 974 million. KBN's unrealised losses in 2017 reflect losses on borrowings measured at fair value as a consequence of lower credit spreads on KBN's own bonds and favourable changes in relation to currency swap agreements.

KBN's liquidity portfolio investments and fixed rate loans generated unrealised gains when measured at fair value. KBN's financial instruments are normally held to maturity and the effects of unrealised gains and losses on KBN's profits reverse either when fluctuations in the market reverse or the instruments reach maturity.

Net trading income (from market transactions such as repurchasing KBN's own bonds and selling securities held in the liquidity portfolio) totalled NOK 9 million in 2017, as compared to NOK 15 million in 2016.

Total operating expenses were NOK 193 million in 2017 as compared to NOK 177 million in 2016. This increase was in line with budget and was due primarily to an increase in staffing levels as well as to expenses related to further developing KBN’s customer portal and finance system and upgrading to 24/7 IT security monitoring. KBN’s operating expenses were also impacted by the financial sector tax introduced in 2017 and by implementation costs associated with new regulatory requirements. Total operating expenses represented 0.05% of total assets in 2017.

KBN had total assets at 31 December 2017 of NOK 412.9 billion as compared to NOK 418.3 billion at 31 December 2016. The decrease is primarily due to the Norwegian krone strengthening against other currencies, which reduces the NOK carrying amount of KBN’s assets and liabilities.

KBN’s total primary capital at 31 December 2017 was NOK 16,625 million, of which NOK 12,436 million is total common equity Tier 1 capital in the form of share capital and retained earnings. KBN’s Tier 1 capital consists of common equity Tier 1 capital and additional Tier 1 capital. The common equity Tier 1 capital adequacy ratio at 31 December 2017 was 18.41%, the Tier 1 capital adequacy ratio was 21.65%, and the total capital adequacy ratio was 24.61%. The leverage ratio at 31 December 2017 was 3.68%.

LENDING

KBN granted 646 new loans totalling NOK 55 billion in 2017. Total lending to the local government sector at the end of 2017 was NOK 281.7 billion. KBN’s loan portfolio grew by NOK 15.2 billion in 2017, representing an increase of 5.7%. KBN’s market share for the sector was approximately 46%.

All Norway’s municipalities and county authorities as well as Longyearbyen Local Council had loans from KBN at the end of 2017. In addition, a range of municipal and inter-municipal companies have loans from KBN. Loans to limited liability companies require municipal or county authority guarantees. KBN offers long-term loans with the same interest rate terms to all its borrowers regardless of their size, ensuring all municipalities have equal access to debt financing on competitive terms. In its recommendation to Parliament regarding the national budget for 2018, the Standing Committee on Local Government and Public Administration wrote that “KBN plays an important sectoral-policy function that contributes to high-quality welfare services across Norway”.

At the end of 2017, loans to toll road companies accounted for NOK 26.3 billion of the NOK 56.6 billion in outstanding loans to municipal and inter-municipal companies and borrowers with municipal or county authority guarantees.

The level of investment taking place in the local government sector is increasing and is being driven by the need to invest in schools, the health and care sectors, and the water and wastewater area. Analysis shows that there continues to be a significant maintenance backlog in the water and wastewater area. In addition, there is expected to be an increasing need for investment in measures to prevent and adapt to the effects of climate change. In June 2017 the Norwegian Government increased the subsidies available for round-the-clock health and care services. This creates an incentive for municipalities to invest in modernising their existing offer and to develop new capacity. The level of investment activity in the health and care sectors is expected to grow strongly in the years ahead.

The rate of growth in Norway’s population has slowed over the last few years. It is unclear what the consequences of this will be in terms of investment levels going forward. In a number of municipalities that have previously experienced strong population growth, the level of investment is now decreasing relative to previously very high levels. Other municipalities will continue to need to invest significantly in the years ahead. The strong financial performance of the local government sector taken as a whole in recent years means that municipalities are financing welfare services from their own reserves to a greater extent than in previous years. Borrowing growth in the sector in 2017 was 4.9%, which is approximately in line with 2016. This represents a significantly lower rate of growth than in previous years.

KBN again conducted a customer survey in 2017, and this demonstrated that customers are very satisfied with KBN. KBN's high levels of service and availability, as well as its attractive lending margins and skilled customer managers, attracted particularly high scores. Approximately half of KBN’s customers adopted KBN’s debt management portal, KBN Finans, in 2017. Those customers that use KBN Finans are KBN's most satisfied customers. KBN will continue to work to further develop KBN Finans as a tool for customers in 2018.

No customer has defaulted or had problems with making payments, so there are no grounds to expect any loan losses in 2018.

The lending market

In 2017 the local government lending market was again dominated by KBN and by municipalities making direct use of the capital market. KBN is the most important provider of long-term, instalment loans, which other market players only offer to a limited extent. There was satisfactory demand for long-term loans in 2017. Over the course of 2017 a number of customers chose to refinance short-maturity loans by arranging long-term, instalment loans.

The strong growth in the use of the capital markets seen in previous years stabilised in 2017. The amount of outstanding short-term local government sector borrowing decreased in 2017. This can be seen in the context of the more extensive information requirements regarding the maturity dates of interest-bearing debt that entered into force on 1 January 2017. Total local government sector borrowing in the capital markets grew by 3.7% in 2017, which represents approximately 30% of total debt growth in the sector in 2017.

KBN's aim is to contribute to the availability of robust but simple financing solutions and responsible debt management to ensure the sector's borrowing patterns are financially sustainable.

KBN's portfolio of loans with maturities of less than 12 months represents a small part of its overall lending and is part of its ongoing liquidity and capital management activities. This portfolio represented 3.5% of KBN's overall lending at the end of 2017 as compared to 4.7% at the end of 2016.

Green lending and green funding

KBN is committed to serving as a driving force in relation to municipalities making the transition into climate-robust low-carbon societies. KBN has offered a separate lending product specifically to finance investment in environmentally friendly projects since 2010, namely green loans. KBN finances its green loans by issuing green bonds in the capital markets, both in Norway and internationally.

The interest rate on KBN's green loans is 0.1 percentage points lower than the interest rate on its ordinary interest rate products. In order to be granted a green loan, the customer must demonstrate that its project complies with KBN's criteria, which were adopted in 2016. These criteria require the municipality to have a clear environmental ambition for the project and for it to exceed the requirements of the relevant legislation and regulations. A lower interest rate is intended to create incentives for municipalities and county authorities to invest in projects that are more ambitious from an environmental and climatic perspective.

At the end of 2017 KBN's green lending portfolio totalled NOK 14.6 billion. This is an increase of around 7% from the end of 2016. NOK 11.5 billion of the NOK 14.6 billion in outstanding green lending satisfies KBN's updated criteria set, which has been graded as "dark green" by CICERO Center for International Climate Research. "Dark green" means that the portfolio is compatible with the vision of making Norway a low-carbon society by 2050.

KBN granted new green loans totalling NOK 1.65 billion in 2017 to 47 different projects. Examples of projects financed using green loans include the new upper secondary schools in Romsdal and Horten that have been built in mass timber, an expansion to a seawater source heating system in Nordfjordeid, a biogas plant in Grødaland in Rogaland, and electrifying Båtsfjord port in Finnmark. Details of all the projects that were financed through green loans in 2017 are provided in KBN's environmental impact report for 2017, which is published at the same time as the annual report.

KBN wishes to play a leading role in the development of green finance in Norway and internationally. KBN was elected to the governing body of Green Bond Principles in 2017, which is the leading international industry standard for green bonds. In 2017 KBN held and participated in a number of events designed to promote green finance solutions in order to drive forward the transition to a low-carbon society.

KBN published its first impact report for its green bonds in March 2017. KBN collaborated with nine other Nordic green bond issuers in 2016 and 2017 to produce a joint reporting framework. This document, entitled "Nordic Public Sector Issuers: Position paper on Green Bonds Impact Reporting", was launched at an OECD event in October and has attracted a lot of attention both internationally and in Norway.

FUNDING

KBN's AAA/Aaa credit ratings ensure it has stable access to funding on favourable terms. KBN pursues a diversified funding strategy that ensures it has a broad investor base and low refinancing risk.

New long-term borrowings amounted to NOK 118.5 billion in 2017, which is NOK 35.8 billion higher than in 2016. Japan, other Asian markets, Europe and the USA were KBN's most important markets in 2017. KBN issued bonds in 13 different currencies in 2017.

KBN issued three USD-denominated benchmark bonds totalling USD 3.5 billion in 2017, while in Europe KBN issued a EUR-denominated benchmark bond of EUR 1.0 billion with a maturity of 10 years. These issues attracted a high level of interest from investors, and all KBN's benchmark bonds were significantly oversubscribed.

KBN's total borrowings decreased slightly in 2017 from NOK 376.8 billion to NOK 373.8 billion, and this change was due to the NOK exchange rate.

LIQUIDITY MANAGEMENT

KBN's policy is to operate with cash and cash equivalents that match its capital requirements, including lending growth, for the subsequent 12 months at all times. This means that KBN is able in any situation to meet its ongoing obligations over the next 12 months without having to raise additional funds.

KBN's liquidity portfolio is primarily held in zero-risk-weighted investments, and primarily in foreign currencies. As a result of the Norwegian krone strengthening against the US dollar in 2017, the value of the liquidity portfolio at 31 December 2017 was NOK 107.5 billion, down from NOK 116.4 billion at the end of 2016.

The liquidity portfolio is managed in a way that is intended to ensure KBN has 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. There were sizeable exchange rate fluctuations in 2017, and this affected the value of the liquidity portfolio in NOK terms.

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 570% at the end of 2017.

Credit margins for both financial institutions and European states fell in 2017, at the same time as interest rates rose in both Europe and the USA, with the Federal Reserve raising interest rates three times. Falling credit margins reduce the returns from the liquidity portfolio.

CORPORATE GOVERNANCE

KBN complies with the Norwegian Code of Practice for Corporate Governance in those areas that are relevant to its type of company, its ownership structure and its financial regulatory requirements. KBN is organised as a limited liability company that is 100%-owned by the Norwegian state. In its White Paper on Ownership Policy (Diverse and Value-Creating Ownership, White Paper No. 27 2013-2014), 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.

The objectives set for KBN as a state-owned entity stipulate 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.

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

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 and the Supervisory Board are elected by the Annual General Meeting. The Supervisory Board is a governing body required by KBN's Articles of Association, and its purpose is, inter alia, to produce statements on issues that concern the company and to be particularly focused on corporate governance.

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. An analysis of the proportion of time the Board spent on its various activities in 2017 shows that it allocated its time in a balanced way to strategy, organisational issues, internal control and audit, reporting and developing its work.

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 and Compliance department has overall responsibility for risk management and compliance at KBN. The Chief Risk and Compliance Officer reports to the CEO, but has a direct reporting line to the Board of Directors in accordance with Section 29 of the Norwegian CRD V Regulations. The Head of Compliance has a direct reporting line to the CEO and also to the Board of Directors for material breaches of compliance.

Figure: KBN Governing Bodies

THE BOARD OF DIRECTOR'S STATEMENT ON THE REMUNERATION OF SENIOR EXECUTIVES

Each year the Board of Directors approves guidelines on the remuneration of senior executives in the following financial year. The Board submits its statement on the remuneration of senior executives to the Annual General Meeting each year. The statement and information on the remuneration paid to senior executives are provided in Note 6 of KBN's financial statements in this annual report.

RISK MANAGEMENT AND INTERNAL CONTROL

KBN finances its lending to Norwegian municipalities in Norwegian kroner by borrowing in the capital markets, primarily in foreign currencies from the international markets. KBN has a liquidity portfolio that consists of interest-bearing securities in a range of currencies. This means that its earnings and balance sheet are affected by market fluctuations and the level of correlation between different risk components in the markets in which it operates.

KBN seeks to avoid interest rate and exchange rate risk. However, its earnings and balance sheet, including its equity, are affected by changes in market prices as a consequence of the unrealised gains and losses that these create, as well as by the fact that the vast majority of its funding is denominated in currencies other than Norwegian kroner. Changes in credit spreads and indices also contribute to unrealised gains and losses.

Organisation and governance

KBN's Board of Directors has established a risk appetite framework and sets policies and limits relating to KBN's operational activities. These policies are reviewed annually. The Board of Directors has also produced policies on internal control and considers the CEO's assessment of internal control on a yearly basis.

The purpose of risk management is to ensure that KBN manages its assets and liabilities responsibly. Risk assessments are carried out in relation to material risks for all KBN's business areas at least annually. Stress tests and scenario analysis are used to assess the vulnerability of KBN's key risk areas. The results of these stress tests are evaluated and considered as part of KBN's strategy formation process, its capital planning process, its recovery planning, and decisions on central policies.

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 exposure and risk events, with this forming an integral part of KBN's routine activity reporting processes.

The Audit Committee's role is to help the Board of Directors supervise the company's financial reporting and control systems 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 Remuneration Committee's role is to help the Board assess the company's remuneration arrangements by preparing issues related to this area and advising the Board accordingly.

KBN operates 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 and in accordance with internal and external regulations. The second line of defence monitors, guides and helps to improve and report on the first line checks. This responsibility comprises risk management and compliance control in relation to both internal and external regulations. KBN's financial control function and its risk management and compliance function comprise the second line of defence. The compliance function is part of the risk management function, and both functions have direct reporting lines to the CEO and the Board. The third line of defence is provided by the Board's independent supervisory and control function, which is carried out by the internal auditor.

Credit risk

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 may not be declared insolvent. The Local Government Act also contains provisions regarding the procedures that must be followed if payments have to be deferred. This in practice protects lenders from any losses in relation to debt and accrued interest.

KBN manages its liquidity by investing in securities with a low credit risk, and it has a low appetite for credit risk in relation to its liquidity counterparties.

KBN uses derivatives to reduce or eliminate the interest rate risk and exchange rate risk associated with its lending and funding activities and its liquidity portfolio investments. The risk associated with entering into derivative contracts is controlled by the use of central counterparties or other counterparties with a high credit rating, and by exchanging cash collateral in order to reduce KBN's exposure.

