ANNUAL REPORT 2016

Kommunalbanken Norway

KBN Kommunalbanken Norway

The annual report 2016
is produced by KBN

Cover photo:
Johnny Bråtseth / Romsdalsmuseet

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KRONA, ROMSDALSMUSEET

The museum building Krona has a distinctive wooden interior as well as exterior. The building contains showrooms for rent, a café, a museum shop, work shop and showroom for national costumes, auditorium, and library.

KBN has partly financed the building which was officially opened in 2016.

Photo: Johnny Bratseth/Romsdalsmuseet

KEY FIGURES

(Amounts in NOK 1 000 000)

	2016	2015
RESULTS		
Net interest income	2 087	1 642
Core earnings[1]	1 400	1 043
Profit before tax	919	2 583
Profit for the year	689	1 870
Return on equity after tax[2]	6.27%	20.84%
Return on equity after tax (core earnings)[2]	12.74%	11.70%
Return on assets after tax[2]	0.16%	0.42%
Return on assets after tax (core earnings)[2]	0.33%	0.23%
LENDING		
New disbursements	48 117	46 757
Outstanding loans[3]	266 558	254 421
LIQUIDITY PORTFOLIO[3]	116 413	146 611
BORROWINGS		
New long-term borrowings	82 752	68 644
Repurchase of own debt	1 159	2 979
Redemptions	93 926	110 604
Total borrowings[3]	376 785	400 894
TOTAL ASSETS	418 327	449 361
EQUITY	12 452	12 202
Total capital adequacy ratio	21.45%	18.81%
Tier 1 capital adequacy ratio	18.39%	16.53%
Common equity Tier 1 capital adequacy ratio	16.86%	15.09%
LIQUIDITY COVERAGE RATIO (LCR)[4]		
Total	1 116%	1 418%
NOK	1 848%	3 855%
EUR	558%	530%[5]
USD	471%	54%
AUD	Infinite	Infinite
JPY	852%	525%

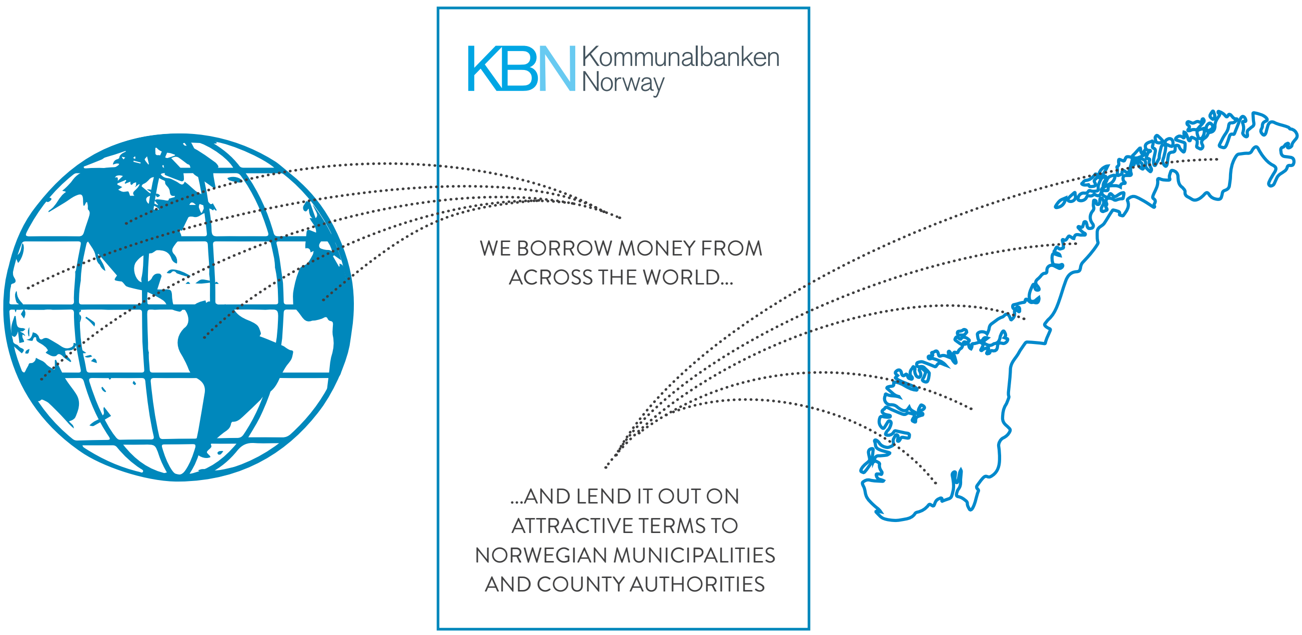
*1 Profit after tax adjusted for unrealised gain/(loss) on financial instruments after tax (NOK 689 million + (0.75*NOK 974 million) - NOK 19 million). This result measure is included to give relevant information about the company's underlying operations.*
2 Annualised return on equity and return on 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.
5 EUR was not a significant currency at this time.

THIS IS KOMMUNALBANKEN

Our role is to offer municipalities and county authorities stable financing on attractive terms.

KBN has played a key role in the growth and development of Norway for nearly 90 years. In order to play this role, we need to be able to operate with sufficiently low costs. KBN finances its lending to the local government sector by borrowing in the capital markets. Its low borrowing costs are the result of its AAA rating, and this enables us to fulfil our mission.

www.kbn.org



45%
of municipal debt
is financed through KBN

266.6
NOK billion.
KBN's total lending to the sector

390
NOK million
paid in dividends to the
owner in 2016

OUR VISION

Long-term partner for local welfare

OUR VALUES

Open, responsible, engaging

82.8

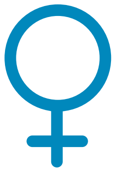
NOK billion
in new long-term
borrowings in 2016

89 YEARS

KBN was founded in 1927 and will
celebrate its 90th anniversary in 2017

44%

share of women
among KBN
employees

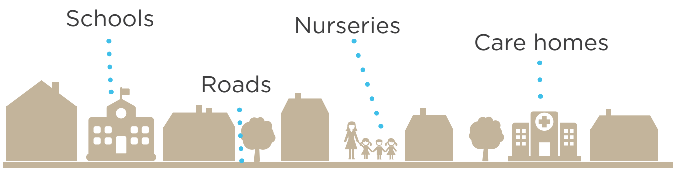


610

new loans
granted in
2016

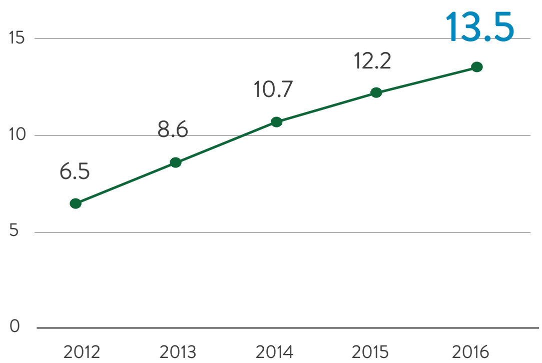
99%

of the country's
municipalities are
KBN customers



GROWTH IN GREEN LOANS

NOK bill



Satisfied customers

Both large and small customers were satisfied with Kommunalbanken in 2016. On a scale from 1 to 6 KBN achieved 5.14 points on average for all the questions. Small municipalities are slightly more satisfied (5.31 points) than the largest municipalities (5.00 points). Municipalities believed that KBN is well run (5.16 points).

5.14
(of 6)

13.5

NOK billion
lending to climate-friendly
municipal projects

AAA/Aaa

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

12

KBN issued bonds in
12 currencies

OUR ROLE IN SOCIETY
CEO'S FOREWORD

KBN's vision is to be a long-term partner for the local government sector and its financing of local welfare. We want to create value for society as a whole, while at the same time having a positive impact on people and the environment.

KBN HAS SERVED an important social function throughout its 90-year history. We have made it easier for Norwegian municipalities to carry out major investments in welfare by providing financing on favourable terms. A high-quality welfare system is a central part of Norway's social model. KBN helps ensure that this democratically agreed policy does not cost more than necessary. Our customers are some of the lowest-risk borrowers in the world. 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. This low level of risk is reflected in KBN's own creditworthiness, and is important to KBN maintaining the highest possible credit rating of AAA. This rating ensures that KBN can charge the lowest possible interest rates on its lending. We therefore have a shared interest in ensuring that the production of services by the local government sector is carried out as cost-effectively as possible. KBN is in many ways a tool for the public sector to self-finance. We bring together the local government sector's borrowing needs, and KBN's profits benefit the public sector. The low interest rates offered by KBN ensure investing in welfare services does not constitute a greater burden on municipalities' budgets than necessary. At the same time, our annual dividends benefit society as a whole. This means that KBN is not at all like a normal commercial bank. In order for KBN to be able to serve its function in society, it needs regulatory conditions that reflect this.

ONE OF THE OVERRIDING objectives identified in our long-term strategy is that we fully recognise KBN's corporate social responsibility. We achieved many of the targets set for 2016. We carried out a comprehensive program of work in 2016 to ensure that we will be even better at managing our corporate social responsibility in future. We asked our key stakeholders what expectations they had of us, approved separate corporate social responsibility guidelines, and clarified our priorities and ambitions.

WE INTEND TO FOCUS in future on areas where we believe we can make a difference. There are two areas where this is particularly apparent. Firstly, we want to contribute to the development of green financing by on-lending funds from green investment mandates to Norwegian municipalities wishing to invest in ambitious environmentally friendly projects. We expanded the range of lending products available for investments of this type in 2016. At the same time, we want to contribute to the creation of global best practice in the definition of projects that qualify for green loans. This involved us drawing up clearer requirements for climate projects financed using funds from green investment mandates. Secondly, we want to lend in a responsible way that will help to ensure that our customers have financially sustainable borrowing portfolios. This places particular emphasis on sharing expertise and maintaining a good dialogue with our customers. We launched 'KBN Finans' in 2016. Our target is to strengthen our customers' analysis capabilities by providing them with a better digital basis for decision making.

IN ADDITION TO THESE two areas, we are committed to ensuring that we maintain high ethical standards in everything we do. In order to satisfy the high expectations set for our activities, we are very reliant on employing the best people in our sector. We achieve this by taking proactive measures to improve the diversity of our employees and maintain a good gender balance in our organisation.

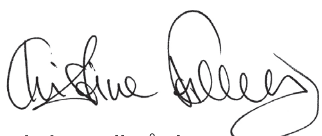
IF I WERE TO SUMMARISE 2016 from an international perspective, I would say that in many ways 2016 was a year

of unexpected events. The world is facing a period of major economic and political uncertainty. In Norway, much of the focus has been on adjustment following the downturn in oil. The fact that Norway has coped so well through a period with a sharp fall in the price of oil demonstrates that its society is robust. However, it seems likely that we are facing changes and adjustments that will affect us regardless of the size of the oil fund. We live in an age in which technology is challenging many established structures. In 2016 KBN defined clearer targets for its digitalisation work. Newly available technology is opening up a lot of exciting opportunities that we look forward to investigating in collaboration with our customers.

The results of the work we carried out in 2016 show that we once again made a solid contribution to the development of society across Norway. Our lending grew by 4.8% in total, and lending to climate and environment projects grew by 11%. We granted more than 600 loans totalling NOK 48.1 billion in 2016.

WE EXPECT THE LOCAL government sector to continue to have sizeable investment needs in future. Norwegians are moving to urban areas, are growing in number and are ageing. While in 1950 there were seven people of working age behind each pensioner, there will be fewer than two by 2050. Following the Paris Agreement, Norway has significant commitments in terms of reducing its greenhouse gas emissions. All of these factors affect municipalities as well. Our ambition is to be able to deliver competitive and efficient finance solutions to keep the cost of producing welfare services as low as possible. At the same time, we want to help our customers across the whole of Norway to manage their finances responsibly and sustainably.

KBN SEEKS TO BE the most important financial collaboration partner to the local government sector. We aim to work with our customers to address the challenges of tomorrow by seizing the opportunities of today. Together we will help increase local welfare.



Kristine Falkgård
President & CEO

KISTEFOSSDAMMEN NURSERY SCHOOL

When the nursery school opens it might possibly be Norway's first public energy-plus house. An energy-plus house produces excess energy through the use of a 300 square metres solar roof and geothermal heat pump. Climate friendly building materials, such as wood, has been the first choice. The construction itself reduces energy consumption to a minimum.

The nursery school is partly financed through KBN's green interest rate product in 2016.

Illustration: Christensen & Co AS

WE FINANCE WELFARE SERVICES

KBN provides stable long-term loan financing for investment in welfare services by municipalities and county authorities. Population growth, climate change, demographic changes and the continual need to upgrade and modernise facilities and services mean that KBN expects the level of investment and the need for long-term borrowing to remain high.

INVESTMENT BY THE LOCAL GOVERNMENT SECTOR grew by 3.6% in 2016. This is the lowest rate of investment growth since 2012 and may be an indication that annual investment growth will be lower in future. Over the last ten years, all types of municipality have increased the amount they invest. This investment growth has been strongest in areas of the country that have experienced the greatest population growth.

KBN expects there to be bigger differences between municipalities in future in terms of their levels of investment. Many municipalities will for some time to come have lower investment requirements as a result of having carried out many large investments. At the same time, some municipalities that are experiencing strong population growth may be responsible for a larger share of the overall level of investment and debt growth in the sector than in the last ten years.

The rate of growth in the local government sector's total debt was lower in 2016 than for many years at 6.1%. There is evidence that this can be explained by the sector financing a higher proportion of its investments using its own funds thanks to the strong financial results it achieved in both 2015 and 2016. Going forward, lower annual investment growth will also lead to a lower annual rate of debt growth. KBN expects the rate of debt growth in the local government sector in the years ahead to gradually decrease from the 2016 level.