Liquidity risk

KBN has a very limited risk appetite with regard to liquidity risk and the purpose of liquidity management is to ensure it has sufficient liquid assets to cover its ongoing liabilities at any point. The liquidity portfolio is subject to requirements in respect of liquidity, ratings, diversification, counterparties and instrument types, inter alia. Liquidity management is designed to incur only limited price risk and to ensure KBN complies with the capital and liquidity requirements to which it is subject.

Interest rate risk and exchange rate risk

KBN has a very limited risk appetite with regard to its exposure to interest rate and exchange rate changes. Interest rate risk and exchange rate risk are managed by ensuring that the risk exposure arising from KBN's assets and liabilities is balanced at all times. Hedging transactions are also used to hedge interest rate risk and exchange rate risk.

Operational risk

The purpose of operational risk management is to identify risk across the organisation and to ensure there are sufficient risk-reduction measures (controls) in place to prevent losses. Annual risk reviews are undertaken for all critical functions. The operational risk management process is a tool for prioritising resources and balancing the costs associated with risk and risk-reduction activities. The processes and controls set up to reduce operational risk are intended to contribute to high-quality internal control at KBN.

CORPORATE COMMUNICATIONS AND PUBLIC RELATIONS

The Board of Directors regards regular, high-quality contact with KBN's major stakeholders as an important means of ensuring that there is a good understanding of its model and the framework in which it operates. The Government has expressed its expectations of the company in White Paper No. 27 (2013–2014) "Diverse and Value-Creating Ownership".

KBN's external communication activities are intended to help highlight issues that constitute potential obstacles to its ability to achieve its purpose or that affect its customers. In its external communications in 2017, KBN particularly emphasised the importance of a sustainable approach to borrowing by the local government sector, its green lending products, and its further development of its debt management portal KBN Finans.

KBN carried out a range of activities in 2017 to measure its reputation among major stakeholders. These activities prioritised KBN's customers in the local government sector as well as investors and investment banks active in the capital markets.

A good reputation is important to ensuring KBN is able 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 different specialist conferences and seminars in 2017.

KBN held its annual conference in April 2017, the theme of which was the local government sector's investment requirements through to 2040.

KBN organised two events at the Arendalsuka conference in 2017. One of these was in collaboration with the Norwegian Association of Local and Regional Authorities (KS) and addressed the local government sector's role in the "green shift". KBN organised the other event on its own, which addressed how digitalisation and innovation can help the local government sector to provide better welfare services using fewer resources in future. The main target audience of the events KBN organised was, in addition to customers for KBN's lending products, local and national politicians and advisers, and the official authorities.

KBN 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 once again a priority area in 2017. The purpose of this was to improve the level of contact KBN has with its target audiences, to increase the level of understanding of the role KBN plays in society, and to drive more traffic to its website.

ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

In 2016 KBN engaged in extensive dialogue with its stakeholders, revised its corporate social responsibility priorities and developed separate corporate social responsibility guidelines. In 2017 KBN worked on the priorities that it adopted in 2016. KBN's corporate social responsibility work is incorporated into its strategy work and the process for developing its activity plans. This approach ensures corporate social responsibility is an integral part of KBN's ordinary activities. KBN has produced a corporate social responsibility report for 2017 in accordance with the Global Reporting Initiative (GRI) reporting standard.

KBN decided to prioritise the following areas for its work on corporate social responsibility in 2018:

- Topic 1: Ethical conduct
- Topic 2: The supply chain
- Topic 3: Green finance
- Topic 4: Diversity and equality
- Topic 5: Sharing expertise and responsible lending
- Topic 6: Dialogue with stakeholders

For KBN's reporting on corporate social responsibility for 2017 and its objectives for 2018, see the separate Corporate Social Responsibility Report.

ORGANISATION AND EMPLOYEES

KBN is a knowledge business that needs to recruit and develop skilled employees across a range of specialist areas in order to fulfil its aims.

KBN had 80 employees at the end of 2017 equating to 77.2 full-time employees. 70 employees hold permanent positions. The temporary employees are students, replacements for employees on parental leave and temporary staff appointed in connection with various projects.

Changes were made to KBN's organisational structure in 2017 to further strengthen key deliveries and to ensure a unified allocation of responsibility for its various areas. Legal and regulatory affairs have been made into a separate department, and a new "People, strategy and digital development" department was also set up. This houses HR, cyber security, business management and internal service functions.

KBN increased its focus on building relationships with selected educational institutions to increase awareness of KBN's activities and to further strengthen its reputation. It also for the first time participated in 2017 in a number of career days on various campuses and gave a number of guest lectures in its core areas for a number of courses. It also expanded the number of student placements it offers, which give students the opportunity to acquire practical experience relevant to their studies.

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 other critical roles is for internal candidates of both genders to be identified and developed in order to reduce vulnerability and to develop expertise.

At the end of 2017 the proportion of women on the Board of Directors was 56%, while the equivalent proportions for the CEO's management team and for all employees (permanent and temporary) were 40% and 43%. The average age of KBN employees was 41.

Health, safety and the working environment

KBN is committed to ensuring all its employees have high-quality working conditions. The Working Environment Committee's aim is to actively contribute to the creation of a good working environment and the promotion of good physical health by building a culture characterised by well-being and collaboration. The Committee held regular meetings and carried out risk assessments in relation to health, safety and environmental issues. In 2017 the ethics program that was run for all employees focused on KBN's zero-tolerance approach to discrimination and harassment.

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.

No accidents or serious injuries were recorded as having occurred during working hours or in connection with journeys for work purposes or to or from work. No accidents or injuries were reported to the Norwegian Labour Inspection Authority.

The sickness rate was 2.73% in 2017 as compared to 1.41% in 2016. KBN's target is for the sickness rate to be below 2.5%. 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 following leave of absence and sickness. Staff turnover in 2017 was 11%.

ALLOCATION OF PROFIT

The Board of Directors of Kommunalbanken AS proposes the following allocation of the profit for the 2017 financial year: NOK 443 million is to be paid to KBN's owner as a dividend and NOK 986 million is to be transferred to retained earnings.

FUTURE PROSPECTS

In 2017 the Norwegian economy grew at an annual rate of 1.5%, with unemployment at 3.0% at the end of the year. Norwegian municipalities' finances are benefiting from the Norwegian economy's good general progress and the strong income growth they have enjoyed in recent years. In the 2008-2017 period, the local government sector saw its total real average income grow by 2.3% per year. The positive trend seen for local government finances is expected to continue going forward.

The local government sector will continue to have sizeable investment needs, with this driven by demographic changes to Norway's population, urbanisation, and the transition to a low-carbon society. KBN has worked with the analysis firm Menon Economics to produce a forecast of the local government sector's investment and borrowing needs in the years ahead. This analysis indicates that borrowing by the local government sector will increase by 2.1% per year in the period up to 2040. This is approximately one-third the rate of growth seen in the previous 12 years and is more in line with growth in the sector's income.

The Board of Directors of KBN has approved KBN's strategy for the 2018-2020 period, which involves a greater focus on customers through digitalisation and simpler financial management. In dialogue with its customers, KBN will seek to develop the customer experience by adopting new technological solutions in relation to efficient customer management, operational robustness and analysis capabilities. KBN will fulfil its role in society by lending responsibly.

KBN's framework, including its commitment to complying with all regulatory requirements and achieving the return requirement set for it, forms the basis of its activities. Achieving satisfactory earnings ensures KBN can achieve its mandate as a reliable and stable provider of long-term credit. A strong business performance enables

KBN to satisfy the expectations of its customers and other stakeholders. The Board expects that KBN will maintain a stable market share for lending to the local government sector over time.

The regulatory requirements for financial institutions have increased in scope in recent years. KBN is working continuously on adapting to a range of new regulatory requirements. As a low-risk instrument of the state, KBN has a different business model. In designing the regulations, the EU has to some extent taken low-risk financial institutions such as KBN into account. Several countries have issued suitably adapted regulations for financial institutions that lend to the public sector, for example by classifying them as "promotional banks". A predictable environment and framework conditions that are adapted to KBN's distinctive nature are important to KBN's ability to fulfil the major role it plays in building a better society.

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

Oslo, 31 December 2017

28 February 2018

The Board of Directors of Kommunalbanken AS

Else Bugge Fougner
Chair of the Board

Martin Skancke
Vice Chair

Rune Midtgaard
Member of the Board

Martha Takvam
Member of the Board

Nanna Egidius
Member of the Board

Brit Kristin Sæbø Rugland
Member of the Board

Petter Steen Jr.
Member of the Board

May-Iren Walstad Wassås
Employee representative

Jarle Byre
Employee representative

Kristine Falkgård
President & CEO

THE BOARD OF DIRECTORS OF KBN

From left: Brit Kristin Sæbø Rugland, Rune Midtgaard, Jarle Byre, Nanna Egidius, Else Bugge Fougner, Martin Skancke, Martha Takvam, Petter Steen Jr. and May-Iren Walstad Wassås.

BRIT KRISTIN SÆBØ RUGLAND	RUNE MIDTGAARD	JARLE BYRE
Member of the Board since 2016.	Member of the Board since 2014.	Employee representative since 2015.
Bachelor of Business Administration, Master of Management. Member, KBN Audit Committee. Member of the Board, Figgjo AS. Member of the Board, Norfund and Talent Norge AS. Member of Council on Ethics for the Norwegian Government Pension Fund Global.	Master of Business and Authorised Financial Analyst (AFA). CEO, Norsk Luftambulanse AS. Member, KBN Remuneration Committee and KBN Audit Committee.	Master of Business and Economics. Senior Relationship Manager, KBN. Member, KBN Remuneration Committee Personal alternate is Andreas Aleström.
Participated in 14 board meetings in 2017.	Participated in 13 board meetings in 2017.	Participated in 13 board meetings in 2017.

NANNA EGIDIUS	ELSE BUGGE FOUGNER	MARTIN SKANCKE
Member of the Board since 2004.	Chair since 1999.	Member since 2013, Vice Chair since 2015.
Master of Business. Director of Strategic Planning and Development, Lillehammer municipality. Member, KBN Audit Committee. Vice Chair, Ikomm AS.	Attorney - Admitted to the Supreme Court. Lawyer at Hjort DA. Chair, KBN Remuneration Committee. Member, KBN Risk Committee. Chair, Eksportkreditt Norge AS. Member of the Aker Kværner Holding ASA board and Protector Forsikring ASA board.	MSc in business. Owner and CEO of, Skancke Consulting AS. Chair, KBN Risk Committee. Chair, Principles for Responsible Investment. Member of the Board, Storebrand ASA and Norfund.
Participated in 13 board meetings in 2017.	Participated in 14 board meetings in 2017.	Participated in 14 board meetings in 2017.

MARTHA TAKVAM	PETTER STEEN JR.	MAY-IREN WALSTAD WASSÅS
Member of the Board since 2015.	Member of the Board since 2005.	Employee representative since 2016.
Master of Business and MBA in Finance. Director Group Internal Audit, Telenor ASA. Chair, KBN Audit Committee. Member, KBN Risk Committee.	Teacher. Consultant/advisor to Sveio Municipality. Member, KBN Remuneration Committee. Member of the Board, Haugaland Kraft AS.	Master of Business and Economics. Senior Portfolio Manager, KBN Treasury. Member of the Board, ACI Norge. Personal alternate is Marit Urmo Harstad.
Participated in 14 board meetings in 2017.	Participated in 14 board meetings in 2017.	Participated in 14 board meetings in 2017.

FINANCIAL STATEMENTS 2017

NOTES TO THE FINANCIAL STATEMENTS

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	2017	2016
Interest income		5 843	5 617
Interest expense		3 681	3 530
Net interest income	**1**	**2 162**	**2 087**
Fees and commission expenses	**2**	32	32
Net unrealised gain/(loss) on financial instruments	**3**	(163)	(974)
Net trading income	**4**	9	15
Total other operating income		**(186)**	**(991)**
Salaries and administrative expenses	**5,6,7**	132	125
Depreciation on fixed assets		21	20
Other expenses	**9**	40	32
Total operating expenses		**193**	**177**
Profit before tax		**1 783**	**919**
Income tax	**8**	354	230
Profit for the year		**1 429**	**689**
Portion allocated to shareholder		1 395	670
Portion allocated to owners of additional Tier 1 capital		34	19

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	2017	2016
Profit for the year		1 429	689
Other comprehensive income			
Items which will not be reclassified to profit or loss			
Actuarial gain/(loss) on defined benefit plan		(1)	(1)
Of which is tax		0	0
Total other comprehensive income		**(1)**	**(1)**
Total comprehensive income for the year		**1 428**	**688**

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	2017	2016
Assets			
Deposits with credit institutions	**10,11,12,14,21**	10 400	16 182
Instalment loans	**10,11,12,15**	283 396	267 521
Notes, bonds and other interest-bearing securities	**10,11,12,13,16**	107 445	118 550
Financial derivatives	**10,12,13,20,21**	11 476	15 921
Deferred tax asset	**8**	0	0
Other assets	**17**	137	153
Total assets		**412 854**	**418 327**
Liabilities and equity			
Loans from credit institutions	**10,12,18,21**	4 714	7 584
Senior securities issued	**10,11,12,13,19**	369 482	369 933
Financial derivatives	**10,12,13,20,21**	21 082	26 275
Other liabilities	**17**	86	45
Current tax liabilities	**8**	214	0
Deferred tax liabilities	**8**	551	12
Pension liabilities	**7**	50	52
Subordinated debt	**10,12,22**	2 008	1 974
Total liabilities		**398 187**	**405 875**
Share capital	**23**	3 145	3 145
Additional Tier 1 capital	**24**	2 189	994
Retained earnings		9 333	8 314
Total equity		**14 667**	**12 452**
Total liabilities and equity		**412 854**	**418 327**

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)