WE PROVIDE LOW-COST FUNDING TO NORWEGIAN LOCAL GOVERNMENT SECTOR

INNOVATION AND NEW TECHNOLOGY will potentially contribute to changes in the local government sector's investment requirements in several areas. As a result of new digital opportunities, municipalities and county authorities are having to look to the future when drawing up their investment plans. At the same time, new technology will require infrastructure to be adapted, while the new technology itself will also require significant investment. Although the rate of investment growth is expected to be lower than in previous years, the annual level of investment will continue to rise. KBN thinks that investments in water, waste-water and sanitation (WWS) area and elderly care will be the areas with the strongest growth going forward.

Investment in the WWS area has grown by 254% over the last ten years. A number of reports highlight that there continues to be a sizeable need to carry out upgrades and for new investment in the WWS area in the years ahead in order to satisfy increasingly strict quality and safety requirements and to adapt the infrastructure to climate change, for example.

In the future, elderly care will increasingly involve making extensive use of welfare technologies in combination with different ways of providing nursing services. KBN expects there to be a continuing need to upgrade Norway's existing care homes and to build new ones, and this will lead to an increase in the level of investment in the nursing and care area in the years ahead.

THE FINANCING MODEL used by the local government sector to invest in facilities and services is primarily based on a combination of its own funds and funds it borrows. Over the last ten years, Norwegian municipalities have consistently borrowed about 60% of the amount they have invested. However, borrowing represented a smaller proportion of the total amount invested by the sector in both 2015 and 2016. An increasing number of municipalities are introducing budgetary rules that, for example, set requirements for the proportion of each new investment that has to be financed using

In the future, elderly care will increasingly involve making extensive use of welfare technologies. Oppegård municipality introduced a digital documentation system in all municipal care homes in 2016. The system has resulted in improved patient care through better communication among nursing staff.

their own funds. These measures may of their own accord contribute to decreases in the level of investment at some municipalities. Budgetary rules of this sort also create a focus on operational efficiency and the need to maintain a stable net operating surplus that can be used as the basis for financing investments from their own resources.

High revenue growth in the sector in 2016 caused the aggregated debt ratio for all municipalities to decrease, even though the overall amount of debt increased. The debt ratio for municipalities is usually measured as net interest-bearing debt as a percentage of gross operating revenue. The aggregated debt ratio for all municipalities decreased in 2016 to 77.8% from 78.3%, while for county authorities it increased from 58.6% to 66.6% as a result of a higher level of investment.

KBN'S OBJECTIVE IS TO BE the most important provider of long-term financing to the Norwegian local government sector. In 2016, loans from KBN represented about half the amount borrowed by the sector. KBN's objective is to offer financing that is flexible and adapted to each customer's requirements with the best possible interest rate terms. The foundation for providing stable financing at low interest rates is KBN's credit rating. KBN's highest possible credit rating of AAA ensures it enjoys good access to attractive sources of funding from all across the world. This rating also means that KBN is able to offer loans with low interest rates entirely independently of the economic cycle. KBN thinks this is important to municipalities' ability to plan their investments and to provide local welfare services.

KBN offers long-term financing at the same attractive interest rate to all municipalities and county authorities. We do this because they represent the same low risk, regardless of their size and requirements.

MANY MUNICIPALITIES ARE CHOOSING to finance investments using loans with shorter maturities. The capital markets are the largest provider of this type of loan. KBN also from time to time offers lending products with shorter terms when customers so request. KBN's most important lending products are, however, loans with long maturities, of which there are few other providers. Norwegian municipalities invest in numerous projects with long-term investment horizons. KBN's long-term lending products are important to ensuring financing is available throughout the whole life of projects. In 2016 KBN launched KBN Finans, which is a borrowing portal and analysis tool for its customers. KBN Finans is intended to contribute to KBN's customers having access to the best possible basis for making decisions regarding managing their financing and borrowing, and to help customers make decisions that ensure their exposure to interest rate risk and refinancing risk is as at the level they desire.

In 2016 there was a lot of focus on the sector's use of short-term debt financing, in part as a response to the fact that approximately 20% of the sector's outstanding debt would mature within a twelve-month period. Changes were made in 2016 to the Regulations on municipalities and county authorities' financial and debt management, with municipalities and county authorities being required with effect from 1 January 2017 to report the proportion of their borrowing that will reach maturity over the following twelve months. The amount of debt of this type remained stable in 2016 after several years of growth.

BY THE END OF 2016, the Local Government Reform had resulted in 90 municipalities voting to combine to form 37 new municipalities. There is a proposal for today's 426 municipalities to be reduced in number to 358. The ongoing Regional Reform will involve significant alterations to the structure of Norway's county authorities. KBN is Norway's largest lender to the local government sector and offers loans to all the country's municipalities, regardless of size. KBN is adapting to the structural changes taking place by offering the best financing solutions for the local government sector's future borrowing needs.

PRICING OF BONDS ISSUED BY THE LOCAL GOVERNMENT SECTOR

Liquidity risk, credit risk and regulatory risk are all factors that investors consider when evaluating the yield on a fixed income security. In this article, we consider how investors assess Norwegian municipalities and price fixed income securities issued by the sector.

INTEREST RATE FLOOR

The Kingdom of Norway has the best possible credit rating available, and has done so since 1975 in the case of Standard & Poor's and since 1995 in the case of Moody's. Currently only ten countries in the world hold the highest possible credit rating from both rating agencies.

The yield on Norwegian five-year government bonds has fallen over the last 20 years, from a high of nearly 7% in 2000 to 0.5% in 2016. During this same period, the three-month money market rate (NIBOR) has varied between 8.5% in 1998 and under 1% this year. The levels seen this year are record lows. Norges Bank holds interest rate statistics going back to 1820. These show that even the low-interest rate records set in the period just after the Second World War were beaten in 2016. Borrowing has never been cheaper.

CREDIT RISK

Lenders require compensation for the risk that the borrower might be declared insolvent, taking into account the expected loss in the event that the borrower is actually declared insolvent. Although countries may become insolvent, this is extremely unlikely to happen to an AAA-rated country.

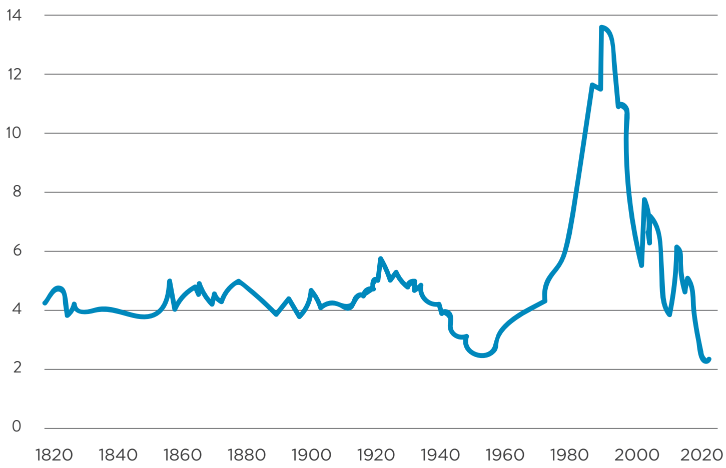
Section 55 of the Norwegian Local Government Act states that «A municipality or county authority may not be declared insolvent or institute debt settlement proceedings». In theory, however, payments can be deferred until a solution is found to the situation that has arisen. In such cases, investors are compensated in the form of penalty interest, cf. the Act relating to Interest on Overdue Payments etc. and the associated Regulations.

Section 60 of the Local Government Act also contains provisions on the «State review and approval of financial obligations». Borrowing decisions taken by a municipality that is struggling to balance its budget and is on the Norwegian Register for Governmental Approval of Financial Obligations (ROBEK) are only valid once they have been approved by the County Governor. Primarily as a result of the Norwegian state's AAA rating, and also taking into account the role of the Norwegian Ministry of Local Government and Modernisation, the credit risk associated with lending to the Norwegian local government sector should therefore be virtually zero.

APPROXIMATION OF INTEREST RATES IN NORWAY SINCE 1820

Unweighted average of various interest rates in Norway over just under 200 years. From the year 2000, we have used the interest rate on five-year bonds.

Source: Norges Bank and Nordic Bond Pricing



LIQUIDITY RISK

Government bonds can be bought and sold quickly and efficiently in the secondary market with low transaction costs. They generally have good liquidity, even in turbulent times.

There are not as many buyers for bonds issued by municipalities, and the total outstanding volume of each issue and the overall amount of debt issued by each municipality are much lower. The Norwegian state currently has 12 outstanding bonds totalling NOK 478 billion. For comparison, the fixed income securities issued in the Norwegian market by 152 of Norway's county authorities and municipalities, approximately 600 issues, have a total outstanding value of NOK 148 billion. The local government sector represents 6.5% of the total volume of around NOK 2,300 billion of fixed income securities in the Norwegian market.

A NUMBER OF CONSIDERATIONS AFFECT THE PRICING OF FIXED INCOME SECURITIES

- **The price that the country itself** has to pay to borrow money in the securities markets, i.e. the interest rate on government bonds.
- **The amount of compensation required** for the credit risk involved, which is to say the risk that the investor might not get back 100% of the money it lends.
- **Liquidity of the securities.** Large borrowers that have many different investors benefit from greater liquidity. Investors in transferable fixed income securities issued by such borrowers can easily sell their holdings before maturity if they require.
- **Regulatory issues.** For financial institutions, capital adequacy requirements and the weightings applied to different categories of bond mean that, for example, investing in local government bonds has to offer a better return than investing in covered bonds.
- *KBN, however, offers all municipalities the same terms, regardless of their size.*

The average size of local government sector fixed income issues is NOK 250 million, while the average for government bond issues is NOK 40 billion. The largest local government sector bonds are issued by Oslo and Bergen, both of which have NOK 3 billion issues. The smallest player is the municipality of Vang, with a certificate loan of NOK 10 million. In general, larger issues will be more liquid and will therefore have a lower liquidity risk than smaller issues.

KBN borrows from a large number of investors from across the world. Its largest outstanding bond in US dollars is equivalent to NOK 2 billion.

During periods of market turbulence, such as during the Norwegian banking crisis in the 1990s and the financial crisis starting in 2007, the cost of liquidity for the local government sector increased by less than the increase seen for the financial sector. The financial sector includes the market for covered bonds, which are the safest category of bonds issued by the financial sector. These bonds are AAA-rated and so are considered by rating agencies to be as safe as debt issued by the City of Oslo.

REGULATORY RISK

Covered bonds were introduced into the Norwegian market in 2007, and have since then become a very important asset class for banks. They are firstly used as security for loans from Norges Bank, and secondly as an important part of the liquidity portfolios that banks are now required to hold to meet the liquidity coverage ratio (LCR) requirements. The LCR rules mean that the choice between investing in covered bonds or in local government bonds is to a large extent a question of price.

If banks invest in bonds other than government bonds, they have to hold capital in addition to their normal funding. The amount of capital required is determined by the weightings attached to different types of asset, which are 10% for covered bonds and 20% for local government bonds. In addition, LCR calculations require a 15% haircut to be applied to the amount invested for both types of bond, while for covered bonds with an outstanding volume of over NOK 5 billion, a haircut of only 7% has to be applied.

In summary, the return offered by local government bonds needs to be around 0.15 percentage points higher than that offered by covered bonds if banks are to choose them over covered bonds. However, banks' needs and preferences for diversification, as well as the existence of investors not subject to LCR requirements, may lead to local government bonds being purchased at a slightly lower margin. Up until 2013, the credit spreads on local government bonds were lower than the credit spreads on covered bonds. In 2013 the spreads were approximately the same, while over the last three years the spreads on local government bonds have generally been between 0.05 and 0.15 percentage points higher than the spreads on covered bonds.

It therefore seems that the influence of regulatory factors on the pricing of covered bonds has been an important factor in the pricing of bonds issued by the local government sector in recent years.

Although the credit spreads on local government sector bonds have fallen by more than 0.25 percentage points in the last year, it is possible that they may fall further. In Europe, covered bonds are being priced with almost no spread over the applicable reference rate. Currency swaps from the euro to the Norwegian krone in such securities produce an additional return of around 0.3 percentage points. Norwegian local government bonds can therefore offer almost twice the return of covered bonds. Before the financial crisis led to a strong increase in spreads in 2008, local government bonds were priced at spreads of between 0 and a quarter of a percentage point below the NIBOR/Swap rate.

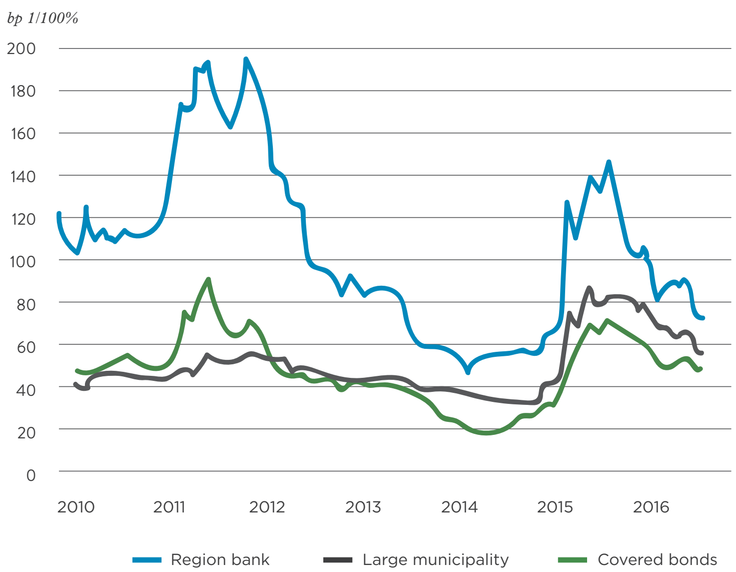
The credit spread on local government bonds may therefore fall further, but meaningfully lower interest rates in absolute terms will be difficult to achieve.

INVESTORS IN THE LOCAL GOVERNMENT SECTOR

In terms of who lends to the sector, the life insurance and pension funds sector holds 40% of bonds and 13% of certificate loans issued by the local government sector, making it the largest investor in the sector. Banks hold 17% local government bonds and 28% of certificate loans, making them the second largest group. By comparison, their share of the overall market is slightly below 40%.

SPREAD OVER NIBOR/SWAP

5-year bonds for municipalities and banks



GOL SCHOOL

In August 2016 750 students in primary and secondary school moved into the new school building in Gol. The building contains facilities with a stage and retractable seating. The school is located in a rural area some distance from the Gol village.

The building was completed in 2016, partly financed by KBN.

Photo: Astrid Blektvedt


Gol skule

FUNDING FROM AROUND THE WORLD

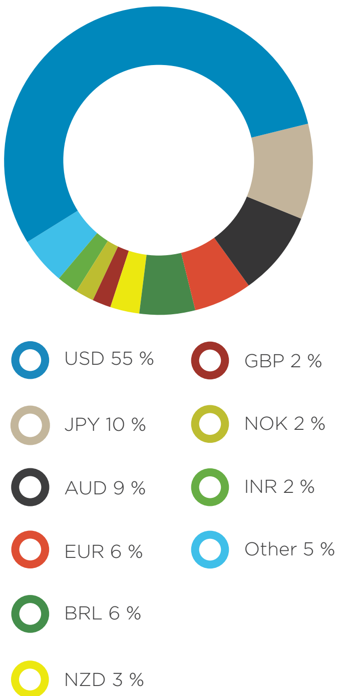
– TO FINANCE WELFARE SERVICES EFFICIENTLY

Bringing together the borrowing requirements of the entire Norwegian local government sector gives KBN cost-efficient access to major investors and important capital markets across the world. This enables investment in Norwegian welfare services to be financed at the lowest possible interest rates.

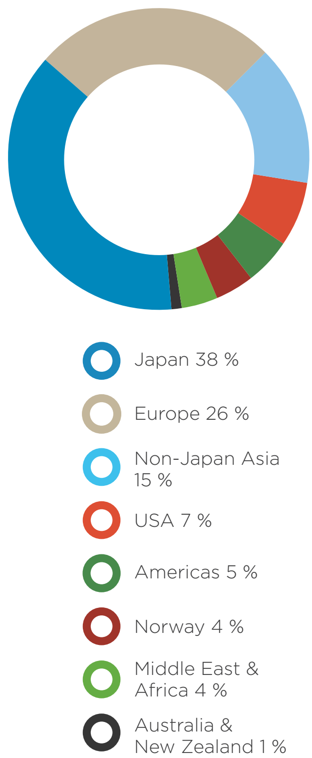
KBN DIFFERS FROM COMMERCIAL BANKS in that it does not take deposits. KBN raises all the money it lends out to the local government sector by issuing securities in the capital markets. KBN is currently one of the largest Norwegian borrowers in the international markets. Its highest possible credit rating of AAA/Aaa from Standard & Poor's and Moody's creates broad demand for its low-risk bonds and ensures that KBN achieves low funding costs.

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

TOTAL BORROWING 2016
by currencies



TOTAL BORROWING 2016
by investor geography



KBN ISSUED ITS THIRD MAJOR green bond in 2016. This was a USD 500 million issue, and gave KBN access to environmentally-conscious investors. Demand for climate-friendly bonds has skyrocketed in recent years. KBN was one of the first Nordic issuers of green bonds. KBN channels the funds from its green bonds directly to environmental projects in the Norwegian local government sector, and thus is playing a role in developing the green finance market. At the same time, issuing green bonds gives KBN access to a wider range of investors, which helps further diversify its investor base. KBN's target is for this to reduce its borrowing costs further, and for this in turn to benefit its customers.

KBN ALSO HAS A TARGET of increasing the proportion of funding it raises in the Norwegian capital market. Few other issuers of bonds in Norway have the same creditworthiness and rating as KBN. KBN made progress in this area in 2016 and issued NOK 1 billion of bonds with a maturity of 20 years in the Norwegian market.

KBN borrows in a range of currencies, with the US dollar as its base currency. This means that all other currencies are hedged to the US dollar at the point of borrowing. In addition, KBN's borrowings are hedged to the Norwegian krone for loans to customers. KBN does not take on interest rate risk or exchange rate risk and only enters into interest rate and exchange rate hedges with banks with high credit ratings. All market risk is offset by exchanging cash as collateral.

GREEN FOCUS

KBN has offered green loans since 2010. We issued our third green bond in 2016, raising USD 500 million.

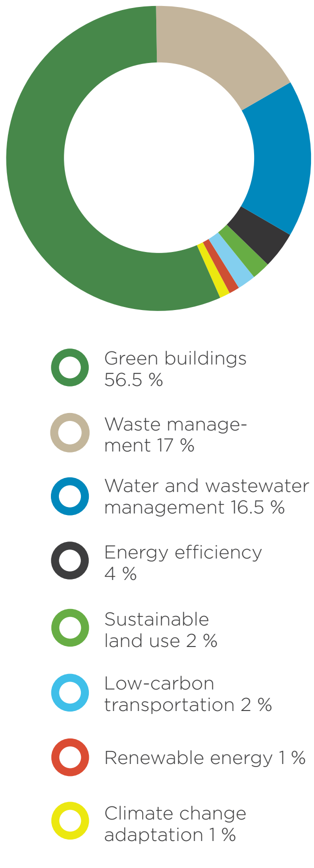
KBN'S GREEN LENDING PROGRAM uses money from investors who want to make environmentally friendly investments to finance innovative green projects in the Norwegian local government sector. KBN on-lends green funds by borrowing money in the form of green bonds in the international capital markets, which it then lends out as green loans to Norwegian municipalities and municipal companies. The interest rate on KBN's green loans is somewhat lower than on its ordinary loans.

A LOT HAS HAPPENED since KBN first became involved in the market for green finance products. Investors now expect much better reporting on the projects that their funds will be used to finance and on the environmental and climate impacts of the projects. This is reflected in the new version of the KBN Green Bond Framework, which we released in 2016. The updated version commits us to having expertise in green lending internally at KBN as well as a high-quality process for assessing applications for green loans. We will also now produce annual reports on the impact of the projects we finance using the proceeds of our green bond issues. Our framework has been awarded the highest rating possible («Dark Green») by the independent climate research centre CICERO. This means that investors and other stakeholders can be certain that KBN's green bonds finance investments that are in line with Norway's national target for the country to become a low-carbon society by 2050.

WITH REGARD TO OUR LENDING, we followed up on the new framework by creating a stricter set of criteria that stipulate specific conditions that projects must satisfy in order to be granted green financing on preferential terms. The reason for this is that investors in green bonds are setting clearer environmental requirements for their portfolios. KBN has therefore introduced a formal application process as part of which customers have to document what the impact of the green project will be for which they are applying for a loan. We also expanded the family of lending products available as green loans from the middle of 2016, with customers now able to apply for a green loan either at a floating rate, a fixed rate, or a NIBOR-linked rate. We hope that expanding the range of green loans we offer in this way will make them attractive to a broader range of customers.

KBN GRANTED 32 GREEN LOANS totalling NOK 1.369 billion in 2016. This is a good result relative to previous years after excluding the funding provided by KBN for Bergen's light rail service, which is the largest single project being financed by green loans (a total of approximately NOK 5.3 billion). In 2016 green buildings represented approximately 60% (NOK 824 million) of the total lending volume. Renovation projects in the WWS area accounted for NOK 416 million of the total lending volume, while the rest was made up of smaller projects in the energy efficiency, renewable energy, climate change adaptation, low-carbon transportation and sustainable land use categories. KBN aims to contribute to the development of the green finance market by connecting the funds of investors wishing to make environmentally friendly investments with innovative green projects in the Norwegian local government sector.

GREEN LENDING
2016



THE NORWEGIAN ECONOMY

– A STATUS REPORT

2016 saw low growth in the Norwegian economy as a result of the downturn in oil prices and the moderate level of international demand growth. There continues to be a marked divide in the Norwegian economy. Oil-dominated Southern and Western Norway are facing challenges, while growth in more diversified regions such as Oslo, Trøndelag and Northern Norway is stable.

THE NEGATIVE IMPULSES from the petroleum industry continue to be significant, but there are numerous indications that Norway has come through the biggest challenges it was facing. The fact that Norway's economy coped so well through a period with a sharp fall in the price of oil demonstrates that it is more robust than many thought, and that it has a flexible and adaptable labour market.

Investment in the oil sector fell markedly once again in 2016, and the challenging times facing the supply industry continued. Towards the end of 2016, however, there were signs of improvement in petroleum-sensitive regions as well, and by this point the price of oil had increased to nearly double the level seen at the start of the year. At the same time, the costs associated with many large projects on the Norwegian continental shelf virtually halved. This is reason for hope that brighter times lie ahead.

THE UNEMPLOYMENT RATE was somewhat higher in 2016 than in 2015, but with an annual unemployment rate for 2016 of 3%, unemployment remains moderate. There are many indications that unemployment peaked in 2016, and unemployment was lower at the end of the year than at the beginning. The regional differences are, however, sizeable. The counties of Rogaland, Aust Agder and Vest Agder have struggled, with unemployment heading towards 5% as a result of the strong presence of petroleum-related industry. Although investment in the petroleum sector continues to fall, the unemployment rate in these counties fell in 2016. This indicates that the labour market is flexible, and that other industries are managing to use workers from the petroleum sector, who often have a lot of expertise.

INFLATION WAS MARKEDLY HIGHER in 2016 than in previous years. The 3.6% increase in the consumer price index can in part be explained as a delayed effect of the krone having weakened over the last three years, with imported goods consequently becoming more expensive. The strong increase in electricity prices is another important reason. Lower growth in electricity prices and the krone strengthening will probably cause inflation to be significantly lower in 2017.

KEY MACROECONOMIC INDICATORS
Percentage change from previous year.
Source: Statistics Norway and NAV

	2016	2017
Private consumption	1.5	1.9
Public sector consumption	2.2	1.7
Gross fixed capital formation	0.0	1.5
Mainland Norway	5.6	5.0
Exports	-1.7	1.2
Crude oil and natural gas	0.8	0.0
Traditional goods	-5.1	3.0
GDP	0.4	1.4
GDP - Mainland Norway	0.7	1.7
Unemployment rate (NAV)	3.0	-
Consumer Price Index	3.6	2.3
Current account surplus *(percentage of GDP)*	5.1	6.2

UP UNTIL 2016, THE ECONOMIC DOWNTURN had not had much of an effect on household income and consumption. 2016, however, saw higher inflation and low wage growth, and this actually caused a fall in real wages. This impacted

High level of demand for residential property in 2016. Oslo saw the biggest increases, with house price growth in the city reaching a record high of 23.3%. Detail of a building in the Fornebu S area. Photo: Svein Nordrum, NTB scanpix

consumption growth, which in 2016 was at its weakest level since the financial crisis. Low interest rates, the gradual improvement in the labour market and the stronger krone leading to cheaper imports are, however, giving grounds to think that consumption growth will pick up again in the time ahead. The growth in the housing market will also help increase consumption, because households will experience an increase in net worth.

DESPITE THE LOW CONSUMPTION GROWTH, there was a high level of demand for residential property in 2016. This caused house prices to grow strongly, with the annual rate of growth standing at an impressive 12.8% on a country-wide basis. Oslo saw the biggest increases, with house price growth in the city reaching a record high of 23.3%. Other locations in Norway also saw strong growth, including Trondheim, where prices were up 10.3%, and Tromsø, where they were up 7.5%. In contrast, prices in Stavanger fell by 2.6%, but towards the end of the year the situation there seemed to be improving. The strong house price growth on a country-wide basis is leading to strong growth in residential construction. This will probably lessen the excess demand somewhat, and there is consequently reason to expect house prices to grow less strongly in the years ahead.

UNLIKE THE PETROLEUM INDUSTRY, the mainland economy saw higher investment in 2016. This was particularly due to investment in the energy supply and service industries. The level of willingness to invest in the manufacturing industry remains relatively weak.

EXPORTS OF TRADITIONAL GOODS and services benefited from the weak krone. The seafood index was up 23% in 2016 following a record year in 2015, partly due to higher salmon prices. A fall in the level of international demand for oil-related products, however, caused exports to fall significantly, and overall traditional exports were down in 2016. The stronger krone and limited salmon production as a consequence of the need for disease prevention mean there are grounds to expect exports to be low going forward. If the salmon industry satisfies the authorities' environmental targets, the production will potentially increase by 6% every second year.

NORWAY'S LOW KEY POLICY RATE is helping to limit the economic downturn. The key policy rate currently stands at 0.5%, and has led to residential mortgage rates falling to around 2%. Norway's expansive fiscal policy is also further limiting the downturn. Tax reductions are stimulating private consumption growth, while public sector consumption and investment are increasing strongly. Norway's National Budget for 2017 indicates that public sector consumption growth will continue to be high. A lot of the underlying growth is connected with social security benefits, transfer payments made by the National Government, and the healthcare sector. There are few indications that this growth will slow. 2017 is also an election year, which may provide additional impetus for consumption by the state and the local government sector in 2018.

IT IS REASONABLE TO EXPECT GROWTH in the Norwegian economy to pick up in the time ahead. Lower unemployment, expectations that the fall in demand from the petroleum industry will slow sharply, and the prospect of higher international growth are important drivers for this. Increased investment in the residential property sector, and fiscal policy that remains expansive, are also important reasons for the expectation that there will be a gradual return to more normal growth over time.

THE BOARD OF DIRECTORS' ANNUAL REPORT 2016

Kommunalbanken Norway (KBN) finances important welfare services provided by Norwegian municipalities and county authorities. In 2016 KBN granted 610 new loans totalling NOK 48.1 billion. KBN's social mission is central to how it conducts its activities. Its target of maintaining the highest possible credit rating of AAA ensures it can reliably access funding on favourable terms. KBN's credit rating enables the local government sector to borrow to invest on predictable terms that are independent of underlying conditions in the financial markets. This is important to ensuring local services can be planned and provided in a stable fashion. KBN is currently one of only a few organisations that provides long-term loans to the local government sector.

KBN's lending grew by 4.8% in 2016, which is a slightly bigger increase than in previous years. Lending for climate and environment projects increased by 11% in 2016.