2017

	Note	Share capital	Additional Tier 1 capital	Retained earnings	Total equity
Equity as of 1 January 2017		3 145	994	8 314	12 452
Profit for the year		0	0	1 429	1 429
Total other comprehensive income		0	0	(1)	(1)
Interest paid on Tier 1 capital	**24**	0	0	(18)	(18)
Issued additional Tier 1 capital	**24**	0	1 195	0	1 195
Dividends for 2016		0	0	(390)	(390)
Equity as of 31 December 2017	**23**	**3 145**	**2 189**	**9 333**	**14 667**

2016

	Note	Share capital	Additional Tier 1 capital	Retained earnings	Total equity
Equity as of 1 January 2016		3 145	994	8 063	12 202
Profit for the year		0	0	689	689
Total other comprehensive income		0	0	(1)	(1)
Interest paid on Tier 1 capital	**24**	0	0	(20)	(20)
Issued additional Tier 1 capital	**24**	0	0	0	0
Dividends for 2015		0	0	(417)	(417)
Equity as of 31 December 2016	**23**	**3 145**	**994**	**8 314**	**12 452**

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	2017	2016
Cash flows from operating activities		
Interest received	5 830	5 433
Interest paid	(3 310)	(3 752)
Fees and commissions paid	(32)	(32)
Receipts from repurchase of issued securities	9	15
Cash payments to employees and suppliers	(172)	(157)
Income taxes paid	404	(838)
Net disbursement of loans to customers	(15 148)	(12 137)
Net (increase)/decrease in deposits with credit institutions	3 527	3 212
Net (increase)/decrease in notes, bonds and other interest-bearing securities	14 406	25 204
Net (increase)/decrease in other assets	13	(12)
Net increase/(decrease) in other liabilities	36	11
Net (increase)/decrease in financial derivatives	(12 094)	0
Net cash flows from operating activities	**(6 531)**	**16 947**
Cash flows from investing activities		
Net (purchase)/sales of property and equipment	(18)	(20)
Net cash flows from investing activities	**(18)**	**(20)**
Cash flows from financing activities		
Proceeds from issuance of commercial paper	0	0
Repayment of commercial paper	0	0
Proceeds from issuance of debt securities	118 509	82 752
Repayment of debt securities	(112 676)	(96 675)
Proceeds from issuance of additional Tier 1 capital	1 195	0
Interest paid on Tier 1 capital	(25)	(26)
Proceeds from issuance of subordinated debt	0	1 991
Repayment of subordinated debt	0	(1 758)
Dividends paid	(390)	(417)
Net cash flows from financing activities	**6 614**	**(14 134)**
Net cash flows	**65**	**2 793**
Effects of foreign exchange differences	(54)	(2 751)
Net cash flows after foreign exchange differences	**11**	**42**
Cash and cash equivalents at 1 January	76	34
Net change in cash and cash equivalents	11	42
Cash and cash equivalents at 31 December	**87**	**76**
Whereof		
Deposits with credit institutions without agreed time to maturity	*87*	*76*
Loans from credit institutions without agreed time to maturity	*0*	*0*

See note 19 for a reconciliation of changes in the carrying amount of liabilities that are part of financing activities. Such liabilities are Senior securities issued and Subordinated debt.

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 2017 were approved by the Board of Directors on 28 February 2018.

BASIS OF PREPARATION

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

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

FOREIGN CURRENCY TRANSLATION

The Company's functional and presentation currency is the Norwegian kroner (NOK). Assets and liabilities denominated in a foreign currency are translated into NOK at the exchange rate on the reporting date. Revenues and expenses denominated in a foreign currency are translated into NOK at the exchange rate at the transaction date. The financial statements are presented in NOK and rounded to the nearest million kroner, with the exception of Notes 6 and 7 that are presented in NOK thousand.

SIGNIFICANT ESTIMATES AND ACCOUNTING JUDGEMENTS

The preparation of financial statements in accordance with IFRS requires management to make judgements and assumptions, and use estimates that will affect the use of accounting policies. The estimates and accounting judgements affect carrying amounts of assets and liabilities, and revenues and expenses. Assumptions made about future development may change due to market changes, and actual results may deviate from the estimates. The most significant judgements and estimates used in the preparation of the financial accounts are:

Fair value measurement

The fair value of financial instruments that are not traded in an active market, or do not have available quoted prices at the reporting date, is determined using valuation techniques. When inputs are to a significant extent not observable, management makes assumptions and uses estimates when considering credit risk and liquidity risk related to financial instruments. Even if the assumptions and estimates are, to the greatest possible extent, based 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 a regular way purchase or sale of a financial asset, 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 has 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 takes place at initial recognition and determines the subsequent measurement according to IAS 39. The category of classification is determined by the characteristics of the financial instrument 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 and 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 derivative contracts used to hedge interest rate and currency risk, which are measured at fair value. This leads to a reduction in measurement inconsistency between bonds and notes, loans and issued bonds on one hand, and financial derivatives on the other hand.

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 that are 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 applied, 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 is 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), and are classified as Level 1-inputs when they represent actual market transactions.

Of the bank's financial instruments a larger share of Notes, bonds and other interest-bearing securities and issued benchmark bonds are allocated to Level 1.

Level 2

For financial instruments without available quoted prices in an active market, KBN will either use quoted prices of similar instruments in active markets, where possible, or valuation techniques where significant inputs are based on observable market data (provided by Reuters).

Level 2-inputs might include:

- Observable interest rate yield curves, basis swap spreads, FX-rates, equity indices, commodity indices and volatilities
- 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 basis swap spread 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

Of the bank's financial instruments Deposits with credit institutions and a larger share of Instalment loans, Notes, bonds and other interest-bearing securities, Financial derivatives and Senior securities issued are allocated to Level 2.

Level 3

Level 3 is relevant for financial instruments that are not traded in an active market and 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. 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 option-elements 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 option-elements is determined using both discounting and option pricing models with observable market data and estimates as inputs. The most significant unobservable input used in the valuation in Level 2 and Level 3 comprises the credit premium for financial instruments that are 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 in the Statement of financial position 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 recognized 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
- Deferral of 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 the lender's risk. 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 recognized 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 recognized 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 as "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 measured at cost with the deduction of accumulated depreciation and write-downs. Ordinary depreciation, based on cost price, is calculated by using a straight line method over the estimated useful life, and the disposal value of the assets is assumed to be zero.

INTANGIBLE ASSETS

Intangible assets are measured at cost. A domain name is classified as an intangible asset with an indefinite useful life and is not depreciated. Other intangible assets consist of IT systems. The acquisition cost is amortised over the useful life. Assets are tested for impairment annually. If there is an indication that assets are impaired, the value of the assets is written down, and the difference between the carrying amount and the recoverable amount is recognized in profit or loss.

PENSIONS

For defined benefit plans, pension liabilities are measured at the present value of future pension obligations accrued on the balance sheet date. Pension liabilities are calculated on a straight-line basis, based on assumptions about discount rates, future salary adjustment, pensions and benefits from the National Insurance, as well as assumptions on mortality and voluntary retirement. The pension cost for the period consists of the sum of the period's accrual, interest expense on the calculated liability and administrative expenses. Changes in previous periods' pension accruals (plan change) are recognized in the income statement when the pension plan change occurs.

The net pension cost for the period is included in «Salaries and administrative expenses». Changes in pension liabilitites and plan assets under defined benefit plans that result from changes and deviations in the calculation assumptions (changes in financial and actuarial assumptions) are presented in the Statement of comprehensive income as Other comprehensive income.

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 was reduced from 27 per cent to 25 per cent, effective from 1 January 2016, and is unchanged in 2017.

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 2017.

CHANGES IN ACCOUNTING POLICIES

The accounting policies applied to the financial statements are consistent with those used in the previous year. Changes in standards with effective date 1 January 2017 have not lead to material changes in KBN's financial statements.

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

TRANSITION TO IFRS 9 FINANCIAL INSTRUMENTS

IASB issued a new standard in 2014, IFRS 9 *Financial Instruments*, which was approved by the EU in 2016. The standard replaces the previous standard IAS 39 *Financial Instruments: Recognition and Measurement*, and is applicable from 1 January 2018. In principle, IFRS 9 introduces new rules in three areas:

1. Classification and measurement of financial instruments
2. Hedge accounting
3. Impairment of financial assets

1. Classification and measurement

According to IFRS 9, the classification of financial assets is determined both by the company's business model and by the characteristics of the contractual cash flows associated with the assets. IFRS 9 further maintains the option to designate assets and liabilities as measured at fair value through profit or loss (Fair Value Option), if doing so eliminates (or significantly reduces) a measurement or recognition inconsistency (accounting mismatch).

The rules for classification and measurement of financial liabilities are unchanged in IFRS 9 compared to IAS 39, except for the treatment of changes in the fair value of liabilities that are attributable to changes in credit risk for liabilities measured at fair value (Fair Value Option). Under IAS 39, these changes were presented in profit or loss, while IFRS 9 requires these to be presented in Other Comprehensive Income (OCI). See table below for the transition effect associated with this change.

KBN's business model for managing financial assets is considered to be "hold to collect" for both the lending and liquidity portfolios. Evaluation of all cash flows suggests that the assets also meet the requirement of solely being payments of principal and interest and therefore can be measured at amortised cost. KBN will, however, continue using Fair Value Option to a significant extent for assets and liabilities in order to avoid inconsistencies (accounting mismatch) that otherwise would arise.

Implementation of IFRS 9 allows for changes of previous classification. KBN will reclassify some loans and floating rate notes (assets and liabilities) without associated derivative contracts from Fair Value Option to Amortised Cost. Transition effects associated with this are shown in the table below.

2. Hedge Accounting

KBN's management has decided to implement IFRS 9 also for hedge accounting. In addition to fair value hedging of Senior securities issued, which already is established, cash flow hedge for parts of the liquidity portfolio is considered, but only for bonds purchased after the system solution for cash flow hedge is in place. Furthermore, it has been decided to introduce portfolio hedging of interest rate risk for parts of the lending portfolio (Instalment loans with fixed interest rate), for Instalment loans granted after the system solution for portfolio hedge is in place.

3. Impairment of financial assets

IAS 39 only requires recognition of impairment in case of objective evidence of impairment (credit loss events). IFRS 9 is forward-looking and requires recognition of Expected Credit Losses (ECL) for all financial assets measured at amortised cost (including those hedge accounted) or at fair value through Other Comprehensive Income (OCI).

IFRS 9 introduces a three-stage model where all instruments will be placed in stage 1 upon initial recognition. Stage 1 requires the calculation of a 12-month expected credit loss. This ECL reflects the entire loss on an asset weighted by the probability that the loss will occur in the next 12 months.

According to IFRS 9, an entity shall assess whether the credit risk of a financial asset has increased significantly on each reporting date. If this is the case, the exposure shall be moved to stage 2 or 3. Stage 2 and 3 require the calculation of a lifetime ECL.

The definition of what is considered to be a significant increase in credit risk is the basis for moving the exposure between the stages. A significant increase in credit risk is mainly based on an increase in the Probability of Default (PD) since initial recognition. KBN uses an internal credit assessment model to determine whether there has been a significant increase in credit risk for lending customers. If a payment stop has been decided under the Municipality Act for a municipality it shall be assessed whether a significant deterioration has taken place. This is expected to be very unlikely given the preventive follow-up system of the municipal sector as laid out by the Municipality Act. Payment delays of at least 90 days are also used as an additional indicator for lending customers including companies with municipal guarantees. For issuers in the liquidity portfolio, a rating fall below investment grade is regarded as a significant increase in credit risk.

Default (Stage 3) is defined for lending as events that result in actual credit losses (has never happened) or as late payments (at least 90 days) above a certain threshold amount. For the liquidity portfolio, default is defined as payment delays, bankruptcy or restructuring due to financial problems.

KBN has developed models and IT system solutions for the calculation of ECL, both in the bank's lending and portfolio systems. Expected credit losses are calculated per loan/instrument, based on the Exposure At Default (EAD), PD and the Loss Given Default (LGD), all estimated at the reporting date.

KBN uses recognised methods for determining the parameters that form the basis for the ECL calculation. For the calculation of LGD, KBN looks for instance to IRB assumptions (internal measurement methods according to the capital requirement regulation). PD will normally be obtained from reputable external sources (such as credit rating agencies) and represent historical (through the cycle) values. For the determination of the PD for municipalities and companies owned or guaranteed for by municipalities, KBN takes into account the rules as laid out by the Municipality Act, namely that municipalities cannot go bankrupt and the subsequent measures that will be taken by the government should there be payment problems.

Through the cycle PDs must be adjusted to reflect prevailing market conditions at the reporting date (point in time PD). KBN uses recognised models for this conversion.

Implementation of IFRS 9 leads to KBN recognising and presenting provisions for credit losses for the first time in its history. However, the recognised provisions are very small due to the quality of the portfolio. Loss provisions reduce equity and will increase the volatility of profit or loss going forward, especially if a significant increase in credit risk is seen to occur. All relevant exposures are considered to be in stage 1 as of 31 December 2017. See also the table below for measurement categories for relevant balance sheet items under IAS 39 and IFRS 9, and related carrying amounts.