Profit for the year was NOK 689 million in 2016 as compared to NOK 1,870 million in 2015. Net interest income was higher than in 2015, and this was due to a combination of relatively high margins in the markets throughout large parts of 2016 and strong lending growth early in the year. KBN's profit for the year was also influenced by unrealised losses of NOK 974 million, which stem from losses on fixed-rate loans and derivatives contracts used to convert KBN's funding into Norwegian kroner. Unrealised gains totalling NOK 1,116 million were recognised in 2015. KBN's return on equity after tax was 6.3% as compared to 20.8% in 2015.

In view of KBN's profit for the year and its payment of a dividend for 2015 to its owner, KBN's equity increased by NOK 250 million in 2016.

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 2016) 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 2016 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 689 million in 2016 as compared to NOK 1,870 million in 2015. Net interest income in 2016 totalled NOK 2,087 million as compared to NOK 1,642 million in 2015. The margins on KBN's lending portfolio increased in 2016, in line with an increase in prices in the market, particularly in the first part of the year.

Net unrealised losses on financial instruments reduced KBN's profit before tax by NOK 974 million in 2016, while in 2015 it was increased by net unrealised gains on financial instruments of NOK 1,116 million. The unrealised losses partly stem from losses on fixed-rate loans measured at fair value. Other market parameters also changed in a way that affected the value of KBN's financial derivatives and caused unrealised losses. KBN's financial instruments are normally held to maturity and the effects of unrealised gains and losses on KBN's profits reverses 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 15 million in 2016, as compared to NOK 6 million in 2015.

Total operating expenses in 2016 were NOK 177 million as compared to NOK 151 million in 2015. Approximately half the increase was due to higher depreciation on a new finance system, while the remainder was due to higher salary costs as a result of an increase in the number of employees in management and control functions. This increase in employee numbers was a necessary consequence of various regulatory requirements, KBN's status as a systemically important financial institution, and increased requirements in relation to internal control and reporting activities. Total operating expenses represented 0.04% of total assets in 2016.

KBN had total assets at 31 December 2016 of NOK 418.3 billion as compared to NOK 449.4 billion at 31 December 2015. The decrease is due to a combination of a decrease in the size of the liquidity portfolio in 2016 and the Norwegian krone strengthening against other currencies from the start of 2016, which reduces the value of KBN's assets and liabilities in NOK terms.

KBN's total primary capital at 31 December 2016 was NOK 13,989 million, of which NOK 10,996 million is total common equity Tier 1 capital. KBN's Tier 1 capital consists of share capital, retained earnings and additional Tier 1 capital. The common equity Tier 1 capital adequacy ratio at 31 December 2016 was 16.86%, the Tier 1 capital adequacy ratio was 18.39%, and the total capital ratio was 21.45%.

LENDING

KBN granted 610 new loans in 2016 totalling NOK 48.1 billion. Total lending to the local government sector at the end of 2016 was NOK 266.6 billion. KBN's loan portfolio grew by NOK 12.1 billion, representing an increase of 4.8%. KBN's market share for the sector was approximately 45%, unchanged from 2015.

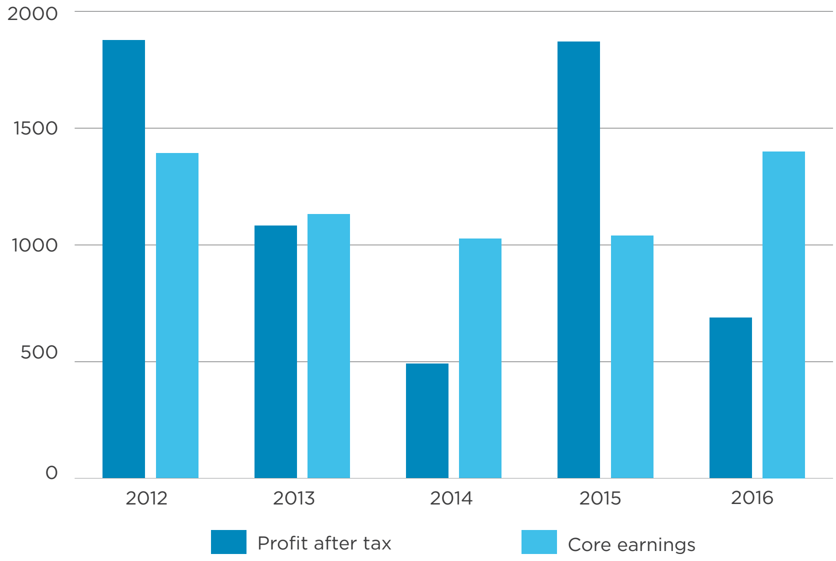
KBN adapted its lending activity in 2016 to the higher capital requirements that it had to meet with effect from 1 July 2016 and from 31 December 2016. KBN's strong earnings throughout 2016 allowed it to grow its lending by more than in 2014 and 2015 while also meeting the higher capital requirements.

Seventeen county authorities and 99% of Norway's 428 municipalities as well as Longyearbyen Local Council had loans from KBN at the end of 2016. In addition, a range of municipal and inter-municipal companies have loans from KBN. Loans to limited liability companies require municipal or county guarantees. KBN offers loans with the same interest rate terms to all its borrowers regardless of their size, thereby ensuring all municipalities and county authorities have equal access to debt financing on competitive terms.

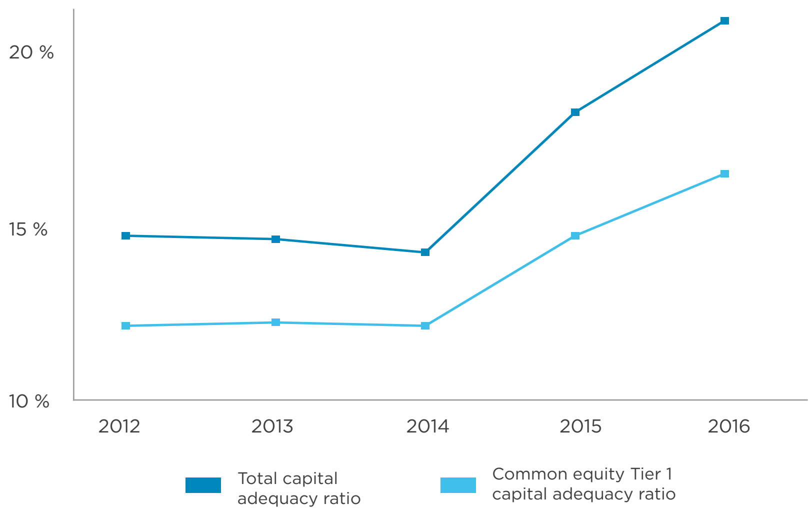
Loans to toll road companies with municipal guarantees accounted for NOK 25.4 billion of the NOK 55.3 billion in outstanding loans to municipal and inter-municipal companies and borrowers with municipal guarantees at the end of 2016.

The local government sector's need to invest is being driven by the need to both invest in new facilities and services and to carry out significant upgrades, particularly in relation to primary schools and further education, and to the water, wastewater and sanitation (WWS) area. With regard to the WWS area, analysis shows that there continues to be a significant maintenance backlog. Norway's

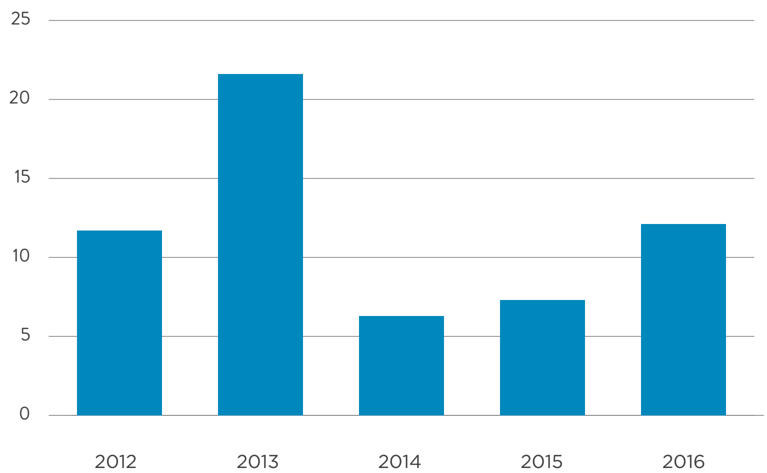
PROFIT AFTER TAX VS. CORE EARNINGS
amounts in NOK mill



CAPITAL ADEQUACY



LENDING GROWTH
amounts in NOK bill



LOAN VOLUME 2016
by type of borrower

municipalities are meeting the demographic changes taking place both by increasing investment in sheltered housing and care home places. In this area, national investment grants made through the Norwegian State Housing Bank are important to municipalities. Population growth in areas around large towns and cities and other urban areas is an additional factor that is creating a need for more investment. According to figures from Statistics Norway's C2 credit indicator (an approximate measure of the gross domestic debt of inter alia municipalities), local government sector borrowing grew by 5% in 2016 relative to 2015, which is 2.7 percentage points less than in 2015.

In 2016 KBN tasked Menon Economics with forecasting the local government sector's investment requirements in the period up to 2040. The forecast predicts that the level of investment and the associated need for debt financing will be high in the years ahead. Over recent years many municipalities have drawn up financial target figures or budgetary rules that set limits on the amounts they can invest and borrow.

In April 2016, KBN launched a new digital platform for customers called 'KBN Finans'. This tool enables KBN's customers to view their portfolio of loans from KBN and to enter any other loans they have. KBN Finans thus gives users a good overview of their borrowings and facilitates analysis, while it can also be used for reporting purposes. One area of focus for KBN in 2017 is to further develop its digital offering for customers.

As in previous years, KBN experienced no loan losses in 2016. No customer has defaulted or had problems with making payments, so there are no grounds to expect any loan losses in 2017.

KBN conducted a detailed customer survey in 2016 that had a high response rate. This demonstrated that customers are on the whole very satisfied with KBN.

THE LENDING MARKET

The local government lending market is characterised by the long-term, instalment loans that KBN offers and by municipalities borrowing directly in the capital markets. Demand for local government bonds and short-term certificate loans was variable in 2016, and figures from VPS suggest that the rate of borrowing in the capital markets has stabilised. In 2016 short-term borrowing grew at its lowest rate since 2012. The more municipalities use short-term financing, the more they become vulnerable to imbalances between supply and demand in the capital markets.

Changes have been made to the Norwegian Regulations on municipalities and county authorities' financial and debt management with effect from 1 January 2017 that increase the information requirements regarding the maturity dates of interest-bearing debt. Approximately 20% of outstanding local government debt will mature 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 focuses on providing long-term financing solutions, which very few other lenders offer. The products KBN offers are, however, market-oriented and adapted to customer demands and requirements. KBN's portfolio of loans with maturities of less than 12 months represent a small part of its overall lending and are part of its ongoing liquidity and capital management activities. This portfolio represented 4.7% of its overall lending at the end of 2016 as compared to 6.26% at the end of 2015.

GREEN LENDING AND GREEN FUNDING

KBN is committed to helping Norwegian municipalities achieve their climate targets. KBN has offered a separate lending product specifically to finance investment in environmentally friendly projects since 2010. KBN's entire green lending program was relaunched in 2016 with a new framework. The interest rate on KBN's green interest rate products is 0.1 percentage point lower than the interest rate on its ordinary interest rate products.

KBN's green lending product is intended to be a means of driving forward ambitious climate and environmental projects in the local government sector. A lower interest rate can be a supplement to the range of government policies used to create incentives for municipalities and county authorities to invest in projects with higher environmental and climate ambitions. At the end of 2016 KBN's green lending portfolio totalled NOK 13.5 billion[1].

The framework for KBN's green lending has been graded by the Center for International Climate and Environmental Research - Oslo (CICERO) as «dark green». This is the highest grade possible and means that the projects that are financed through the framework are part of the solution in terms of achieving the vision of making Norway a low-carbon society by 2050. Examples of projects financed using the green interest rate product in 2016 include Norway's first energy-plus nursery in the municipality of Asker, innovative water and wastewater solutions in northern Jæren and Romerike, and Norway's first nursing home constructed out of mass timber in the municipality of Frogn.

There is increasing demand globally for socially-responsible investments and projects that benefit the climate. At the same time, investors increasingly expect transparency and comprehensive reporting on the climate impact of the investment projects that green bonds enable. In 2016, KBN took steps to further improve its reporting and will publish its first impact report in 2017. This report will show the climate and environmental impacts, including the reductions in CO_2 emissions, that are facilitated by its green loans. KBN finances its green lending by issuing

1 By the end of 2016, KBN had a total of NOK 13.5 billion in outstanding lending granted as Green Loans from 2010 to 2016 under our first Green Bond Framework. In 2016, we updated the Framework to reflect expectations in the Green Bond market. Following this update, some projects previously granted a Green Loan do not satisfy our current eligibility criteria. These projects keep the discounted interest rate but are not included in the portfolio of Green Projects we present in our Environmental Impact Report. Outstanding lending under the new Green Bond Framework is NOK 10.5 billion.

green bonds. KBN is committed to being a leader in green finance. This involves it playing a clear role in on-lending funds from investors who want to invest in green projects. KBN's aim is to be directly involved in further developing both the framework as well as the market for green bonds internationally.

FUNDING

KBN's AAA/Aaa credit ratings ensure it has stable access to funding on favourable terms, and this benefits the local government sector. KBN brings together the sector's borrowing requirements and it has a better credit rating than each municipality would have on its own. KBN pursues a diversified funding strategy that ensures it has a broad investor base, low borrowing costs and low refinancing risk. New long-term borrowings amounted to NOK 82.8 billion in 2016, which is NOK 14.1 billion higher than in 2015. KBN's access to funding is well diversified, and Japan, other Asian markets, Europe and the USA are its most important markets. KBN issued bonds in 12 currencies in 2016, including two USD-denominated benchmark bonds totalling USD 2.0 billion, each with a maturity of five years, as well as a EUR-denominated benchmark bond of EUR 1.0 billion with a maturity of ten years. There was a high level of interest from investors and all KBN's benchmark bonds were significantly oversubscribed.