Amounts in NOK 1 000 000)

1 January 2018	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39	Carrying amount IFRS 9
Deposits with credit institutions	At fair value through profit or loss (FVO)	Amortised cost	1 228	1 228
Deposits with credit institutions	Loans and receivables	Amortised cost	9 172	9 172
Deposits with credit institutions			**10 400**	**10 400**
Instalment loans	At fair value through profit or loss (FVO)	At fair value through profit or loss (FVO)	79 648	79 648
Instalment loans	At fair value through profit or loss (FVO)	Amortised cost	89 129	89 106
Instalment loans	Loans and receivables	Amortised cost	114 619	114 613
Instalment loans			**283 396**	**283 367**
Notes, bonds and other interest-bearing securities	At fair value through profit or loss (FVO)	At fair value through profit or loss (FVO)	90 181	90 181
Notes, bonds and other interest-bearing securities	At fair value through profit or loss (FVO)	Amortised cost	17 254	17 230
Notes, bonds and other interest-bearing securities	Held to maturity	Amortised cost	10	10
Notes, bonds and other interest-bearing securities			**107 445**	**107 421**
Financial derivatives	At fair value through profit or loss (Held for trading)	At fair value through profit or loss	10 805	10 805
Financial derivatives	At fair value through profit or loss (Fair value hedge)	At fair value through profit or loss (Fair value hedge)	671	671
Financial derivatives			**11 476**	**11 476**
Total financial assets			**412 717**	**412 664**
Loans from credit institutions	Other liabilities	Amortised cost	**4 714**	**4 714**
Senior securities issued	At fair value through profit or loss (FVO)	At fair value through profit or loss (FVO) and OCI (own credit)	154 365	154 365
Senior securities issued	At fair value through profit or loss (FVO)	Amortised cost	57 025	56 942
Senior securities issued	Other liabilities (Fair value hedge)	Amortised cost (Fair value hedge)	158 092	158 092
Senior securities issued			**369 482**	**369 399**
Financial derivatives	At fair value through profit or loss (Held for trading)	At fair value through profit or loss	19 720	19 720
Financial derivatives	At fair value through profit or loss (Fair value hedge)	At fair value through profit or loss (Fair value hedge)	1 362	1 362
Financial derivatives			**21 082**	**21 082**
Subordinated debt	At fair value through profit or loss (FVO)	At fair value through profit or loss (FVO) and OCI (own credit)	**2 008**	**2 008**
Total financial liabilities			**397 286**	**397 203**

The following table shows transition effects:

(Amounts in NOK 1 000 000)

1 January 2018	Transition effect in equity—reclassification	Transition effect in equity—Expected Credit Loss (ECL)	Value change based on own credit from profit or loss to Other Comprehensive Income (OCI)*
Instalment loans	(18)	(10)	
Notes, bonds and other interest-bearing securities	(23)	(1)	
Senior securities issued and subordinated debt	84		(480)

*Changes in the fair value of liabilities that are attributable to credit risk comprise changes in the USD price of issued bonds, in the form of a spread above the USD Libor interest rate. This includes value changes for derivative contracts directly associated with issued bonds, based on KBN issuing debt converted to US dollars.

NOTE 1

NET INTEREST INCOME

(Amounts in NOK 1 000 000)

2017	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	**(3)**	(4)	0	0	0	1	0
Instalment loans	**4 844**	3 123	0	0	0	1 721	0
Notes, bonds and other interest-bearing securities	**423**	391	0	0	0	32	0
Financial derivatives	**579**	0	594	(15)	0	0	0
Total interest income	**5 843**	**3 510**	**594**	**(15)**	**0**	**1 754**	**0**
Loans from credit institutions	**1**	1	0	0	0	0	0
Senior securities issued	**8 818**	6 326	0	0	0	0	2 492
Financial derivatives	**(5 198)**	0	(4 591)	(607)	0	0	0
Subordinated debt	**60**	60	0	0	0	0	0
Total interest expenses	**3 681**	**6 387**	**(4 592)**	**(607)**	**0**	**0**	**2 492**
Net interest income	**2 162**	**(2 877)**	**5 185**	**592**	**0**	**1 754**	**(2 492)**

2016	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	**(20)**	(20)	0	0	0	0	0
Instalment loans	**4 933**	3 293	0	0	0	1 639	0
Notes, bonds and other interest-bearing securities	**562**	496	0	0	0	66	0
Financial derivatives	**142**	0	192	(50)	0	0	0
Total interest income	**5 617**	**3 769**	**192**	**(50)**	**0**	**1 706**	**0**
Loans from credit institutions	**1**	1	0	0	0	0	0
Senior securities issued	**10 563**	8 308	0	0	0	0	2 256
Financial derivatives	**(7 098)**	0	(6 493)	(606)	0	0	0
Subordinated debt	**64**	64	0	0	0	0	0
Total interest expenses	**3 530**	**8 373**	**(6 493)**	**(606)**	**0**	**0**	**2 256**
Net interest income	**2 087**	**(4 604)**	**6 685**	**556**	**0**	**1 706**	**(2 256)**

NOTE 2

FEES AND COMMISSION EXPENSES

(Amounts in NOK 1 000 000)

	2017	2016
Expenses of banking services	20	18
Other transaction costs	13	14
Total fees and commission expenses	**32**	**32**

NOTE 3

NET UNREALISED GAIN/(LOSS) ON FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

2017	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge		
Instalment loans	**760**	760	0	0	0	0
Notes, bonds and other interest-bearing securities	**71**	60	0	0	11	0
Financial derivatives	**2 271**	0	3 050	(779)	0	0
Loans from credit institutions	**0**	0	0	0	0	0
Senior securities issued	**(3 231)**	(4 046)	0	0	0	815
Subordinated debt	**(34)**	(34)	0	0	0	0
Net unrealised gain/(loss) on financial instruments	**(163)**	**(3 260)**	**3 050**	**(779)**	**11**	**815**

2016	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge		
Instalment loans	**(1 542)**	(1 542)	0	0	0	0
Notes, bonds and other interest-bearing securities	**(185)**	(158)	0	0	(27)	0
Financial derivatives	**3 247**	0	3 962	(716)	0	0
Loans from credit institutions	**0**	0	0	0	0	0
Senior securities issued	**(2 564)**	(3 274)	0	0	0	711
Subordinated debt	**70**	70	0	0	0	0
Net unrealised gain/(loss) on financial instruments	**(974)**	**(4 904)**	**3 962**	**(716)**	**(27)**	**711**

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 issued bonds may on the other hand lead to significant income statement effects, as may changes in basis swap spreads.

Of net unrealised losses in 2017 amounting to NOK 163 million, Senior securities issued and related financial derivatives contribute with a loss of NOK 756 million. The loss is primarily due to narrowing of credit spreads for issued bonds and narrowing of basis swap spreads between USD and the currency of the issued bond. Basis swap spreads affect the value of derivatives that are used to convert local currency bonds to USD. Furthermore, the widening of USD-NOK basis swap spreads contributes somewhat to the loss by affecting the value of derivatives used to convert USD funding to NOK. Funding losses are to a large extent offset by unrealised gains from Notes, bonds and other interest-bearing securities and from Instalment loans with gains of NOK 106 million and NOK 488 million, respectively. Net unrealised losses amounting to NOK 974 million in 2016 came from Instalment loans and Senior securities issued and related financial derivatives. In cases where the changes in fair value are realised on sale, repurchase or termination before maturity, the resulting gain or loss is presented as "Net trading income" in the income statement.
Financial derivatives in fair value hedges, see Note 13 Hedge accounting, are measured at fair value through profit or loss. The related hedged items comprise NOK 158.1 billion in "Senior securities issued", that are classified as Other liabilities and measured at amortised cost. Changes in fair value for the hedged item that is attributable to the hedged risk adjust the carrying amount of the item, and are recognized and presented 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 table above.

NOTE 4

NET TRADING INCOME

(Amounts in NOK 1 000 000)

KBN to some extent does transactions that entail realisations and derecognition before maturity of either assets or liabilities. These transactions comprise sales of securities from the liquidity portfolio or repurchases of bond debt. Realised gain/(loss) is presented as Net trading income.

	2017	2016
Gain/(loss) from repurchase of securities issued	3	5
Gain/(loss) from sales of bond investments and derivatives terminations	6	10
Net trading income	**9**	**15**

NOTE 5

SALARIES AND ADMINISTRATIVE EXPENSES

(Amounts in NOK 1 000 000)

	2017	2016
Salaries	76	73
Employer contributions	15	10
Pension costs	7	12
Other personnel benefits	2	3
Administrative expenses	33	27
Total salaries and administrative expenses	**132**	**125**
Average number of man-years	*74*	*70*

Employers' contributions include finance tax of 5.0% from 1 January 2017. Hence total employers' contribution is 19.1% from 2017.

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 Financial Undertakings Regulation 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 in the following financial year of up to 1.5 times one month's salary for all employees.

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 management team, comprising 8 persons.

MANAGEMENT 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 four members, who are appointed annually by and among the members of the Board. At year end 2017, the Committee's members are Else Bugge Fougner (Chair), Rune Midtgaard, Petter Steen jr. and Jarle Byre (employee representative).

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 Financial Undertakings 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 takes into account the Board's views when making final decisions on such remuneration. 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 2017

Fixed salary

Fixed salary payable in 2017 included the normal annual salary increase.

Variable salary

Guidelines for variable salary were adopted by the Board in December 2016 for the financial year 2017. These have resulted in a variable salary of 1.5 monthly wages for all employees, which will be approved by the Board after the annual report 2017 has been adopted.

Other benefits

Other benefits include 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 and the Chief Lending Officer are entitled to a fixed annual car benefit of NOK 130,000 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.

Pension benefits

Until 31 December 2017, senior executives were members of KBN's defined benefit pension scheme administered by KLP for salaries below 12 times the National Insurance base amount (G). Members of this 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. The scheme also includes disability and life pensions and contractual early retirement.

From 1 January 2018 on, the pension scheme has been changed to a defined contribution scheme with Storebrand Livsforsikring AS. The new scheme applies to all employees, except those who are 55 years or older at 1 January 2018, as well as partially disabled or fully incapacitated employees entitled to sickness benefit payments at the starting time of the defined contribution pension plans. These are covered by previous arrangements in KLP.

The defined contribution pension scheme was established with a deposit rate of 7% for salaries between zero and 7.1G and 18% for salaries between 7.1 and 12G. A contractual pension plan (AFP) in the private sector associated with the joint scheme is offered if and when a collective agreement is entered into. Related insurance coverings are included in the scheme and include disability pension scheme with child allowance without the right to paid-up policies, child pension and group life insurance / death benefit. Employees who are estimated to receive a lower expected retirement pension at the age of 67 according to the new scheme compared to the defined benefit plan, have been granted a partial compensation (30%), paid monthly over two years, provided they are still under KBN employment during the payout period.

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1) The Financial Enterprises Act

2) The Financial Undertakings Regulation

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 Ministry of Trade, Industry and Fisheries with effect from 13. February 2015.

2017

Remuneration to senior executives	Agreed fixed salary	Paid fixed salary*	Variable salary accrued in the period**	Other benefits	Pension costs
Kristine Falkgård (President & CEO)	2 967	3 056	371	198	196
Sigbjørn Birkeland (Chief Capital Markets Officer), from 1 August 2017	1 950	813	102	17	61
Jannicke Trumpy Granquist (CFO)	1 845	1 885	231	40	157
Tor Ole Steinsland (Chief Communications Officer)	1 261	1 290	158	39	163
Håvard Thorstad (CRO)	1 707	1 740	213	40	151
Ilse Margarete Bache (Chief of IT and Operations)	1 435	1 493	179	34	161
Lars Strøm Prestvik (Chief Lending Officer)	1 547	1 583	193	112	154
Morten Hatlem (Chief People, Strategy and Digital Development Officer), from 1 September 2017	1 400	467	58	8	48
Thomas Yul Hanssen (Chief Legal & Regulatory Affairs Officer), from 1 April 2017	1 300	973	122	38	115
Total remuneration to senior executives	**15 412**	**13 299**	**1 627**	**525**	**1 206**
Total remuneration to employees whose professional activities affect the risk position of the institution		**16 582**	**2 039**	**560**	**2 265**
Total remuneration to the employees in the independent control functions		**20 635**	**2 687**	**473**	**2 882**

**11 months fixed salary and holiday pay based on last year's salary **Paid out in the following year*

2016

Remuneration to senior executives	Agreed fixed salary	Paid fixed salary*	Variable salary accrued in the period**	Other benefits	Pension costs
Kristine Falkgård (President & CEO)	2 895	3 075	361	200	192
Martin Spillum (Chief Financial Markets Officer) (until 30.10.16)	2 381	2 462	298	134	172
Jannicke Trumpy Granquist (CFO)	1 791	1 830	224	49	150
Tor Ole Steinsland (Chief Communications Officer)	1 233	1 266	154	39	157
Håvard Thorstad (CRO)	1 683	1 651	210	31	166
Ilse Margarete Bache (Chief of Staff and Operations)	1 412	1 470	177	46	142
Lars Strøm Prestvik (Chief Lending Officer)	1 505	1 546	188	118	147
Total remuneration to senior executives	**12 900**	**13 300**	**1 612**	**617**	**1 126**
Total remuneration to employees whose professional activities affect the risk position of the institution		**17 239**	**1 886**	**590**	**2 317**
Total remuneration to the employees in the independent control functions		**21 450**	**2 775**	**517**	**2 711**

**11 months fixed salary and holiday pay based on last year's salary **Paid out in the following year*

Remuneration to Board of Directors	2017	2016
Chairman Else Bugge Fougner 1) 3)	414	405
Vice-chairman Martin Skancke (vice-chairman from 5 June 2015) 3)	270	264
Board member Nanna Egidius 2)	202	197
Board member Martha Takvam 2) 3)	317	310
Board member Rune Sollie (until 3 June 2016) 2)	0	98
Board member Rune Midtgaard 1) 2)	244	210
Board member Petter Steen jr (from 5 June 2015) 1)	187	162
Board member Brit Rugland (from 3 June 2016) 2)	202	100
Board member employees' representative Jarle Byre (from 5 June 2015) 1)	161	182
Board member employees' representative Marit Urmo Harstad (until 3 June 2016)	0	70
Board member employees' representative May-Iren Walstad Wassås (from 3 June 2016)	145	72
Alternate Board member employees' representative Andreas Alestrøm (from 5 June 2017)	6	0
Total remuneration to Board of Directors	**2 148**	**2 070**

1) Member of remuneration committee

2) Member of audit committee

3) Member of risk committee

Remuneration to Control Committee	2017	2016
Chairman Kjell Inge Skaldebø (until 3 June 2016)	0	29
Committee member Anne-Ma Tostrup Smith (until 3 June 2016)	0	18
Committee member Ole Rødal (until 3 June 2016)	0	18
Committee alternate member Roy Jevard (until 3 June 2016)	0	18
Total remuneration to Control Committee	**0**	**83**

Remuneration to Supervisory Board	2017	2016
Chairman Svein Ludvigsen	24	23
Board members	70	73
Total remuneration to Supervisory Board	**94**	**96**

Fees to the statutory auditor	2017	2016
Statutory audit fees	866	983
Other financial audit and attestation services	1 156	981
Tax services	490	520
Other services not related to audit*	1 087	57
Total fees excl. VAT	**3 599**	**2 541**

*Other services not related to audit in 2017 is accounting related assistance related to KBN’s implementation of the new accounting standard IFRS 9.

NOTE 7

PENSIONS

(Amounts in NOK 1 000)

As of 31 December 2017 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 are 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 benefits 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 (G) has been closed as of 1 April 2011, and was terminated in 2015 for current employees that were part of the plan.

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

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

KBN's pension scheme has been changed to a defined contribution scheme as from 1 January 2018. The new scheme applies to all employees, except for those who are 55 years or older at transition date, as well as partially or fully disabled employees entitled to sickness benefit at the time of transition. These individuals are still covered by the defined benefit plan described above. The defined contribution pension scheme was established with a deposit rate of 7% for salaries between zero and 7.1 G and 18% for salaries between 7.1 and 12 G. AFP in the private sector associated with the joint scheme will be offered if and when a collective agreement is entered into. Employees who are estimated to receive a lower expected retirement pension at the age of 67 according to the new scheme compared to the defined benefit plan, have been granted a partial compensation (30%). The compensation is calculated on transition date 1 January 2018 and is based on the estimated reduction in pension. The compensation amount has been finally set. Compensation payments will take place monthly over the course of two years, provided that the employee works at KBN during the payout period. The compensation cost will be recognised over these two years.

The change of pension scheme for 62 of 74 employees at year end constitutes a plan change that results in a recognition of income amounting to NOK 6.8 million at 31 December 2017, and a corresponding reduced pension liability in the Statement of financial position. The new pension scheme entails costs from 2018.

Economic estimates used in calculation of pension costs and defined benefit obligation	31.12.2017	31.12.2016
Discount rate	2.40%	2.60%
Estimated wage growth	2.50%	2.50%
Estimated growth in Base amount	2.25%	2.25%
Expected growth in benefit levels	1.48%	1.48%

KBN has used Norwegian covered bonds as input when determining the discount rate for 2017 and 2016. The actuarial assumptions are based on standard assumptions related to demographic factors recommended by the Norwegian Accounting Standards Board.

Pension costs	Funded plan		Unfunded plan	
	2017	2016	2017	2016
Net periodic pension cost	9 877	8 934	0	0
Net interest	1 099	1 027	438	443
Service cost	271	249	0	0
Employer contributions	1 586	1 440	62	62
Plan change at transition to defined contribution scheme	(6 791)	0	0	0
Total pension cost recognised in income statement	**6 041**	**11 649**	**499**	**505**
Actuarial gain/(loss) recognised in other comprehensive income	320	902	506	273
Net pension costs	**6 361**	**12 551**	**1 005**	**778**

Pension liabilities	Funded plan		Unfunded plan	
	2017	2016	2017	2016
Defined benefit obligation	117 487	107 371	17 598	16 958
Plan assets	(91 700)	(78 422)	0	0
Employer contributions	3 636	4 082	2 481	2 391
Net pension liabilities	**29 424**	**33 031**	**20 079**	**19 349**

Movement in pension liabilities	Funded plan		Unfunded plan	
	2017	2016	2017	2016
Net pension liabilities as of 1 January	33 031	29 900	19 349	18 840
Net pension costs	6 361	12 551	1 005	778
Contribution to the pension scheme	(9 969)	(9 419)	(275)	(270)
Net pension liabilities as of 31 December	**29 424**	**33 031**	**20 079**	**19 349**

Movement in the fair value of plan assets	Funded plan		Unfunded plan	
	2017	**2016**	**2017**	**2016**
Fair value of plan assets as of 1 January	78 422	68 608	0	0
Net interest	1 931	1 762	0	0
Actuarial gain/(loss)	4 320	996	0	0
Service cost	(271)	(249)	0	0
Contribution to the pension scheme	8 737	8 255	241	237
Benefits paid	(1 440)	(951)	(241)	(237)
Fair value of plan assets as of 31 December	**91 700**	**78 422**	**0**	**0**

NOTE 8

TAX

(Amounts in NOK 1 000 000)

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

	2017	**2016**
Payable taxes on income for the period*	220	0
Change in deferred tax	539	230
Change in deferred tax as a result of changes in tax return for previous years	(315)	0
Effect of reduced tax rate as a result of changes in tax return for previous years	(89)	0
Total income tax	**354**	**230**

*Change in payable taxes on income for the period from items recognised under equity capital (additional Tier 1 capital) reduces payable tax as at 31 December 2017 in the Statement of financial position to NOK 214 million.

Reconciliation of effective income tax rate	**2017**	**2016**
Profit before tax	1 783	919
Calculated tax expense	446	230
Effect of reduced tax rate as a result of changes in tax return for previous years	(89)	0
Effect of change in tax rate	(2)	0
Tax expense	**354**	**230**
Effective income tax rate	20 %	25 %

Deferred tax liability/(asset)	**2017**	**2016**
Deferred tax liability/(asset) as at 1 January	12	(201)
Change in deferred tax	539	230
Changes in deferred tax on items recognised in other comprehensive income	0	0
Changes in deferred tax on items recognised in equity (additional Tier 1 capital)	0	(17)
Deferred tax liability/(asset) as at 31 December (25%)	**551**	**12**

Temporary differences	**2017**	**2016**
Fixed assets	(6)	(4)
Pension liabilities	(50)	(52)
Provisions	(11)	(10)
Financial derivatives	1 055	2 597
Premiums/discounts on financial instruments	(4 734)	(1 602)
Unrealised gain/loss on financial instruments	(574)	(411)
Currency gain/loss on financial instruments	9 905	7 900
Losses carried forward for tax purposes	(3 384)	(8 370)
Total temporary differences	**2 202**	**48**
Deferred tax liability/(asset)	**551**	**12**

KBN received a decision in November 2017 regarding changes in the tax return for the tax year 2014. The amendment relates to the tax treatment and periodisation of financial instruments, principally regarding the use of the realisation principle on the currency element of financial instruments. In the financial statements for 2017 KBN has adapted to the decisions of the tax authorities, and thus has recognised changes in ending temporary differences for financial instruments, in accordance with the decision.

The decision regarding changes in the tax return for the tax year 2014 leads to the original taxable income for 2014 and 2015, when the tax rate was 27%, being moved forward in time until 2016 or later, with a tax rate of 25%. The effect of this is a reduction in the tax expense amounting to NOK 89 million, which is recognized in 2017, based on the tax authorities' decision. This results in an effective tax rate of 20% for 2017, see table Reconciliation of effective income tax rate above.

The tax authorities' decision implies a changed periodisation and timing of taxable income / expense over time, but no changes in which items are included in taxable income in total over the instruments' lifetime. It is the bank's view that the tax authorities' decision will result in larger and more volatile temporary differences and tax payments, but without a material effect for the bank tax expense, with the exception of when the tax rate changes.

NOTE 9

LEASES

(Amounts in NOK 1 000 000)

Future minimum lease payments	2017	2016
Under 1 year	7	6
1-5 years	6	17
Over 5 years	0	0
Total future minimum lease payments	**13**	**23**

Lease payments recognised as an expense in the period	7	7

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

NOTE 10

CATEGORISATION OF FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

		At fair value through profit or loss					
2017	Total	Fair value option	Held for trading	Fair value hedge	Held to maturity	Loans and receivables	Other liabilities
Deposits with credit institutions	**10 400**	1 228	0	0	0	9 172	0
Instalment loans	**283 396**	168 777	0	0	0	114 619	0
Notes, bonds and other interest-bearing securities	**107 445**	107 435	0	0	10	0	0
Financial derivatives	**11 476**	0	10 805	671	0	0	0
Total financial assets	**412 717**	**277 440**	**10 805**	**671**	**10**	**123 791**	**0**
Loans from credit institutions	**4 714**	0	0	0	0	0	4 714
Senior securities issued	**369 482**	211 390	0	0	0	0	158 092
Financial derivatives	**21 082**	0	19 720	1 362	0	0	0
Subordinated debt	**2 008**	2 008	0	0	0	0	0
Total financial liabilities	**397 286**	**213 398**	**19 720**	**1 362**	**0**	**0**	**162 806**

		At fair value through profit or loss					
2016	Total	Fair value option	Held for trading	Fair value hedge	Held to maturity	Loans and receivables	Other liabilities
Deposits with credit institutions	**16 182**	5 208	0	0	0	10 974	0
Instalment loans	**267 521**	164 748	0	0	0	102 773	0
Notes, bonds and other interest-bearing securities	**118 550**	117 414	0	0	21	1 115	0
Financial derivatives	**15 921**	0	14 955	966	0	0	0
Total financial assets	**418 174**	**287 370**	**14 955**	**966**	**21**	**114 864**	**0**
Loans from credit institutions	**7 584**	0	0	0	0	0	7 584
Senior securities issued	**369 933**	223 710	0	0	0	0	146 223
Financial derivatives	**26 275**	0	25 246	1 029	0	0	0
Subordinated debt	**1 974**	1 974	0	0	0	0	0
Total financial liabilities	**405 765**	**225 684**	**25 246**	**1 029**	**0**	**0**	**153 807**

NOTE 11

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE
(Amounts in NOK 1 000 000)

2017	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	1 228	0	**1 228**
Instalment loans	0	99 464	69 313	**168 777**
Notes, bonds and other interest-bearing securities	85 910	20 951	574	**107 435**
Financial derivatives	0	8 754	2 722	**11 476**
Total financial assets measured at fair value	**85 910**	**130 397**	**72 609**	**288 916**
Loans from credit institutions	0	0	0	**0**
Senior securities issued	7 980	123 251	80 159	**211 390**
Financial derivatives	0	8 177	12 905	**21 082**
Subordinated debt	0	0	2 008	**2 008**
Total financial liabilities measured at fair value	**7 980**	**131 428**	**95 072**	**234 479**

Holdings of NOK 22 billion kroner are transferred from Level 2 to Level 1 for Notes, bonds and other interest-bearing securities per 31 December 2017

2016	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	5 208	0	**5 208**
Instalment loans	0	99 019	65 728	**164 747**
Notes, bonds and other interest-bearing securities	58 275	56 628	2 511	**117 414**
Financial derivatives	0	13 507	2 414	**15 921**
Total financial assets measured at fair value	**58 275**	**174 363**	**70 653**	**303 291**
Loans from credit institutions	0	0	0	**0**
Senior securities issued	0	146 853	76 857	**223 710**
Financial derivatives	0	5 909	20 366	**26 275**
Subordinated debt	0	0	1 974	**1 974**
Total financial liabilities measured at fair value	**0**	**152 762**	**99 197**	**251 959**

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

Information about 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”.

KBN has established policies and guidelines for valuation that describe principles for fair value measurement of financial instruments. The main principles are that fair value should be measured at the value the asset may be sold for or the liability repurchased/transferred for, and that observable data shall be used to the extent possible in the valuation, and quality assurance should be undertaken against alternative sources. The guidelines also set out the frequency of valuation for different instrument types, and procedures for control of fair value.

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. These placements are allocated to Level 2.

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 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 for different maturities, based on prices for loans issued in a period closer to the balance sheet date. Loans from a limited time-period before the reporting date are used in determining the credit spread, in order to ensure sufficient data and representative estimates. In addition an evaluation is carried out of whether conditions leading up to the balance sheet date suggest that the chosen time period does not to a sufficient extent reflect the market conditions on the balance sheet 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 by the use of the discounted cash flow method, where discount rates are derived from observable money market interest rate yield curves. Discount rates are adjusted for the issuer's credit and liquidity risk 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. Management allocates all investments to their respective levels on each reporting date. Unobservable credit spreads are used to some extent when there is little or no market activity for the security in concern or equivalent securities. Where these are material 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. Hedge accounting is mainly applied for these bonds, see Note 12 and 13. 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. The determination of fair value of these securities is mainly done by 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 collects non-binding price indications from brokers.

Group three is comprised of 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 non-professional investors. 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 that are linked to stock prices, equity indices, FX rates or commodity prices. Quoted prices are hence not available for the security, and unobservable inputs are used to a significant degree in the valuation. These loans are therefore allocated to Level 3 in the fair value hierarchy, and thus are characterised by significant valuation uncertainty. The choice of valuation techniques and inputs depends on the structure and terms of each loan. For all bonds in these groups fair value is determined by using the discounted cash flow method where inputs are current interest rate yield curves and credit spreads that are estimated from price indications to brokers via the Company's information channels. Credit spreads are for these groups regarded as an unobservable input, and hence an estimate. For structured bonds with option elements, option pricing models are used in addition to determine expected cash-flows. These models use interest rates, FX-rates, stock prices, equity indices and implicit or 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), FRAs and plain vanilla interest rate and cross currency swaps without option elements, fair value is determined by using the discounted cash flow method with discount rates derived from observable basis swap spreads and swap interest rates. Hence, these contracts are allocated to Level 2, with considerable market activity for new contracts and relevant market parameters. Cross-currency swaps and interest rate swaps which are economic hedges of structured bonds and that have option elements linked to for instance equity or FX rates are valued using the same valuation models as corresponding issued bonds and are classified as Level 3 when unobservable inputs are used to a significant extent.