KBN is the largest Norwegian issuer of green bonds. KBN carried out its third green bond issue in October 2016 with a USD 500 million issue of four-year bonds. There is increasing demand globally for socially-responsible investments and projects that benefit the climate, and KBN's green bonds were significantly oversubscribed.

KBN's total borrowings decreased in 2016 from NOK 400.9 billion to NOK 376.8 billion.

LIQUIDITY MANAGEMENT

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

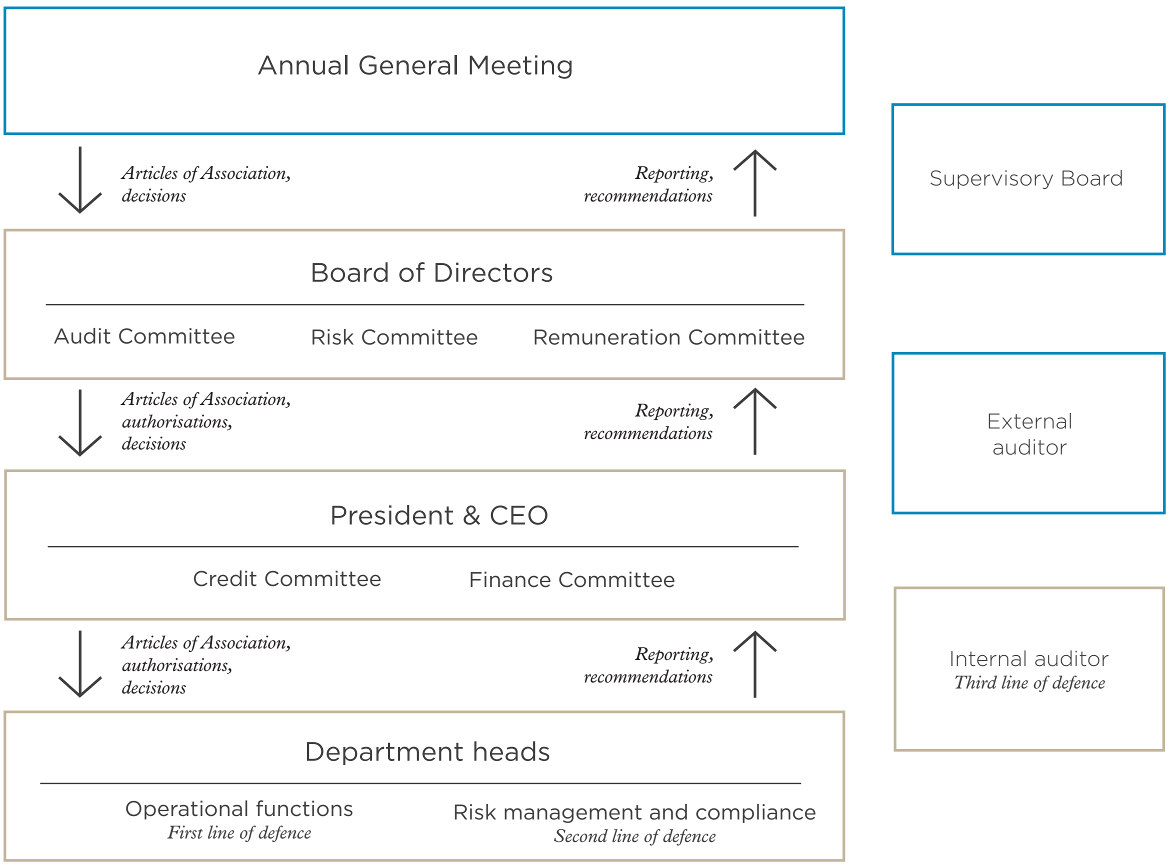
KBN's liquidity portfolio is primarily held in foreign currencies. The value of the liquidity portfolio at 31 December 2016 was NOK 116.4 billion, down from NOK 146.6 billion at the end of 2015, at which point the value of the portfolio was unusually high.

The liquidity portfolio is managed in a way that reflects KBN's target of having liquidity reserves sufficient to allow it to meet its obligations at all times. Excess liquidity is managed according to an investment strategy that is low risk in terms of both credit risk and market risk. KBN's liquidity reserves are invested in fixed income securities issued by governments, regional authorities, multilateral development banks and financial institutions that have high credit ratings as well as in covered bonds. KBN had a liquidity coverage ratio (LCR) of 1,116% at the end of 2016.

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 100%-owned by the Norwegian state. In its White Paper

KBN GOVERNING BODIES



on Ownership Policy[2], the Government classified KBN as a 'Category 3' entity, which is to say an entity with commercial objectives and other specifically defined objectives that define the purpose of the state's ownership of it. In Norway's National Budget for 2017, the purpose of the state's ownership of KBN is defined as follows:

«The objective of the state's ownership of Kommunalbanken AS is to facilitate financing for the local government sector, while the company shall also provide the state with a satisfactory return on paid-in capital.»

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%.

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

KBN's governing bodies are organised in accordance with the provisions of the Norwegian Public Limited Liability Companies Act and the Financial Enterprises Act, as well as KBN's Articles of Association. The Board of Directors and the Supervisory Board are elected by the Annual General Meeting. In connection with the new Financial Enterprises Act, changes were made in 2016 to KBN's governing bodies. It ceased to be a legal requirement for KBN to have a Supervisory Board and a Control Committee. The Annual General Meeting voted to abolish the Control Committee. The Supervisory Board has been retained as a governing body required by KBN's Articles of Association, and it will, inter alia, produce statements on issues that concern the company and 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.

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.

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 on page 48 in this annual report.

RISK MANAGEMENT AND INTERNAL CONTROL

The purpose of risk management is to ensure that KBN manages its assets and liabilities responsibly. The Board of Directors has established a risk appetite and risk tolerance framework for KBN and within this framework sets financial policies and risk limits, including 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 management's assessment of internal control on a yearly basis.

The Board of Directors is regularly informed of KBN's activities, financial position and earnings situation. The Board considers the management's assessment of risk and adverse events, 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 monitor financial reporting and oversee the systems for internal control and audit by preparing issues related to these areas and advising the Board on them.

The Risk Management Committee's role is to help the Board of Directors oversee and manage the overall level of risk at KBN by preparing issues related to this area and advising the Board accordingly.

The 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.

Risk management and internal control offer three lines of defence. KBN's operational activities represent the first line of defence and are responsible for monitoring and controlling whether KBN's activities are carried out within the approved limits. The risk management and compliance functions represent the second line of defence, with both serving to support the first line of defence by assisting with advice and facilitating appropriate methodology. However, they are independent control functions that monitor compliance with the approved risk limits and whether internal control at KBN is functioning satisfactorily. The internal auditor represents the third line of defence. The Board uses the internal auditor as an independent inspection and control function in its monitoring of KBN's activities.

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. These provisions stipulate that the state, operating through the Ministry of Local Government and Modernisation, will take charge of running a municipality if it is unable to meet its payment obligations. This in practice protects lenders from any losses in relation to debt and accrued interest.

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

LIQUIDITY RISK

The Board has a very limited risk appetite with regard to liquidity management, the purpose of which is to ensure sufficient liquid assets to cover KBN's ongoing liabilities at any point, including to meet all liabilities arising during a subsequent 12-month period without new borrowing.

The liquidity portfolio is subject to requirements in respect of liquidity, ratings, diversification, counterparties and instrument types, inter alia. Furthermore, liquidity management is designed such that KBN complies with the capital and liquidity requirements set by the authorities.

INTEREST RATE RISK AND CURRENCY RISK

Interest rate risk and currency risk are managed by ensuring that the risk exposure arising from KBN's assets and liabilities is balanced at all times. Hedging transactions are entered into to avoid interest rate and currency risk. When entering into a hedging transaction to minimise interest rate or currency risk, KBN assumes credit risk in respect of the counterparty to the derivative transaction. KBN is only willing to accept low credit risk in relation to such counterparties. This credit risk is further reduced by exchanging cash collateral for the market value of the derivative.

COUNTERPARTY RISK

KBN's counterparty exposure is continually monitored. The Board of Directors is informed of risk levels by the activity reports it receives and more frequently when required.

OPERATIONAL RISK

Operational risk is managed through processes and controls that help ensure good internal control at KBN, which includes ensuring there is an adequate separation of duties between operational and control functions, that there are documented work processes and controls, and that in relation to critical functions there is a sufficient number of employees with a high level of expertise. Annual risk reviews are undertaken for all critical functions to ensure there are sufficient risk-reduction measures in place to prevent losses. The Board of Directors is kept informed of operational risk and adverse events by activity and risk reports and annual assessments of internal control.

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 aims to help identify issues that constitute potential obstacles to its ability to achieve its purpose or that represent challenges to its customers' interests. In its external communications in 2016, KBN particularly emphasised the importance of a prudent approach to borrowing by the local government sector, its green lending products and the launch of KBN Finans.

KBN carried out a range of activities in 2016 to measure its reputation among major stakeholders.

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 specialist conferences and seminars in 2016, some independently and some in partnership with other parties that work in the local government sector.

KBN held its annual conference in April 2016, the theme of which was «Urbanisation the Norwegian way – sustainable cities and urban areas».

KBN's role in the «green shift» was also the theme of a panel discussion that KBN hosted at the Arendalsuka conference in August 2016. The main target audience of the events KBN arranged was, in addition to customers for KBN's lending products, local and national politicians, consultants 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 2016. The purpose of this was to improve the level of contact KBN has with its target audiences, increase the level of understanding of the role KBN plays in society, and to drive more traffic to its website.

ETHICS AND CORPORATE SOCIAL RESPONSIBILITY

KBN further developed its work on corporate social responsibility in 2016. KBN engaged in extensive dialogue with its stakeholders, revised its priorities and developed separate corporate social responsibility guidelines. KBN will produce a corporate social responsibility report for 2016 in accordance with the Global Reporting Initiative reporting standard. 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 decided to prioritise the following areas for its work on corporate social responsibility in 2017:

Topic 1: Ethics, money laundering, corruption, tax evasion, and the finance supply chain

Topic 2: Green bonds and green lending

Topic 3: Diversity and equality

Topic 4: Responsible lending

Topic 5: Knowledge sharing and dialogue with stakeholders

For KBN's reporting on corporate social responsibility for 2016 and its targets for 2017, see the separate Corporate Social Responsibility Report.

ORGANISATION AND EMPLOYEES

In order to meet its targets, KBN needs to recruit and develop skilled employees across a range of specialist areas.

KBN had 72 employees at the end of 2016 equating to 70.3 full-time employees. 61 employees hold permanent positions. The temporary employees are replacements for employees on parental leave and temporary staff appointed in connection with various projects.

Changes were made to KBN's organisational structure with effect from the start of the second half of 2016 in order to clarify further the separation between operational and control functions. KBN's risk management and compliance functions have now been brought together to form a risk management and compliance department. The loan administration and settlement functions have been brought together along with other operational support functions into a staff and operations department.

KBN's focus on digitalisation has concentrated on customers and robust and efficient work processes. We strengthened the customer experience in 2016 by launching a digital customer platform. KBN's finance system was adapted over the course of its first year in operation to further automate and improve internal work processes. This automation work will be accelerated.

CORPORATE DIVERSITY IN KBN
As of 31.12.2016

SHARE OF WOMEN	Board of Directors	Employees	CEO and management	Next management level
	56%	44%	50%	25%
AGE	Mean age men	Mean age women	Employees 30 years or younger	Employees over 50 years
	40	43	12	16
INTERNATIONAL	Other citizenship than Norwegian	Nationalities	International work experience, more than one year	Education abroad, more than one year
	10%	7	17%	42%

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 candidates to be identified and developed in order to reduce vulnerability and to develop talent.

At the end of 2016 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 50% and 44% respectively. The average age of KBN employees was 40 for men and 43 for women, and there are approximately as many employees under 30 as there are employees over 50. 10% of employees do not hold Norwegian citizenship.

HEALTH, SAFETY AND THE WORKING ENVIRONMENT

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 corporate culture characterised by well-being and collaboration. The Committee has held regular meetings and has carried out workplace assessments, indoor climate measurements, and risk assessments in relation to health, safety and environment issues. In 2016 the ethics program that was run for all employees focused on KBN's zero-tolerance approach to discrimination and harassment. One major and one minor employee survey were conducted.

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. No accidents or injuries were reported to the Norwegian Labour Inspection Authority.

The sickness rate was 1.41% in 2016 as compared to 4.4% in 2015. The sickness rate for men was 1.64% and 1.12% for women. 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.

ALLOCATION OF PROFIT

The Board of Directors of Kommunalbanken AS proposes the following allocation of the profit for the 2016 financial year: NOK 390 million is to be paid to KBN's owner as a dividend, NOK 19 million is to be paid in interest on the additional Tier 1 capital instruments, and NOK 280 million is to be transferred to retained earnings.

FUTURE PROSPECTS

2016 saw low growth in the Norwegian economy as a result of the downturn in oil prices and the moderate level of demand growth internationally. There continues to be a marked divide in the Norwegian economy. Oil-dominated Southern and Western Norway are facing difficult times, while growth in more diversified regions such as Oslo, Trøndelag and Northern Norway is stable. Growth in the Norwegian economy is expected to pick up in the time ahead. The fact that Norway has come through this period so well despite the sharp fall in the price of oil demonstrates that it has a robust economy and a flexible and adaptable labour market.

The local government sector will continue to have sizeable investment needs in the future, and this is the result of population growth, urbanisation and the continuing increase in the proportion of older people in the population. KBN has worked with the analysis firm Menon Economics to produce a forecast of the local government sector's investment needs in the years ahead. This analysis predicted that the local government sector's investment budget would double in size between now and 2040.