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 or option elements 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 that are not traded in an active market. Fair value of financial instruments with embedded derivatives or option elements is determined using a combination of a discounted cash flows method and 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

	Instalment loans	Notes, bonds and other interest-bearing securities	Senior securities issued	Subordinated debt	Financial derivatives
Carrying amount at 31 December 2016	**65 728**	**2 511**	**76 857**	**1 974**	**(17 952)**
Purchase	0	164	(1 126)	0	(1 717)
Sale	0	0	0	0	0
Issue	26 680	0	40 661	0	0
Settlement	(23 221)	(760)	(37 775)	0	(6 081)
Transfer into Level 3	1 149	871	0	0	0
Transfer out of Level 3	(3 519)	(3 491)	0	0	0
Gain/(loss) recognised in the period	2 495	1 279	1 542	34	15 568
Carrying amount at 31 December 2017	**69 313**	**574**	**80 159**	**2 008**	**(10 183)**

	Instalment loans	Notes, bonds and other interest-bearing securities	Senior securities issued	Subordinated debt	Financial derivatives
Carrying amount at 31 December 2015	**58 830**	**5 967**	**72 702**	**1 764**	**(27 421)**
Purchase	0	6 255	(925)	0	(1 011)
Sale	0	0	0	0	0
Issue	30 857	0	33 974	2 051	0
Settlement	(23 184)	(7 223)	(25 721)	(1 787)	3 642
Transfer into Level 3	1 874	6 309	0	0	0
Transfer out of Level 3	(5 908)	(7 560)	0	0	0
Gain/(loss) recognised in the period	3 259	(1 236)	(3 173)	(54)	6 838
Carrying amount at 31 December 2016	**65 728**	**2 511**	**76 857**	**1 974**	**(17 952)**

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 2017 vary from –89 bp to +39 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 –12 bp to +35 bp for notes and bonds. Other significant unobservable inputs include volatilities within option pricing models. Other than this, inputs used in option pricing are mainly observable.

In 2017, Notes, bonds and other interest-bearing securities amounting to NOK 2 620 million were transferred from Level 3 to Level 1 or 2, based on improved liquidity and increased market activity 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 – yield curve” below.

Impact of changes in key assumptions - yield curve	2017		2016	
	Carrying amount	Impact of changes in key assumptions	Carrying amount	Impact of changes in key assumptions
Instalment loans	69 313	(277)	65 728	(283)
Notes, bonds and other interest-bearing securities	574	(1)	2 511	(5)
Financial derivatives	(10 183)	(16)	(17 952)	(41)
Senior securities issued	(80 159)	352	(76 857)	321
Subordinated debt	(2 008)	21	(1 974)	22
Total	**(22 463)**	**79**	**(28 544)**	**14**

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 will lead to a reduction in value of NOK 277 million for these loans. 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 1 million. This could be caused by either an increase in credit spreads for relevant bonds, or increased liquidity risk in interest rate 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 352 million, which results in an unrealised gain. Again this could be caused by an increase in the credit spread, in this case for KBN. The table above assumes a parallel shift of the yield curve, different changes for different maturities may also be envisaged.

Change of fair value of an issued bond, that is based on the change of a parameter that is part of option pricing (observable or unobservable) will lead to an equivalent change in fair value with opposite sign for the associated hedging derivative. These effects (gains/losses) will cancel each other out and will have no income statement effect. Structured bonds with option elements linked to equities or equity indices are a type of issued bonds where the equity exposure is fully hedged using a derivative contract and where volatility is a significant unobservable input in the option pricing both for the bond and the associated derivative. The table below shows the value sensitivity associated with a 10% increase in volatility, for such structured bonds with option elements linked to equities or equity indices and associated financial derivatives. The table also shows that the net income statement effect is zero. This is also the case for other types of structured funding with option elements.

Impact of changes in key assumptions - volatility	**2017**		**2016**	
	Carrying amount	**Impact of changes in key assumptions**	**Carrying amount**	**Impact of changes in key assumptions**
Senior securities issued - with option element linked to equities or equity indices	(7 730)	298	(15 912)	512
Financial derivatives - with option element linked to equities or equity indices	(228)	(298)	1 946	(512)
Total	**(7 958)**	**0**	**(13 966)**	**0**

The table below shows total unrealised gain/(loss) recognised in the income statement in 2017 and 2016 for assets and liabilities allocated to Level 3.

Level 3 unrealised gain/(loss) in the period

	2017		**2016**	
	Carrying amount	**Unrealised gain/ (loss)**	**Carrying amount**	**Unrealised gain/ (loss)**
Instalment loans	69 313	(747)	65 728	(1 532)
Notes, bonds and other interest-bearing securities	574	(18)	2 511	32
Senior securities issued	(80 159)	(3 978)	(76 857)	(2 093)
Financial derivatives	(10 183)	3 771	(17 952)	4 225
Subordinated debt	(2 008)	(34)	1 974	70
Total	**(22 463)**	**(1 006)**	**(28 544)**	**702**

Amounts in column "Unrealised gain/(loss)" in the table above are included on the line "Net unrealised gain/(loss) on financial instruments" in the income statement.

NOTE 12

FINANCIAL INSTRUMENTS MEASURED AT AMORTISED COST
(Amounts in NOK 1 000 000)

	2017		2016	
	Carrying amount	Fair value	Carrying amount	Fair value
Deposits with credit institutions	9 172	9 172	10 974	10 974
Instalment loans	114 619	114 712	102 773	102 683
Notes, bonds and other interest-bearing securities classified as Loans and receivables	0	0	1 115	1 119
Notes, bonds and other interest-bearing securities classified as Held to maturity	10	9	21	18
Total financial assets measured at amortised cost	**123 801**	**123 893**	**114 883**	**114 794**
Loans from credit institutions	4 714	4 714	7 584	7 584
Senior securities issued	158 092	158 041	146 223	145 815
Total financial liabilities measured at amortised cost	**162 806**	**162 755**	**153 807**	**153 399**

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

2017	Level 1	Level 2	Level 3	Total
Instalment loans	0	90 470	24 242	114 712
Notes, bonds and other interest-bearing securities classified as Loans and receivables	0	0	0	0
Notes, bonds and other interest-bearing securities classified as Held to maturity	0	9	0	9
Total fair value of financial assets, measured at amortised cost	**0**	**90 479**	**24 242**	**114 722**
Senior securities issued	153 198	4 842	0	158 041
Total fair value of financial liabilities, measured at amortised cost	**153 198**	**4 842**	**0**	**158 041**

2016	Level 1	Level 2	Level 3	Total
Instalment loans	0	87 456	15 226	102 683
Notes, bonds and other interest-bearing securities classified as Loans and receivables	0	499	620	1 119
Notes, bonds and other interest-bearing securities classified as Held to maturity	0	18	0	18
Total fair value of financial assets, measured at amortised cost	**0**	**87 974**	**15 846**	**103 820**
Senior securities issued	142 372	3 443	0	145 815
Total fair value of financial liabilities, measured at amortised cost	**142 372**	**3 443**	**0**	**145 815**

INFORMATION ABOUT 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 for 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, 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	2017	2016
Notes, bonds and other interest-bearing securities	0	1 115
Senior securities issued	158 092	146 223
Financial derivatives	(691)	(62)
Total	**157 402**	**147 275**

Recognised value changes on financial instruments in fair value hedges	2017	2016
Notes, bonds and other interest-bearing securities	11	(27)
Senior securities issued	815	711
Financial derivatives	(779)	(716)
Total	**46**	**(32)**

Recognised value changes are a result of changes in underlying risk factors, such as interest rates and currency basis swap spreads, hence the hedged risk. For the hedging instrument (the financial derivative), the full fair value change is recognised, as these are measured at fair value.

NOTE 14

DEPOSITS WITH CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2017	2016
Deposits with credit institutions without agreed time to maturity	87	76
Deposits with credit institutions with agreed time to maturity	1 228	5 208
Cash collateral pledged	9 085	10 898
Total deposits with credit institutions	**10 400**	**16 182**

NOTE 15

INSTALMENT LOANS

(Amounts in NOK 1 000 000)

	2017	2016
Principal amount	281 668	266 518
Accrued interest	1 023	1 056
Fair value adjustment	667	(93)
Total loans to customers	**283 358**	**267 481**
Other loans	38	40
Total instalment loans	**283 396**	**267 521**

Geographic distribution	2017	2016
Østfold	11 027	11 226
Akershus	26 613	26 644
Oslo	6 507	6 229
Hedmark	12 902	11 419
Oppland	8 732	8 212
Buskerud	31 417	31 158
Vestfold	10 764	9 818
Telemark	9 623	9 678
Aust-Agder	6 659	6 376
Vest-Agder	12 581	10 971
Rogaland	23 850	22 930
Hordaland	34 014	31 436
Sogn og Fjordane	9 354	8 468
Møre og Romsdal	15 581	14 779
Sør-Trøndelag	13 706	12 320
Nord-Trøndelag	11 032	9 215
Nordland	18 960	17 585
Troms	10 666	10 701
Finnmark	7 548	7 219
Svalbard	133	136
Loans to customers, principal amount	**281 668**	**266 518**

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	2017	2016
Domestic		
Issued by public bodies[1]	0	0
Issued by other borrowers	5 938	2 281
Foreign		
Issued by public bodies[1]	96 696	107 028
Issued by other borrowers	4 809	9 241
Total notes, bonds and other interest-bearing securities	**107 445**	**118 550**

[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	2017	2016
Under 1 year	68 980	52 497
1-5 years	33 073	59 965
Over 5 years	5 391	6 087
Total notes, bonds and other interest-bearing securities	**107 445**	**118 550**

NOTE 17

OTHER ASSETS

(Amounts in NOK 1 000 000)

	2017	2016
Intangible assets	125	138
Fixed assets	11	14
Other assets	1	1
Prepaid, non-accrued expenses and accrued income	0	0
Total other assets	**137**	**153**

Intangible assets comprise three IT systems. The portfolio system was brought into use in 2015, the lending portal in 2016, while the management information system was brought into use in 2017. All are amortised over their expected lifetimes.

OTHER LIABILITIES

(Amounts in NOK 1 000 000)

	2017	2016
Accounts payable	11	6
Public fees	1	8
Other short term liabilities	13	10
Accrued expenses and received, not yet accrued interest	61	21
Total other liabilities	**86**	**45**

NOTE 18

LOANS FROM CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2017	2016
Cash collateral received	4 714	7 584
Total loans from credit institutions	**4 714**	**7 584**

NOTE 19

SENIOR SECURITIES ISSUED

(Amounts in NOK 1 000 000)

	2017	2016
Senior securities issued (nominal amounts) as at 1 January	**376 785**	**400 894**
New issuance	118 509	82 752
Redemptions*	(113 392)	(93 926)
Amortisation**	716	(2 749)
Translation differences	(8 802)	(10 185)
Senior securities issued (nominal amounts) as at 31 December	**373 816**	**376 785**
Accrued interest	3 336	4 390
Fair value adjustment	(7 670)	(11 242)
Total senior securities issued	**369 482**	**369 933**
Of which gain/(loss) from fair value adjustment that is due to changes in own credit risk	(495)	(118)

* Redemptions in 2017 include buybacks of 837 million NOK.

**Amortisation is shown in an own line in the table above, but is included in Repayment of debt securities in the table below.

There was no breach in debt covenants as of 31 December 2017.

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)

RECONCILIATION OF CHANGES IN LIABILITIES THAT ARE PART OF FINANCING ACTIVITIES

(Amounts in NOK 1 000 000)

	Senior securities issued	Subordinated debt
Carrying amount 31 December 2016	**369 933**	**1 974**
Cash flows		
Proceeds from issuance of debt securities	118 509	0
Repayment of debt securities	(112 676)	0
Changes that are not related to cash flows		
Change due to accrued interest and amortisation	(1 054)	1
Changes in fair value	3 572	34
Translation differences	(8 802)	0
Carrying amount 31 December 2017	**369 482**	**2 008**

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, and to economically hedge exposure to option elements in issued structured bonds. 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.

See note 21 for information on ISDA agreements and collateral transfers that reduce counterparty risk. Counterparty risk is measured and monitored on an ongoing basis.

(Amounts in NOK 1 000 000)	2017			2016		
	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	128 577	795	2 084	119 665	798	2 553
Currency derivatives	470 355	9 888	17 281	467 790	13 936	20 513
Equity related derivatives	8 012	122	355	17 107	221	2 180
Commodity related derivatives	0	0	0	0	0	0
	606 944	**10 805**	**19 720**	**604 561**	**14 955**	**25 246**
Fair value hedges:						
Interest rate derivatives	155 541	230	1 362	143 411	420	986
Currency derivatives	3 078	441	0	4 053	546	43
	158 619	**671**	**1 362**	**147 464**	**966**	**1 029**
Total financial derivatives	**765 563**	**11 476**	**21 082**	**752 026**	**15 921**	**26 275**

All financial derivatives are measured at fair value through profit and 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 offsetting in the Statement of financial position even if they imply the right to offset in case of default, 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.

(Amounts in NOK 1 000 000)	**2017**	**2016**
Cash collateral received	4 714	7 584
Cash collateral pledged	(9 085)	(10 898)
Total cash collateral	**(4 371)**	**(3 315)**

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. This is due to the fact that the ISDA agreements do not fulfil the requirements for net presentation in the Statement of financial position, since payments are not netted in the ordinary course of business, even if the agreement implies a right to offset in case of default . In the column Netting effect for counterparties with both assets and liabilities items the effect that KBN has 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 that are subject to a netting agreement		
2017	**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	11 476	0	11 476	8 588	4 714	0
Liabilities						
Financial derivatives	21 082	0	21 082	8 588	9 085	3 409

(Amounts in NOK 1 000 000)

				Amounts that may not be presented net in the Statement of financial position but that are subject to a netting agreement		
2016	**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	15 921	0	15 921	7 584	7 584	0
Liabilities						
Financial derivatives	26 275	0	26 275	10 898	10 898	5 901

NOTE 22

SUBORDINATED DEBT

(Amounts in NOK 1 000 000)	Currency	Nominal amount in CCY	Redemption right	Coupon	Nominal amount in NOK 2017	2016
Ordinary subordinated loan capital	NOK	2 000	2028	3.02 %	2 000	2 000
Total subordinated debt					**2 000**	**2 000**

NOTE 23

SHARE CAPITAL

	2017		2016	
	Number of shares	Share in %	Number of shares	Share in %
The Kingdom of Norway	3 144 625	100	3 144 625	100

NOTE 24

ADDITIONAL TIER 1 CAPITAL

(Amounts in NOK 1 000 000)	Currency	Nominal amount in CCY	Redemption right	Coupon	Carrying amount 2017	2016
Additional Tier 1 capital	NOK	1 000	2020	3 month NIBOR +1.5%	994	994
Additional Tier 1 capital	NOK	1 200	2027	3.26%	1 195	0
Total additional Tier 1 capital					**2 189**	**994**

KBN issued additional Tier 1 capital in the form of a subordinated bond in June 2015 and a further one in June 2017. The bonds form 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 bonds do not qualify as a liability under IAS 32 and are 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 2017 interest amounting to NOK 17.9 million (after tax)(NOK 19.7 million in 2016) has been paid. In addition, NOK 16.0 million had accrued at year end (NOK 0.6 million in 2016), such that in total NOK 33.9 million (NOK 19.4 million in 2016) of profit after tax is attributed to the additional Tier 1 capital holders in 2017, 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 decisions 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 is following up changes in KBN’s risk exposures on an ongoing basis.

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 post trade operation functions. The second line of defence comprises financial control, as well as the risk management and the compliance function. The second line of defence monitors, guides and contributes to improving the first line controls, and performs comprehensive risk measurement. This responsibility includes also risk management and monitoring of compliance to external and internal regulations. The third line of defence is carried out by the internal auditor Deloitte, 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. Interest rate and currency risk is hedged on transaction level for all currencies except for NOK, USD and EUR. Interest rate risk for these currencies is hedged with interest rate swaps, such that the bank is only exposed to changes in three-month interest rates.

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. Guidelines for lending to municipal borrowers are approved annually by the Board and special credits are assessed by management and, if necessary, the Board before granting the loan. 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 for the economic development and prospects of the customer. 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 (netting). In addition, KBN enters into collateral agreements which require posting of cash collateral, with all new swap counterparties.

KBN uses clearing services at a central counterparty (London Clearing House—LCH) for interest-related hedging instruments. KBN does not have direct membership with LCH, and two clearing brokers act on behalf of KBN versus LCH. KBN has chosen to segregate its derivative positions and collateral (cash deposits of collateral) in relation to the possible default of a clearing broker and the bank's exposure is therefore directly against LCH. KBN achieves a high degree of protection through this type of setup.

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 assessments, counterparties' external ratings, size of the bank's risk capital, types of financial instruments and tenor.

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, then 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. Counterparties in these derivative contracts are financial institutions or central counterparties. All new transactions are subject to strict rating requirements and also require an ISDA agreement and a collateral agreement with the counterparty. A central counterparty established in the EU/EEA area is subject to capital and risk management requirements through an own EU regulation (EMIR) and is considered to have a lower counterparty risk than ordinary counterparties.

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 89 per cent of the portfolio is invested in securities with a BIS-weight of zero per cent. Average time to maturity of the portfolio was1.1 years as of 31 December 2016. 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 mainly 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 Financial Enterprises Act and its capital requirements. 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 have increased KBN's capital requirements.

KBN's Common equity Tier 1 capital adequacy ratio is 18.29 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. KBN holds a liquidity portfolio in order to be able to meet its payment obligations for a minimum of 12 months without access to new funding. Short average time to maturity ensures that KBN's liquidity requirements mainly can be met through maturities on the asset side. The liquidity portfolio is invested in liquid bonds and notes with high credit rating and short time to maturity.

OPERATIONAL RISK

KBN has zero tolerance for money laundering and corruption and very low tolerance for other operational risk. Assessment of operational risk is performed at least on a yearly basis and otherwise when circumstances warrant it. Risks are reported to the Board through business reporting. Events are reported and recorded without undue delay. KBN's internal control facilitates targeted and efficient operations, reliable reporting and compliance with external and internal regulations. Operational risk arises in all functions and is minimised through controls of work processes, high professional and competency level, focus on ethical behaviour internally and versus business relations, and robustness in critical functions, amongst others. 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 issuers of covered bonds within the OECD. For the Norwegian municipal sector, the maximum maturity is determined by the Municipality Act and the credit framework is governed by regulations on large commitment. 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 2017, and neither is there any evidence of actual default as at 31 December 2017. KBN does not issue financial guarantees.

The table below includes exposures that are recognised as Deposits with credit institutions, Instalment loans and Notes, bonds and other interest-bearing securities.

Amounts in the table below represent actual credit exposure

2017

Time to maturity	< 1 year			> 1 year					
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**BBB**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Sovereigns and central banks	0	11 361	0	0	0	1 700	12 120	0	**25 181**
Regional authorities [1]	0	44 407	19 700	0	0	2 535	10 431	266 589	**343 663**
Multilateral development banks	0	4 277	0	0	0	952	6 021	0	**11 249**
Financial institutions	2 493	8 724	0	0	0	0	0	0	**11 217**
Securitisation	0	0	0	0	0	0	9	0	**9**
Covered bonds	0	6 402	747	0	0	433	2 339	0	**9 920**
Total	**2 493**	**75 170**	**20 448**	**0**	**0**	**5 619**	**30 920**	**266 589**	**401 240**

[1] Including loans to the municipal sector of NOK 283.4 billion.

Undisbursed loan commitments amount to NOK 7.2 billion as at 31 December 2017.

Credit exposure by country

2017

Time to maturity	< 1 year			> 1 year					
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**BBB**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Australia	0	103	0	0	0	0	0	0	**104**
Belgium	0	766	0	0	0	1 477	0	0	**2 244**
Canada	0	1 570	0	0	0	0	1 006	0	**2 575**
Denmark	0	4 249	0	0	0	0	2 155	0	**6 404**
Finland	0	1 779	0	0	0	589	495	0	**2 862**
France	0	8 518	0	0	0	904	0	0	**9 422**
Japan	2 493	3 772	0	0	0	0	0	0	**6 265**
Netherlands	0	199	0	0	0	0	356	551	**1 105**
Norway	0	3 278	19 479	0	0	433	1 568	264 665	**289 421**
Austria	0	369	0	0	0	0	0	0	**369**
Spain	0	0	0	0	0	0	9	0	**9**
United Kingdom	0	3 076	0	0	0	0	0	0	**3 076**
Supranationals	0	4 277	0	0	0	952	6 021	0	**11 249**
Switzerland	0	420	0	0	0	0	0	0	**420**
Sweden	0	21 302	0	0	0	1 148	987	151	**23 588**
Germany	0	18 346	969	0	0	117	8 431	1 222	**29 085**
United States	0	3 149	0	0	0	0	9 892	0	**13 041**
Total	**2 493**	**75 170**	**20 448**	**0**	**0**	**5 619**	**30 920**	**266 589**	**401 240**

Amounts in the table below represent actual credit exposure

2016

Time to maturity		**< 1 year**				**> 1 year**			
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**BBB**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Sovereigns and central banks	0	9 784	0	0	181	12 065	4 805	0	**26 835**
Regional authorities [1]	0	20 732	24 565	0	1 006	16 567	16 562	251 877	**331 309**
Multilateral development banks	0	6 979	0	0	0	1 538	6 943	0	**15 460**
Financial institutions	6 618	10 271	0	0	0	0	0	0	**16 889**
Securitisation	0	18	0	0	0	0	0	0	**18**
Covered bonds	0	9 598	0	0	0	0	1 960	183	**11 741**
Total	**6 618**	**57 382**	**24 565**	**0**	**1 187**	**30 170**	**30 270**	**252 060**	**402 253**

[1] Including loans to the municipal sector of NOK 267.5 billion.

Undisbursed loan commitments amount to NOK 3.4 billion as at 31 December 2016.

Credit exposure by country

2016

Time to maturity		**< 1 year**				**> 1 year**			
Risk class	**A-2**	**A-1/A-1+**	**Not rated**	**BBB**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Australia	0	159	0	0	0	0	0	0	**159**
Belgium	0	1 402	0	0	0	650	0	0	**2 052**
Canada	0	1 348	0	0	1 006	76	310	0	**2 739**
Denmark	0	746	0	0	0	0	5 368	0	**6 113**
Finland	0	963	182	0	0	1 667	0	916	**3 728**
France	0	10 686	0	0	0	1 336	0	0	**12 022**
Japan	5 710	3 227	0	0	181	0	0	0	**9 118**
Netherlands	0	253	455	0	0	0	0	1 034	**1 741**
Norway	0	1 630	19 886	0	0	0	986	247 635	**270 137**
Austria	0	87	0	0	0	83	0	0	**169**
Spain	0	9	0	0	0	0	0	0	**9**
United Kingdom	909	4 631	0	0	0	0	0	0	**5 540**
Supranationals	0	7 458	0	0	0	1 538	7 130	0	**16 126**
Switzerland	0	627	0	0	0	0	0	0	**627**
Sweden	0	10 886	333	0	0	2 481	5 127	144	**18 971**
Germany	0	11 733	3 709	0	0	12 006	11 351	2 331	**41 130**
United States	0	1 537	0	0	0	10 332	0	0	**11 869**
Total	**6 618**	**57 382**	**24 565**	**0**	**1 187**	**30 170**	**30 270**	**252 060**	**402 253**

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 for 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 for each of the currencies NOK, USD and EUR and NOK 36 million all together. 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	10.2	10.2
USD	(11.7)	11.7
EUR	(3.1)	3.1
Total	**(4.6)**	**25**

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 guidelines require hedging of all currency risk related to assets and liabilities in foreign currency. 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.

	2017		2016	
Currency	**Net position**	**10% change in FX rate**	**Net position**	**10% change in FX rate**
USD	12	1.2	1.7	0.2
EUR	5.3	0.5	8.2	0.8
Other currencies	3.3	0.3	5.9	0.6
Total	**20.6**	**2.0**	**15.8**	**1.6**

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 2017 and 2016. 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 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 the liquidity portfolio should generally cover 12 months' net redemptions, and at any time a minimum of 10 months' net redemptions. This implies that the bank has to be in the position to 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.

KBN has a portfolio of highly liquid securities. 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 shall have low credit and market risk and is invested in notes and bonds issued by sovereigns, local authorities, multilateral development banks and highly rated financial institutions.

2017

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	**10 400**	10 400	0	0	0	0	0
Instalment loans	**330 118**	3 518	48 628	11 423	42 729	223 820	0
Notes, bonds and other interest-bearing securities	**108 661**	11 238	22 555	35 948	33 691	5 229	0
Total assets	**449 179**	**25 157**	**71 183**	**47 371**	**76 420**	**229 050**	**0**
Loans from credit institutions	**4 714**	4 714	0	0	0	0	0
Senior securities issued	**409 821**	4 970	40 517	41 162	235 854	87 319	0
Other liabilities	**899**	17	274	8	551	0	50
Subordinated debt	**2 664**	0	0	60	242	2 362	0
Additional Tier 1 capital	**2 631**	0	6	50	1 179	1 396	0
Total liabilities	**420 729**	**9 700**	**40 797**	**41 281**	**237 825**	**91 077**	**50**
Financial derivatives	**21 331**	**1 260**	**(2 004)**	**1 220**	**9 637**	**11 218**	**0**
Net liquidity exposure	**49 781**	**16 716**	**28 382**	**7 310**	**(151 768)**	**149 191**	**(50)**

The table shows the sum of net maturities in that period, including interest payments.

2017

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	**10 400**	10 400	0	0	0	0	0
Instalment loans	**330 118**	114 599	137 317	16 831	37 824	23 546	0
Notes, bonds and other interest-bearing securities	**108 661**	15 266	36 532	25 917	25 726	5 220	0
Total assets	**449 179**	**140 265**	**173 849**	**42 749**	**63 551**	**28 765**	**0**
Loans from credit institutions	**4 714**	4 714	0	0	0	0	0
Senior securities issued	**409 821**	6 006	81 387	39 996	191 988	90 443	0
Other liabilities	**899**	17	274	8	551	0	50
Subordinated debt	**2 664**	0	0	60	242	2 362	0
Additional Tier 1 capital	**2 631**	0	1 006	50	179	1 396	0
Total liabilities	**420 729**	**10 737**	**82 667**	**40 115**	**192 960**	**94 201**	**50**
Financial derivatives	**21 331**	**2 099**	**(1 847)**	**1 366**	**9 563**	**10 149**	**0**
Net liquidity exposure	**49 781**	**131 628**	**89 335**	**4 000**	**(119 846)**	**(55 287)**	**(50)**

The table shows the net amounts that are subject to interest rate adjustment in the relevant periods.

2016

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	**16 182**	16 182	0	0	0	0	0
Instalment loans	**320 490**	104	9 873	19 650	75 356	215 506	0
Notes, bonds and other interest-bearing securities	**120 011**	8 051	16 153	29 486	60 267	6 054	0
Total assets	**456 683**	**24 337**	**26 026**	**49 137**	**135 623**	**221 560**	**0**
Loans from credit institutions	**7 584**	7 584	0	0	0	0	0
Senior securities issued	**411 555**	3 123	26 119	68 008	241 862	72 443	0
Other liabilities	**110**	16	22	7	12	0	52
Subordinated debt	**2 725**	0	0	60	242	2 423	0
Additional Tier 1 capital	**1 056**	0	6	12	1 038	0	0
Total liabilities	**423 030**	**10 723**	**26 147**	**68 087**	**243 154**	**74 866**	**52**
Financial derivatives	**23 793**	**1 795**	**2 292**	**516**	**9 468**	**9 722**	**0**
Net liquidity exposure	**57 447**	**15 409**	**2 171**	**(18 434)**	**(98 064)**	**156 417**	**(52)**

The table shows the sum of net maturities in that period, including interest payments.