Following the Paris Agreement, there is a significant expectation that greenhouse gas emissions will fall, including in Norway. The local government sector plays an important role in this work, and KBN is committed to helping to ensure that Norway's municipalities access favourable funding terms when borrowing to finance important environmental projects. Going forward, one of KBN's ambitions is to increase the proportion of its lending that is used for environmentally friendly projects as well as to meet the demand in the market for green investments by issuing green bonds.

The development of services and products with a basis in digital solutions is accelerating. In dialogue with our customers, we will seek to develop the customer experience by adopting relevant technological solutions in relation to efficient customer management, operational robustness and analysis capabilities.

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. The EEA Agreement will require Norway to introduce regulations that the EU has drawn up primarily to prevent banks from causing another financial crisis. As a low-risk instrument of the state, KBN has a different business model. In designing the regulations, the EU has to some extent made provision for low-risk financial institutions such as KBN. Several countries have issued suitably adapted regulations for financial institutions that lend to the public sector, for example by classifying them as "promotional banks". Predictability and maintaining the same terms with regard to the long-term framework in which KBN operates are important to ensuring KBN is able to continue to play its key role in building Norwegian society.

The accounts for 2016 show that KBN achieved satisfactory results. KBN's aim is to contribute to the long-term financing of local government welfare services in the years ahead. The Board of Directors would like to thank KBN's employees for a job well done.

Oslo, 31 December 2016
24 March 2017

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

BRIT KRISTIN SÆBØ RUGLAND
Member since june 2016
Bachelor of Business Administration, Master of Management. Member, KBN Audit Committee. Chair, Figgjo AS. Member of the Board, Norfund and Talent Norge AS. Participated in five board meetings in 2016.

RUNE MIDTGAARD
Member since 2014
Master of Business and Authorised Financial Analyst (AFA). CEO, Norsk Luftambulanse AS. Member, KBN Remuneration Committee and KBN Audit Committee.
Participated in eight board meetings in 2016.

JARLE BYRE
Employee representative since 2015
Master of Business and Economics. Senior Relationship Manager, KBN. Personal alternate is Andreas Aleström. Participated in nine board meetings in 2016.

NANNA EGIDIUS
Member since 2004
Master of Business. Director of Strategic Planning and Development, Lillehammer municipality. Member, KBN Audit Committee. Chair, Norsk Luftambulanse AS. Vice Chair, Ikomm AS.
Participated in nine board meetings in 2016.

ELSE BUGGE FOUGNER
Chair since 1999
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 liquidation board, Aberdeen Eiendomsfond Norden/Baltikum ASA and Aberdeen Eiendomsfond Norge II ASA. Member of the Board, Aker Kværner Holding ASA and Protector Forsikring ASA. Participated in nine board meetings in 2016.

MARTIN SKANCKE
Member since 2013,
Vice Chair since 2015
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 nine board meetings in 2016.

MARTHA TAKVAM
Member since 2005
MSc in business and an MBA in finance. Director, Group Internal Audit, Telenor ASA. Chair, KBN Audit Committee. Member, KBN Risk Committee.
Participated in nine board meetings in 2016.

PETTER STEEN JR.
Member since 2015
Teacher. Consultant/advisor to Sveio Municipality. Member, KBN Remuneration Committee. Member of the Board, Haugaland Kraft AS.
Participated in nine board meetings in 2016.

MAY-IREN WALSTAD WASSÅS
Employee representative since 2016
MSc in business. Senior Portfolio Manager, Treasury, KBN. Member of the Board, ACI Norge. Personal alternate is Marit Urmo Harstad.
Participated in five board meetings in 2016.

FINANCIAL STATEMENTS 2016

NOTES TO THE FINANCIAL STATEMENTS

Income statements

Balance

Risk management

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	2016	2015
Interest income		5 617	5 496
Interest expense		3 530	3 854
Net interest income	**1**	**2 087**	**1 642**
Fees and commission expenses	**2**	32	30
Net unrealised gain/(loss) on financial instruments	**3**	(974)	1 116
Net trading income	**4**	15	6
Total other operating income		**(991)**	**1 092**
Salaries and administrative expenses	**5,6,7**	125	115
Depreciation on fixed assets		20	5
Other expenses	**9**	32	30
Total operating expenses		**177**	**151**
Profit before tax		**919**	**2 583**
Income tax	**8**	230	713
Profit for the year		**689**	**1 870**
Portion allocated to shareholder		670	1 859
Portion allocated to owners of additional Tier 1 capital		19	11

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	2016	2015
Profit for the year		689	1 870
Other comprehensive income			
Items which will not be reclassified to profit or loss			
Actuarial gain/(loss) on defined benefit plan		(1)	16
Of which is tax		0	4
Total other comprehensive income		**(1)**	**12**
Total comprehensive income for the year		**688**	**1 882**

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	2016	2015
Assets			
Deposits with credit institutions	**10, 11, 12, 14, 21**	16 182	19 428
Instalment loans	**10, 11, 12, 15**	267 521	256 815
Notes, bonds and other interest-bearing securities	**10, 11, 12, 13, 16**	118 550	149 944
Financial derivatives	**10, 12, 13, 20, 21**	15 921	22 831
Deferred tax asset	**8**	0	201
Other assets	**17**	153	142
Total assets		**418 327**	**449 361**
Liabilities and equity			
Loans from credit institutions	**10, 12, 18, 21**	7 584	7 167
Senior securities issued	**10, 11, 12, 13, 19**	369 933	390 107
Financial derivatives	**10, 12, 13, 20, 21**	26 275	37 207
Other liabilities	**17**	45	36
Current tax liabilities	**8**	0	829
Deferred tax liabilities	**8**	12	0
Pension liabilities	**7**	52	49
Subordinated debt	**10, 12, 22**	1 974	1 764
Total liabilities		**405 875**	**437 159**
Share capital	**23**	3 145	3 145
Additional Tier 1 capital	**24**	994	994
Retained earnings		8 314	8 063
Total equity		**12 452**	**12 202**
Total liabilities and equity		**418 327**	**449 361**

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)

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
Issue of share capital		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**

2015

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

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	**2016**	**2015**
Cash flows from operating activities		
Interest received	5 433	5 616
Interest paid	(3 752)	(3 175)
Fees and commissions paid	(32)	(30)
Receipts from repurchase of issued securities	15	6
Cash payments to employees and suppliers	(157)	(146)
Income taxes paid	(838)	(404)
Net disbursement of loans to customers	(12 137)	(7 298)
Net (increase)/decrease in deposits with credit institutions	3 212	(20 789)
Net (increase)/decrease in notes, bonds and other interest-bearing securities	25 204	19 049
Net (increase)/decrease in other assets	(12)	(123)
Net increase/(decrease) in other liabilities	11	(7)
Net cash flows from operating activities	**16 947**	**(7 302)**
Cash flows from investing activities		
Net (purchase)/sales of property and equipment	(20)	69
Net cash flows from investing activities	**(20)**	**69**
Cash flows from financing activities		
Proceeds from issuance of commercial paper	0	3 758
Repayment of commercial paper	0	(3 855)
Proceeds from issuance of debt securities	82 752	68 644
Repayment of debt securities	(96 675)	(116 443)
Proceeds from issuance of additional Tier 1 capital	0	994
Interest paid on Tier 1 capital	(26)	(14)
Proceeds from issuance of subordinated debt	1 991	0
Repayment of subordinated debt	(1 758)	0
Dividends paid	(417)	0
Proceeds from issuance of share capital	0	1 000
Net cash flows from financing activities	**(14 134)**	**(45 917)**
Net cash flows	**2 793**	**(53 149)**
Effects of foreign exchange differences	(2 751)	53 163
Net cash flows after foreign exchange differences	**42**	**13**
Cash and cash equivalents at 1 January	34	21
Net change in cash and cash equivalents	42	13
Cash and cash equivalents at 31 December	**76**	**34**
Whereof		
Deposits with credit institutions without agreed time to maturity	*76*	*34*
Loans from credit institutions without agreed time to maturity	*0*	*0*

ACCOUNTING POLICIES

REPORTING ENTITY

Kommunalbanken AS (”the Company” or “KBN”) is a limited company providing loans to counties, municipalities, intermunicipal companies and other companies that carry out tasks at a municipal level. KBN’s registered office is in Haakon VIIs gate 5B, Oslo. The financial statements for the year ended 31 December 2016 were approved by the Board of Directors on 24 March 2017.

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 de-recognition 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.

Level 2-inputs might include:

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

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 derivatives is determined using the discounted cash flows method, where discount rates are derived from the relevant observable money market interest rates and other risk factors that may significantly affect the fair value of the instruments. When such factors cannot be reliably observed at a reporting date, management may make assumptions and use estimates when determining the fair value.

Fair value of financial instruments with embedded derivatives is determined using option pricing models with observable market data and estimates as inputs. The most significant unobservable 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 does not qualify for offsetting under IAS 32. Cash collateral is presented on a gross basis in the Statement of Financial Position.

IMPAIRMENT OF FINANCIAL ASSETS

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

Individual impairments

When there is objective evidence that a loss has been incurred, the loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows. The loss is 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 carried 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

A domain name is classified as an intangible asset with an indefinite useful life and is not depreciated. A newly acquired portfolio system was deployed in November 2015 and is also classified as an intangible asset. The acquisition cost is amortised over the useful life. The same applies for a new customer portal that was deployed in 2016. 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

The Company has an employee pension scheme. The pension scheme is treated as a defined benefit plan. A linear profile of benefits earned and expected final salary are used to determine entitlements. The net pension cost for the period is included in "Salaries and administrative expenses" and consists of the sum of the period's service costs, interest costs on the calculated liability and administrative expenses. The value of net pension liabilities is calculated based on economic and actuarial assumptions.

LEASES

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

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

TAXES

Taxes are recognised in the income statement as they accrue, i.e. the income tax is based on profit before tax. Temporary and permanent differences are adjusted for before the year's tax base for current taxes is calculated. Deferred tax liabilities and deferred tax assets are calculated on the basis of temporary differences between the accounting and tax values at the financial year end. The nominal tax rate is used for this calculation. Tax increasing and tax-reducing differences within the same period are offset. Income tax consists of current taxes (tax on the taxable profit or loss for the year), changes in net deferred tax and adjustment to taxes payable in respect of previous years. The corporate income tax rate in Norway 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 2016.

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 2016 have not lead to material changes in KBN's financial statements.

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

IFRS 9 *Financial Instruments* was completed and published by the IASB in July 2014, with effective date 1 January 2018. The standard was endorsed by the EU in the second half of 2016 and replaces IAS 39 *Financial instruments: Recognition and Measurement.* It is expected that the new rules will give some effects for the Company's loan loss provisioning (impairment) for loans and bond investments measured at amortised cost, based on the new standard using an expected loss method, while the current standard uses an incurred loss method. KBN is currently assessing the effects of the new impairment model on the bank's financial statements. Due to the low credit risk associated with the bank's assets and a considerable amount of financial assets measured at fair value, it is not expected that the effects from the new impairment model will be material. The new standard also includes a new model for hedge accounting, and hence the adoption may entail adjustments to KBN's rule application on hedge accounting. It will be assessed whether further economic hedges that are not subject to hedge accounting as of today, may be given such treatment under the new standard. Finally the new IFRS 9 has changed the model for classification and measurement. The Company has also started assessing changes to classification of its financial instruments under the new rules. An expected effect for the bank's financial statements is that value changes that are caused by changes in own credit risk for issued bonds that are measured at fair value, will be recognised in other comprehensive income instead of in the income statement. KBN will implement IFRS 9 as of 1 January 2018.

NOTE 1

NET INTEREST INCOME

(Amounts in NOK 1 000 000)

2016	Total	At fair value through profit or loss			Held to maturity	Loans and receivab-les	Other liabi-lities
		Fair value option	Held for trading	Fair value hedge			
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)**

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

NOTE 2

FEES AND COMMISSION EXPENSES

(Amounts in NOK 1 000 000)

	2016	2015
Expenses of banking services	18	19
Other transaction costs	14	11
Total fees and commission expenses	**32**	**30**

NOTE 3

NET UNREALISED GAIN/(LOSS) ON FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

2016	**Total**	**At fair value through profit or loss**			**Loans and receivab-les**	**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**

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

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.

Net unrealised losses in 2016 amounting to NOK 974 million come from Instalment loans and Senior securities issued and related financial derivatives, with around NOK 400 million and NOK 550 million respectively. For Instalment loans the loss is due to increases in credit spreads in 2016. For funding the loss is primarily due to widening USD-NOK swap spreads, which affect the value of derivatives used to convert USD funding to NOK. Net unrealised gains amounting to NOK 1.1 billion in 2015 came from Senior securities issued and related derivatives, with NOK 600 million resulting from increases in credit spreads and NOK 500 million resulting from reduction in USD-NOK swap spreads. 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 1.1 billion in "Notes, bonds and other interest-bearing securities" and NOK 146.2 billion in "Senior securities issued", that are classified as Loans and receivables and 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.

	2016	**2015**
Gain/(loss) from repurchase of securities issued	5	25
Gain/(loss) from sales of bond investments and derivatives terminations	10	(19)
Net trading income	**15**	**6**

NOTE 5

SALARIES AND ADMINISTRATIVE EXPENSES

(Amounts in NOK 1 000 000)

	2016	2015
Salaries	73	66
Employer contributions	10	9
Pension costs	12	12
Other personnel benefits	3	2
Administrative expenses	27	26
Total salaries and administrative expenses	**125**	**115**
Average number of man-years	*70*	*62*

NOTE 6

REMUNERATION

(Amounts in NOK 1 000)

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

THE REMUNERATION SCHEME FOR SENIOR EXECUTIVES

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

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

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

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

Senior executives are defined as the President & Chief Executive Officer (the "CEO") and the CEO's management team, comprising 6 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 three members, who are appointed annually by and among the members of the Board. At year end 2016, the Committee's members are Else Bugge Fougner (Chair), Rune Midtgaard and Petter Steen jr.

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

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 2016

Pension benefits
Senior executives are members of KBN's defined benefit pension scheme administered by KLP for salaries up to 12 times the National Insurance base amount. Members of the scheme are entitled to a life expectancy-adjusted retirement pension upon the completion of 30 years of service equivalent to 66% of base salary at the time of leaving KBN's employment. The scheme also includes disability and life pensions and contractual early retirement.

Fixed salary
Fixed salary payable in 2016 included the normal annual salary increase, as well as a salary compensation in regards to the discontinuation of the supplemental pension schemes for salaries in excess of 12 times the National Insurance base amount from 1 November 2015.

Variable salary
Guidelines for variable salary in respect of the 2016 financial year, including the criteria for variable salary for all KBN employees, were approved by the Board in February 2016, and resulted in all employees receiving variable salary equivalent to 1.5 times one month's salary.

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

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

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1) The Financial Enterprises Act
2) Regulation on remuneration schemes at financial institutions, investment firms and fund management companies
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.

2016

Remuneration to senior executives	**Fixed salary**	**One-off payment above 12G from 01.01.16**	**Variable salary accrued in the period***	**Other benefits**	**Pension costs**
Kristine Falkgård (President & CEO)	3 075	0	361	200	192
Martin Spillum (Chief Financial Markets Officer) (until 30.10.16)	2 462	0	298	134	172
Jannicke Trumpy Granquist (CFO)	1 830	0	224	49	150
Tor Ole Steinsland (Chief Communications Officer)	1 266	0	154	39	157
Håvard Thorstad (CRO)	1 651	0	210	31	166
Ilse Margarete Bache (Chief of Staff & Operations)	1 470	0	177	46	142
Lars Strøm Prestvik (Chief Lending Officer)	1 546	0	188	118	147
Total remuneration to senior executives	**13 300**	**0**	**1 612**	**617**	**1 126**
Total remuneration to employees whose professional activities affect the risk position of the institution	**17 239**	**0**	**1 886**	**590**	**2 317**
Total remuneration to the employees in the independent control functions	**21 450**	**0**	**2 775**	**517**	**2 711**

**Paid out in the following year*

2015

Remuneration to senior executives	**Fixed salary-before one-off payment**	**One-off payment above 12G from 01.01.15**	**Variable salary accrued in the period**	**Other benefits**	**Pension costs**
Kristine Falkgård (President & CEO)	2 551	1 266	351	159	175
Martin Spillum (Chief Financial Markets Officer)	2 319	28	294	116	161
Jannicke Trumpy Granquist (CFO)	1 647	119	217	20	142
Tor Ole Steinsland (Chief Communications Officer)	1 197	62	150	31	148
Håvard Thorstad (CRO from 01.11.2015)	275	0	34	4	0
Frank Øvrebø (CRO until 30.10.2015)	1 355	113	169	19	155
Ilse Margarete Bache (Chief of Staff)	1 355	81	172	23	144
Lars Strøm Prestvik (Chief Lending Officer from 01.07.2015)	1 343	68	182	69	141
Total remuneration to senior executives	**12 042**	**1 737**	**1 569**	**441**	**1 066**
Total remuneration to employees whose professional activities affect the risk position of the institution	**16 827**	**91**	**2 178**	**644**	**2 256**
Total remuneration to the employees in the independent control functions	**16 907**	**0**	**2 231**	**416**	**2 236**

Remuneration to Board of Directors	2016	2015
Chairman Else Bugge Fougner [1 3]	405	386
Vice-chairman Nils R Sandal (until 5 June 2015)	0	70
Vice-chairman Martin Skancke (vice-chairman from 5 June 2015) [3]	264	273
Board member Nanna Egidius [2]	197	178
Board member Martha Takvam [2 3]	310	304
Board member Rune Sollie (until 3 June 2016) [2]	98	178
Board member Rune Midtgaard [1 2]	210	155
Board member Petter Steen jr (from 5 June 2015) [1]	162	70
Board member Brit Rugland (from 3 June 2016) [2]	100	0
Board member employees' representative Roald Fischer (until 5 June 2015)	0	54
Board member employees' representative Jarle Byre (from 5 June 2015) [1]	182	90
Board member employees' representative Marit Urmo Harstad (until 3 June 2016)	70	123
Board member employees' representative May-Iren Walstad Wassås (from 3 June 2016)	72	0
Alternate Board member employees' representative Andreas Alestrøm (from 5 June 2015)	0	0
Alternate Board member employees' representative Marit Urmo Harstad (from 3 June 2016)	0	0
Alternate Board member employees' representative Jarle Byre (until 5 June 2015)	0	32
Total remuneration to Board of Directors	**2 070**	**1 913**

1 Member of remuneration committee
2 Member of audit committee
3 Member of risk committee

Remuneration to Control Committee	2016	2015
Chairman Kjell Inge Skaldebø (until 3 June 2016)	29	57
Committee member Anne-Ma Tostrup Smith (until 3 June 2016)	18	35
Committee member Ole Rødal (until 3 June 2016)	18	35
Committee alternate member Roy Jevard (until 3 June 2016)	18	35
Total remuneration to Control Committee	**83**	**162**

Remuneration to Supervisory Board	2016	2015
Chairman Svein Ludvigsen	23	23
Board members	73	67
Total remuneration to Supervisory Board	**96**	**90**

Fees to the statutory auditor	2016	2015
Statutory audit fees	983	1 098
Other financial audit and attestation services	981	822
Tax services	520	77
Other services not related to audit	57	7
Total fees excl. VAT	**2 541**	**2 004**

NOTE 7

PENSIONS

(Amounts in NOK 1 000)

KBN has a defined benefit plan that covers all employees and is administered through Kommunal Landspensjonskasse (KLP). Pension benefits include retirement pensions, disability pensions and pensions for spouses and dependent children, and is coordinated with benefits from the National Insurance Scheme.The defined benefit plan is compliant with the requirements of the Norwegian Mandatory Service Pension Act.

Full pension benefit requires a service period of 30 years and gives the right to a retirement pension of 66 per cent of base salary including the National Insurance Scheme. KBN also has a contractual pension plan (AFP). This plan is included in the calculation of pension liabilities. The defined benefit plan covering salaries over 12xBase amount has been closed as of 1 April 2011, and was terminated in 2015 for current employees that were part of the plan. For further information about the unwinding of pension above 12xBase amount, see Note 6.

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

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

Economic estimates used in calculation of pension costs and defined benefit obligation	31.12.2016	31.12.2015
Discount rate	2.60 %	2.70 %
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 2016 and 2015. 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**	
	2016	**2015**	**2016**	**2015**
Net periodic pension cost	8 934	8 191	0	635
Net interest	1 027	1 099	443	450
Service cost	249	224	0	0
Employer contributions	1 440	1 342	62	153
Pension costs recognised in income statement incl. employer contributions and service costs	0	0	0	0
Total pension cost recognised in income statement	**11 649**	**10 856**	**505**	**1 238**
Actuarial gain/(loss) recognised in other comprehensive income	902	(12 208)	273	(3 889)
Net pension costs	**12 551**	**(1 352)**	**778**	**(2 651)**

Pension liabilities	**Funded plan**		**Unfunded plan**	
	2016	**2015**	**2016**	**2015**
Defined benefit obligation	107 371	94 813	16 958	16 512
Plan assets	(78 422)	(68 608)	0	0
Employer contributions	4 082	3 695	2 391	2 328
Net pension liabilities	**33 031**	**29 900**	**19 349**	**18 840**

Movement in pension liabilities	**Funded plan**		**Unfunded plan**	
	2016	**2015**	**2016**	**2015**
Net pension liabilities as of 1 January	29 900	39 029	18 840	21 757
Net pension costs	12 551	(1 352)	778	(2 651)
Contribution to the pension scheme	(9 419)	(7 778)	(270)	(266)
Net pension liabilities as of 31 December	**33 031**	**29 900**	**19 349**	**18 840**

Movement in the fair value of plan assets	Funded plan		Unfunded plan	
	2016	**2015**	**2016**	**2015**
Fair value of plan assets as of 1 January	68 608	58 340	0	0
Net interest	1 762	1 207	0	0
Actuarial gain/(loss)	996	3 424	0	0
Service cost	(249)	(224)	0	0
Contribution to the pension scheme	8 255	6 816	237	233
Benefits paid	(951)	(955)	(237)	(233)
Fair value of plan assets as of 31 December	**78 422**	**68 608**	**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.

	2016	**2015**
Current taxes	0	832
Change in deferred tax	230	(119)
Too low/high expense previous years	0	0
Total income tax	**230**	**713**

Reconciliation of effective income tax rate	2016	2015
Profit before tax	919	2 583
Calculated income tax (25% in 2016, 27% in 2015)	230	697
Effect of change in tax rate	0	16
Tax expense	**230**	**713**
Effective income tax rate	25.0%	27.6 %

Deferred tax liability/(asset)	2016	2015
Deferred tax liability/(asset) as at 1 January	(201)	(86)
Change in deferred tax	230	(119)
Changes in deferred tax on items recognised in other comprehensive income	0	5
Changes in deferred tax on items recognised in equity (additional Tier 1 capital)	(17)	0
Deferred tax liability/(asset) as at 31 December (25% in 2016, 27% in 2015)	**12**	**(201)**

Temporary differences	2016	2015
Fixed assets	(4)	(1)
Pension liabilities	(52)	(33)
Provisions	(10)	(11)
Financial derivatives	2 597	157
Premiums/discounts on financial instruments	(1 602)	(1 465)
Unrealised gain/loss on financial instruments	(411)	563
Currency gain/loss on financial instruments	7 900	0
Losses carried forward for tax purposes	(8 370)	0
Total temporary differences	**48**	**(791)**
Deferred tax liability/(asset)	**12**	**(201)**

KBN has received notification of a probable change in tax returns for 2014. The process is ongoing and a decision is expected in 2017. KBN has opposed some of the assertions in the notification.

The case relates to the tax treatment and periodisation of financial instruments, principally regarding the use of the realisation principle on the currency element in financial instruments. The assertions of the tax authorities may lead to changed periodisation and time of recognition of taxable income/expense over time, but no change in which items are included in taxable income in total over the instruments' lifetime.

In the financial statements for 2016 KBN has adapted to the assertions of the tax authorities, and thus has recognised changes in ending temporary differences for financial instruments, in accordance with the notification. It is the bank's view that the tax authorities' assertions will result in larger and more volatile temporary differences, but without a material effect for the bank's income tax in the income statement. Tax rate changes may however lead to some effect on the income tax.

NOTE 9

LEASES

(Amounts in NOK 1 000 000)

Future minimum lease payments	2016	2015
Under 1 year	6	6
1-5 years	17	23
Over 5 years	0	0
Total future minimum lease payments	**23**	**29**

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)

2016	Total	At fair value through profit or loss			Held to maturi-ty	Loans and receivab-les	Other liabilities
		Fair value option	Held for trading	Fair value hedge			
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**

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

NOTE 11

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

(Amounts in NOK 1 000 000)

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.

2015	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	2 190	0	**2 190**
Instalment loans	0	100 695	58 830	**159 525**
Notes, bonds and other interest-bearing securities	84 660	56 060	5 967	**146 687**
Financial derivatives	0	20 572	2 259	**22 831**
Total financial assets measured at fair value	**84 660**	**179 517**	**67 056**	**331 233**
Loans from credit institutions	0	0	0	**0**
Senior securities issued	0	158 630	72 702	**231 332**
Financial derivatives	0	7 527	29 680	**37 207**
Subordinated debt	0	0	1 764	**1 764**
Total financial liabilities measured at fair value	**0**	**166 157**	**104 146**	**270 302**

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 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)**

	Instalment loans	Notes, bonds and other interest-bearing securities	Senior securities issued	Subordinated debt	Financial derivatives
Carrying amount at 31 December 2014	**46 456**	**4 193**	**89 562**	**1 895**	**(10 405)**
Purchase	0	2 795	(2 306)	0	(4 054)
Sale	0	0	0	0	0
Issue	25 442	0	17 809	0	0
Settlement	(14 177)	(3 589)	(33 648)	0	1 130
Transfer into Level 3	4 279	15 174	0	0	0
Transfer out of Level 3	(5 553)	(12 476)	0	0	0
Gain/(loss) recognised in the period	2 383	(130)	1 285	(131)	(14 092)
Carrying amount at 31 December 2015	**58 830**	**5 967**	**72 702**	**1 764**	**(27 421)**

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 2016 vary from –50 bp to +76 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 –20 bp to + 200 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 2016, Notes, bonds and other interest-bearing securities amounting to NOK 1 251 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	**2016**		**2015**	
	Carrying amount	**Impact of changes in key assumptions**	**Carrying amount**	**Impact of changes in key assumptions**
Instalment loans	65 728	(283)	58 830	(249)
Notes, bonds and other interest-bearing securities	2 511	(5)	5 967	(81)
Financial derivatives	(17 952)	(41)	(27 421)	(58)
Senior securities issued	(76 857)	321	(72 702)	221
Subordinated debt	(1 974)	22	(1 764)	1
Total	**(28 544)**	**14**	**(37 090)**	**(166)**

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 283 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 5 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 321 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	**2016**	
	Carrying amount	**Impact of changes in key assumptions**
Senior securities issued - with option element linked to equities or equity indices	(15 912)	512
Financial derivatives - with option element linked to equities or equity indices	1 946	(512)
Total	**(13 966)**	**0**

The table below shows total unrealised gain/(loss) recognised in the income statement in 2016 and 2015 for assets and liabilities allocated to Level 3.