2016

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	**16 182**	16 182	0	0	0	0	0
Instalment loans	**320 490**	102 108	92 392	18 295	53 570	54 126	0
Notes, bonds and other interest-bearing securities	**120 011**	12 743	25 883	24 967	50 385	6 033	0
Total assets	**456 683**	**131 033**	**118 275**	**43 262**	**103 955**	**60 159**	**0**
Loans from credit institutions	**7 584**	7 584	0	0	0	0	0
Senior securities issued	**411 555**	3 680	79 740	53 825	201 306	73 003	0
Other liabilities	**110**	16	22	7	12	0	52
Subordinated debt	**2 725**	0	0	60	242	2 423	0
Additional Tier 1 capital	**1 056**	0	1 006	12	38	0	0
Total liabilities	**423 030**	**11 281**	**80 768**	**53 904**	**201 598**	**75 426**	**52**
Financial derivatives	**23 793**	**2 946**	**3 839**	**(6)**	**8 412**	**8 602**	**0**
Net liquidity exposure	**57 447**	**122 699**	**41 345**	**(10 649)**	**(89 231)**	**(6 664)**	**(52)**

The table shows the net amounts that are subject to interest rate adjustment in the relevant periods.

NOTE 30

CAPITAL ADEQUACY AND CAPITAL MANAGEMENT

(Amounts in NOK 1 000 000)

KBN's capital consists of share capital, retained earnings, additional 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 common equity Tier 1 capital adequacy ratio, the Tier 1 capital adequacy ratio and total capital adequacy ratio. KBN's capital status is assessed against risk in a normal market situation and using long-term stress tests. The minimum requirement for total capital requirements including buffers is set at 17.5 per cent as at 31 December 2017. Minimum requirement for common equity Tier 1 capital adequacy has been set at 14.0 percent including buffer requirements from the same date on.

KBN's pillar 2 requirement has been set at 1.4 percent by the Financial Supervisory Authority of Norway, in total a 15.4 percent requirement on common equity Tier 1 capital. In addition a leverage ratio requirement of 3 percent came into force 30 June 2017. KBN is compliant with all statutory capital requirements as at 31 December 2017.

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.

KBN is well capitalised on the reporting date, and is adapting its capital structure to new capital requirements.

Capital adequacy	2017			2016		
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Carrying amount	Risk-weighted assets	Minimum capital requirements
Credit risk						
Sovereigns and central banks	25 181	0	0	26 833	0	0
Regional governments and local authorities	335 158	57 344	4 587	323 397	54 347	4 348
Of which are Norwegian municipalities	*283 358*	*57 344*	*4 587*	*267 481*	*54 245*	*4 340*
Public sector entities	8 467	0	0	10 647	0	0
Multilateral development banks	11 249	0	0	16 125	0	0
Financial institutions	19 366	3 672	294	27 918	4 999	400
Of which counterparty exposure on derivatives	*8 528*	*1 504*	*120*	*11 492*	*1 714*	*137*
Claims secured by residential property	38	38	3	40	40	3
Covered bonds	9 920	992	79	11 371	1 137	91
Other assets	12	12	1	15	15	1
Securitisation	9	9	1	21	13	1
Credit Valuation Adjustment	184	2 302	184	140	1 750	140
Total credit risk	**409 585**	**64 369**	**5 150**	**416 507**	**62 302**	**4 984**
Market risk	**0**	**0**	**0**	**0**	**0**	**0**
Operational risk - Basic Indicator Approach		**3 178**	**254**		**2 909**	**233**
Minimum capital requirements		**67 547**	**5 404**		**65 211**	**5 217**
Total capital ratio			**24.61 %**			**21.45 %**
Tier 1 capital adequacy ratio			**21.65 %**			**18.39 %**
Common equity Tier 1 capital adequacy ratio			**18.41 %**			**16.86 %**

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

(Amounts in NOK 1 000 000)	**2017**	**2016**
Common equity Tier 1 capital		
Share capital	3 145	3 145
Retained earnings previous years	7 904	7 624
Profit for the year included in Tier 1 capital	1 429	689
Pension funds above pension commitments	0	0
Deferred tax asset*	0	0
Intangible assets	(125)	(138)
Dividends payable	(443)	(390)
Other additions/deductions in common equity Tier 1 capital	525	65
Share of nulled unamortised estimate differences	0	0
Total common equity Tier 1 capital	**12 436**	**10 996**
Other approved Tier 1 capital	2 189	994
Total Tier 1 capital	**14 625**	**11 989**
Supplementary capital		
Ordinary subordinated debt	2 000	2 000
Total supplementary capital	**2 000**	**2 000**
Total primary capital	**16 625**	**13 989**

*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.

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 2017 have been examined by the Supervisory Board.

The Supervisory Board recommends that the General Meeting approve the Board of Directors' proposals for the income statement and the statement of financial position, as well its proposal for the allocation of profit of NOK 1 429 103 015, of which NOK 443 000 000 is to be paid as a dividend to KBN's owner and NOK 986 103 015 is to be transferred to other equity.

Oslo, 11 April 2018

Supervisory Board for Kommunalbanken AS
Berit Flåmo
Chair

Statsautoriserte revisorer
Ernst & Young AS

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INDEPENDENT AUDITOR'S REPORT

To the Annual Shareholders' Meeting of Kommunalbanken AS

Report on the audit of the financial statements

Opinion

We have audited the accompanying financial statements of Kommunalbanken AS, which comprise the statement of financial position as at 31 December 2017, income statement, statements of comprehensive income, cash flows and changes in equity for the year then ended and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements 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 2017 and its financial performance for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Basis for opinion

We conducted our audit in accordance with laws, regulations, and auditing standards and practices generally accepted in Norway, including International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's *responsibilities for the audit of the financial statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Norway, and we have fulfilled our ethical responsibilities as required by law and regulations. We have also complied with our other ethical obligations in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for 2017. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters. For each matter below, our description of how our audit addressed the matter is provided in that context.

We have fulfilled the responsibilities described in the *Auditor's responsibilities for the audit of the financial statements* section of our report, including in relation to these matters. Accordingly, our audit included the performance of procedures designed to respond to our assessment of the risks of material misstatement of the financial statements. The results of our audit procedures, including the procedures performed to address the matters below, provide the basis for our audit opinion on the financial statements.

Valuation of Financial Instruments

Unlisted or illiquid financial instruments measured at fair value are valued based on models that use assumptions that are not observable in the market place. The valuation of these instruments therefore have a higher risk of errors. Such instruments comprise assets of NOK 72,609 million and liabilities of NOK 95,072 million measured at fair value in the statement of financial position and classified as level 3 instruments within the fair value hierarchy. Due to the materiality of the unlisted or illiquid instruments, we considered the valuation of these instruments a key audit matter.

We assessed the design and tested the operating effectiveness of internal controls over the valuation process including management's determination and approval of assumptions and methodologies used in model-based calculations. Our assessment also included management's review of valuations provided by internal experts. We assessed pricing models against industry practice and valuation guidelines. We performed independent valuations for selected instruments and used external source data where available. We compared results of our valuations to the Company's valuations.

Level 3 instruments which are presented at fair value on the statement of financial position are disclosed in note 11 in the financial statements.

Other information

Other information consists of the information included in the Company's annual report other than the financial statements and our auditor's report thereon. The Board of Directors and Chief Executive Officer (management) are responsible for the other information. Our opinion on the financial statements does not cover the other information, and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information, and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of management for the financial statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the EU, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting, unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements. As part of an audit in accordance with law, regulations and generally accepted auditing principles in Norway, including ISAs, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit 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 Company's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;

- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

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 Board of 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 management has fulfilled its duty to ensure that the Company's accounting information is properly recorded and documented as required by law and bookkeeping standards and practices accepted in Norway.

Oslo, 28 February 2018
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 29 June 2016.
The bylaws are issued in Norwegian and translated into English. In case of discrepancy between the two versions, the Norwegian version prevails.

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 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 collectively exhibit diversity and breadth of qualifications, experience and background and consist of between five (5) and nine (9) members. If a majority of the employees should so decide, it can

§ 15 The Supervisory Board shall endeavour 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 by:

1. Provide a statement to the Annual General Meeting in respect of the Board of Directors' proposals for the income statement and balance sheet and the Board's proposals for the application of profit or covering of loss for the year.
2. Scrutinise the Board of Directors' report and the auditor's report.
3. Give an opinion on matters concerning the Company which are brought before the Supervisory Board by the Board of Directors or that the Supervisory Board considers necessary to address, with a particular focus on corporate governance.

Chapter V - Annual General Meeting

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

The Ministry (The Ministry of Local Government and Modernisation) calls the Annual General Meeting where members of the Board, managing director and the Company's auditor are called.

An extraordinary Annual General Meeting shall be held if called for by the Ministry of Local Government and Modernisation, the Board of Directors or the Company's auditor.

The regular Annual General Meeting shall:

1. Adopt 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. Elect members to the Board of Directors in accordance with § 8.
3. Elect members to the Supervisory Board in accordance with § 13 of the Articles of Association.
4. Elect the Company's auditor.
5. Fix remuneration for members of the Supervisory Board and the Board of Directors, the Board's subcommittees and the Company's auditor.

demand that a third and at least two (2) of the 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 four (4) 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 responsibility for the overall management of the Company belongs to the Board and shall therefore inter alia:

1. Ensure that the Company’s business operations/activities are soundly organised.
2. Draw up strategies and plans, budgets and guidelines for the Company's business operations/activities and check that they are followed:
3. Keep itself informed of the Company’s financial position and ensure that its operations, accounts and fund management are subject to adequate control.
4. Make decisions and grant authority for new loans raised.
5. Grant special powers and authorisation to sign on behalf of the Company per procurationem.
6. Present the annual accounts and directors' report to the Annual General Meeting.
7. Make recommendations to the Annual General Meeting with respect to alterations to the Articles of Association.
8. Appoint the managing director.
9. Fix the managing director's salary.
10. Prepare statements on remuneration policy.
11. Supervise the day-to-day management of the Company and its overall operations.

§ 11 The chairman of the Board, or the vice-chairman of the Board shall jointly with one of the Board members or the managing director sign for the Company.

6. Approve the Board of Director's statement on remuneration policy.
7. Address 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 Auditor

§ 17 The Company's auditor shall be a state-authorised public accountant and shall be elected by the Annual General Meeting based on a recommendation from the Board of Directors.

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 VII

§ 18 The Company shall raise funds for lending by issuing bonds, certificates or other form of loan notes or by entering into loan agreements. The Company may raise primary capital and other foreign capital.

Raising primary capital and Tier 1 capital instruments is effected based on a majority Annual General Meeting resolution as in the case of alterations in the Articles of Association, or by the Board of Directors according to the authority adopted by such a majority. The authority shall be limited upward in amount and is not valid for longer than the next year’s regular Annual General Meeting, or maximum of 18 months.

§ 19 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.

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

§ 21 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 VIII - Annual Report and Accounts

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

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

Chapter IV - Supervisory Board

§ 13 The Supervisory Board shall consist of twelve members and five deputy members. One member and one personal deputy member shall be elected by and from amongst the employees. The remainder of the members and deputy members shall be elected by the Annual General Meeting. 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. No member of the Board of Directors nor any of the Company's senior executives can be elected member of the Supervisory Board.

The members of the Supervisory Board shall be elected for two-year terms. One third of the members shall retire each year. At least one third of the members shall be elected annually.

The Supervisory Board shall elect 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, or by a minimum of two members of the Supervisory Board. The notice of the meeting shall set out the business to be considered.

The Board of Directors 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 members of the Board of Directors 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.

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 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 IX - Age of retirement

§ 23 The age of retirement for the Company's Managing Director is 70 years.

Chapter X - Alterations to the Articles of Association

§ 24 Alterations to the Articles of Association must be approved by the King if prevailing regulations so demand. If such approval is demanded, the Articles of Association will come into force on the date such approval is forthcoming.

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.

GOVERNING BODIES

BOARD OF DIRECTORS

Else Bugge Fougner, Chair

Martin Skancke, Vice Chair

Nanna Egidius

Rune Midtgaard

Brit Kristin Rugland

Martha Takvam

Petter Steen Jr.

May-Iren Walstad Wassås, employee representative

Jarle Byre, employee representative

Alternates to the employee representatives

Marit Urmo Harstad

Andreas Aleström

BOARD PREPARATORY COMMITTEES

Audit Committee

Martha Takvam, Chair

Nanna Egidius

Rune Midtgaard

Brit Kristin Rugland

Risk Committee

Martin Skancke, Chair

Martha Takvam

Else Bugge Fougner

Remuneration Committee

Else Bugge Fougner, Chair

Rune Midtgaard

Petter Steen Jr.

Jarle Byre

SUPERVISORY BOARD

Svein Ludvigsen, Chair, former County Governor, Troms county

Berit Flåmo, Vice Chair, Mayor, Frøya municipality

Alfred Bjørlo, Mayor, Eid municipality

Ane Marie Braut Nese, Mayor, Klepp municipality

Rigmor Brøste, ass. County Governor, Møre og Romsdal county

Arne Johansen, former CEO, Harstad municipality

Bjørn Ropstad, Mayor, Evje og Hornnes municipality

Ida Stuberg, Mayor, Inderøy municipality

Leif Harald Walle, CEO, Stor-Elvdal municipality

Tron Bamrud, CEO, Akershus county

Anne Kathrine Slungård, CEO, Stjørdal municipality

Terje Dalby, employee representative, Senior Relationship Manager, KBN

Alternates

Berit Koht, CFO, Troms county

Hans Seierstad, former Mayor, Østre Toten municipality

Tommy Steinsvik, CEO, Vågan municipality

Nina Bordi Øvergaard, CEO, Sør-Varanger municipality

Torger M. Jonasen, alternates to the employee representative, Senior Relationship Manager, KBN

Observers to the Supervisory Board

Sølve Monica Steffensen, Director General, Ministry of Local Government and Modernisation

Thor Bernstrøm, Assistant Director General, Ministry of Local Government and Modernisation

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