Level 3 unrealised gain/(loss) in the period

		2016		**2015**
	Carrying amount	**Unrealised gain/(loss)**	**Carrying amount**	**Unrealised gain/(loss)**
Instalment loans	65 728	(1 532)	58 830	(269)
Notes, bonds and other interest-bearing securities	2 511	32	5 967	(118)
Senior securities issued	(76 857)	(2 093)	(72 702)	14 801
Financial derivatives	(17 952)	4 225	(27 421)	(16 737)
Subordinated debt	(1 974)	70	(1 764)	115
Total	**(28 544)**	**702**	**(37 090)**	**(2 208)**

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)

	2016		2015	
	Carrying amount	Fair value	Carrying amount	Fair va-lue
Deposits with credit institutions	10 974	10 974	17 238	17 238
Instalment loans	102 773	102 683	97 289	97 264
Notes, bonds and other interest-bearing securities classified as Loans and receivables	1 115	1 119	3 188	3 209
Notes, bonds and other interest-bearing securities classified as Held to maturity	21	18	69	63
Total financial assets measured at amortised cost	**114 883**	**114 794**	**117 784**	**117 773**
Loans from credit institutions	7 584	7 584	7 167	7 167
Senior securities issued	146 223	145 815	158 775	158 436
Total financial liabilities measured at amortised cost	**153 807**	**153 399**	**165 942**	**165 603**

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

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**

2015	Level 1	Level 2	Level 3	Total
Instalment loans	0	81 505	15 759	97 264
Notes, bonds and other interest-bearing securities classified as Loans and receivables	0	2 465	745	3 209
Notes, bonds and other interest-bearing securities classified as Held to maturity	0	63	0	63
Total fair value of financial assets, measured at amortised cost	**0**	**84 032**	**16 503**	**100 535**
Senior securities issued	150 400	8 036	0	158 436
Total fair value of financial liabilities, measured at amortised cost	**150 400**	**8 036**	**0**	**158 436**

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	2016	2015
Notes, bonds and other interest-bearing securities	1 115	3 188
Senior securities issued	146 223	158 775
Financial derivatives	(62)	1 043
Total	**147 275**	**163 006**

Recognised value changes on financial instruments in fair value hedges	2016	2015
Notes, bonds and other interest-bearing securities	(27)	(109)
Senior securities issued	711	336
Financial derivatives	(716)	(213)
Total	**(32)**	**14**

Recognised value changes are a result of changes in underlying risk factors, such as interest rates and currency basis swaps 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)

	2016	2015
Deposits with credit institutions without agreed time to maturity	76	34
Deposits with credit institutions with agreed time to maturity	5 208	2 190
Cash collateral pledged	10 898	17 204
Total deposits with credit institutions	**16 182**	**19 428**

NOTE 15

INSTALMENT LOANS

(Amounts in NOK 1 000 000)

	2016	2015
Principal amount	266 518	254 376
Accrued interest	1 056	945
Fair value adjustment	(93)	1 448
Total loans to customers	**267 481**	**256 769**
Other loans	40	46
Total instalment loans	**267 521**	**256 815**

Geographic distribution	2016	2015
Østfold	11 226	10 913
Akershus	26 644	22 401
Oslo	6 229	6 944
Hedmark	11 419	11 093
Oppland	8 212	8 034
Buskerud	31 158	29 877
Vestfold	9 818	8 569
Telemark	9 678	9 479
Aust-Agder	6 376	5 850
Vest-Agder	10 971	11 618
Rogaland	22 930	19 740
Hordaland	31 436	28 817
Sogn og Fjordane	8 468	8 054
Møre og Romsdal	14 779	16 417
Sør-Trøndelag	12 320	12 491
Nord-Trøndelag	9 215	9 234
Nordland	17 585	16 819
Troms	10 701	11 082
Finnmark	7 219	6 843
Svalbard	136	100
Loans to customers, principal amount	**266 518**	**254 376**

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	2016	2015
Domestic		
Issued by other borrowers	2 281	14 754
Foreign		
Issued by public bodies[1]	107 028	87 978
Issued by other borrowers	9 241	47 212
Total notes, bonds and other interest-bearing securities	**118 550**	**149 944**

[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	2016	2015
Under 1 year	52 497	81 576
1-5 years	59 965	68 368
Over 5 years	6 087	0
Total notes, bonds and other interest-bearing securities	**118 550**	**149 944**

NOTE 17

OTHER ASSETS

(Amounts in NOK 1 000 000)

	2016	2015
Intangible assets	138	125
Fixed assets	14	13
Other assets	1	2
Prepaid, non-accrued expenses and accrued income	0	2
Total other assets	**153**	**142**

Intangible assets are comprised of two IT systems. The portfolio system was brought into use in 2015, while the lending portal was brought into use in 2016. Both systems are amortised over their expected lifetimes.

OTHER LIABILITIES

(Amounts in NOK 1 000 000)

	2016	2015
Accounts payable	6	4
Public fees	8	9
Other short term liabilities	10	11
Accrued expenses and received, not yet accrued interest	21	12
Total other liabilities	**45**	**36**

NOTE 18

LOANS FROM CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2016	2015
Cash collateral received	7 584	7 167
Total loans from credit institutions	**7 584**	**7 167**

NOTE 19

SENIOR SECURITIES ISSUED

(Amounts in NOK 1 000 000)

	2016	2015
Senior securities issued (nominal amounts) as at 1 January	**400 894**	**391 285**
New issuance	82 752	68 644
Redemptions*	(93 926)	(113 583)
Amortisation	(2 749)	(2 860)
Translation differences	(10 185)	57 408
Senior securities issued (nominal amounts) as at 31 December	**376 785**	**400 894**
Accrued interest	4 390	3 017
Fair value adjustment	(11 242)	(13 805)
Total senior securities issued	**369 933**	**390 107**
Of which gain/(loss) from fair value adjustment that is due to changes in own credit risk	(118)	343

** Redemptions in 2016 includes buybacks of 1 159 million NOK.*

There was no breach in debt covenants as of 31 December 2016.

Fair value adjustment (value changes) that are due to changes in KBN's credit risk is a part of the total value change for the bond, which is not due to changes in market parameters like interest or currency risk. Value changes resulting from changes in credit risk amount to the difference between the values calculated using two different discount rates:
A) Relevant money market interest rate at the reporting date with an add-on for the credit risk on the issue date; and
B) Relevant money market interest rate at the reporting date with an add-on for the credit risk on the reporting date (fair value on the reporting date)

NOTE 20

FINANCIAL DERIVATIVES

(Amounts in NOK 1 000 000)

KBN uses financial derivatives only to economically hedge exposures to interest rate and currency risk arising in the Company's business activities, 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)	**2016**			**2015**		
	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	119 665	798	2 553	103 209	648	2 195
Currency derivatives	467 790	13 936	20 513	513 298	20 331	32 121
Equity related derivatives	17 107	221	2 180	11 186	37	2 119
Commodity related derivatives	0	0	0	0	0	0
	604 561	**14 955**	**25 246**	**627 693**	**21 016**	**36 435**
Fair value hedges:						
Interest rate derivatives	143 411	420	986	155 101	776	609
Currency derivatives	4 053	546	43	6 471	1 039	162
	147 464	**966**	**1 029**	**161 572**	**1 815**	**772**
Total financial derivatives	**752 026**	**15 921**	**26 275**	**789 266**	**22 831**	**37 207**

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 netting under IAS 32, financial derivatives are presented on a gross basis in the Statement of Financial Position, such that contracts with a positive fair value are presented as assets and contracts with a negative fair value are presented as liabilities.

NOTE 21

COLLATERAL AND OFFSETTING

(Amounts in NOK 1 000 000)

KBN has entered into ISDA agreements with all derivatives counterparties. This implies that all exposures vs the counterparty may be netted in the event of default. The ISDA agreements contain agreements regarding the exchange of collateral in the form of Credit Support Annex (CSA) related to financial derivatives exposures. The collateral consists of cash in USD or EUR. Cash collateral received and cash collateral pledged is presented in the Statement of financial position as Deposits with credit institutions or Loans from credit institutions with a related payable to or receivable from credit institutions. Cash collateral received is included in KBN's cash management, and is placed either in notes and bonds or in short term money market instruments. See Note 20 for additional information about financial derivatives.

(Amounts in NOK 1 000 000)	**2016**	**2015**
Cash collateral received	7 584	7 167
Cash collateral pledged	(10 898)	(17 204)
Total cash collateral	**(3 315)**	**(10 037)**

Effect of offsetting and collateral

The table below shows items in the Statement of Financial Position that are subject to legally binding netting agreements and related collateral to reduce counterparty risk. In KBN this comprises the item Financial derivatives (assets and liabilities). The column Gross fair value presents the total market value for contracts with positive and negative market value. The same amounts are presented in the column Carrying amount, to make it clear that these items are presented gross in the Statement of Financial Position, based on the ISDA agreements not fulfilling the requirements for offsetting. In the column Netting effect for counterparties with both assets and liabilities items the effect 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**		
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

(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**		
2015	**Gross fair value**	**Amounts that are offset in the statement of financial position**	**Carrying amount**	**Netting effect for counterparties with both asset and liabilities items**	**Cash collateral**	**Amounts after netting and collateral**
Assets						
Financial derivatives	22 831	0	22 831	13 345	7 167	2 318
Liabilities						
Financial derivatives	37 207	0	37 207	13 345	17 204	6 658

NOTE 22

SUBORDINATED DEBT

(Amounts in NOK 1 000 000)	Currency	Nominal amount in CCY	Redemp-tion right	Coupon	Nominal amount in NOK 2016	2015*
Ordinary subordinated loan capital	NOK	2 000	2028	3.02 %	2 000	0
Ordinary subordinated loan capital	CAD	275	2016	3.74 %	0	1 743
Total subordinated debt					**2 000**	**1 743**

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

The ordinary subordinated loan in CAD with redemption rights in 2016 was redeemed in May 2016. A new ordinary subordinated loan was issued in NOK in the same month, with par value NOK 2 billion.

NOTE 23

SHARE CAPITAL

	2016		2015	
	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	Redemp-tion right	Coupon	Carrying amount 2016	2015
Additional Tier 1 capital	NOK	1 000	2020	3 month NIBOR +1.5%	994	994
Total additional Tier 1 capital					**994**	**994**

KBN issued additional Tier 1 capital in the form of a subordinated bond in June 2015. The bond forms part of KBN's Tier 1 capital, see Note 30. Based on KBN having a one-sided right to not pay interest and notional amount to the investors, the bond does not qualify as a liability under IAS 32 and is therefore classified as equity in the Statement of Financial Position. The interest expenses are not presented on the line Interest expense in the income statement, but rather as a reduction of Retained earnings. The expenses are recognised when paid, see the Statement of changes in equity. In 2016 interest in the amount of NOK 19.7 million (after tax) has been paid (NOK 10.3 million in 2015). In addition, NOK 0.6 million had accrued at year end (NOK 0.8 million in 2015), such that in total NOK 19.4 million (NOK 11 million in 2015) of profit after tax is attributed to the additional Tier 1 capital holders in 2016, 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 back office and lending administration functions. The second line of defence monitors, guides and contributes to improving the first line controls, and performs comprehensive risk measurement. These responsibilities include risk management and compliance control of external and internal regulations. The Risk Management department has the overall responsibility for KBN's total risk management and compliance. The CRO reports on a day to day basis to the President & CEO, but has a direct reporting line to the Board in accordance with Section 47.3 of the Norwegian Capital Requirements Regulation. Head of Compliance reports on a day to day basis to the CRO, but has a direct reporting line to both the CEO and the Board. The third line of defence is carried out by the internal auditor KPMG (Deloitte from 1 January 2017), reporting directly to the Board.

RISK TYPES

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

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

Credit risk and counterparty risk

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

Market risk

- Interest rate and currency risk

Capital level

Liquidity risk

Operational risk

CREDIT RISK

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

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

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

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

Procedures and processes to monitor and control credit risk have been established. Management assesses and approves all new limits and counterparties, based on KBN's internal credit risk models, available risk capital, counterparties' external ratings, types of financial instruments and tenor. All counterparties are also reviewed on an ongoing basis. The Board of Directors annually approves the credit policy for municipal lending, and all special exposures are assessed by management prior to granting of the loan.

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

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

Credit risk related to the liquidity portfolio is low. An average rating of the portfolio is AA+ (based on the lowest of S&P and Moody's), and 85 per cent of the portfolio is invested in securities with a BIS-weight of zero per cent. Average time to maturity of the portfolio was 1.1 year 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 of interest rate and currency risk. KBN's risk policy allows minimal exposure to changes in interest rates and FX-rates. Interest rate and currency risk are managed through matching of assets and liabilities as well as through economic hedges with derivative instruments.

CAPITAL MANAGEMENT

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

In the process of capital assessment, management identifies and measures all the risks KBN may be exposed to and estimates the capital level necessary to cover the total risk exposure. The following risks are assessed separately: credit risk, market risk, liquidity risk, operational risk and other non-financial risk.

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

KBN's Common equity Tier 1 capital adequacy ratio is 16.86 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. Loans given to municipalities may have time to maturity of up to 50 years, and credit limits are regulated by the regulation on large exposures. Credit exposures to financial institutions shall have a rating of A or above.

KBN grants loans to public sector entities that carry out tasks for local and regional authorities. The conditions for such loans are that the municipalities or regional authorities provide guarantees that have been politically approved and authorised by government via the County governor or the Ministry of Local Government and Modernisation. KBN has no loan losses in 2016, and neither is there any evidence of default as at 31 December 2016. 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

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**

Amounts in the table below represent actual credit exposure

2015

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

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

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

Credit exposure by country

2015

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

NOTE 27

INTEREST RATE RISK

(Amounts in NOK 1 000 000)

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

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

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

Effect of 100 bp change in interest rate	Net interest rate risk	Gross interest rate risk
NOK	2.1	2.1
USD	5.4	5.4
EUR	3.2	3.2
Total	**10.7**	**10.7**

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.

	2016		2015	
Currency	**Net position**	**10% change in FX rate**	**Net position**	**10% change in FX rate**
USD	1.7	0.2	83.1	8.3
EUR	8.2	0.8	3.1	0.3
Other currencies	5.9	0.6	10.7	1.1
Total	**15.8**	**1.6**	**96.9**	**9.7**

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 2016 and 2015. The sensitivity analysis assumes zero correlation between FX rates and other market risk factors.

NOTE 29

LIQUIDITY RISK

(Amounts in NOK 1 000 000)

Liquidity risk is defined as the risk of KBN not being able to meet its commitments and/or finance lending demand without significant extra costs being incurred in the form of reduction in value of assets that need to be sold, or in the form of more expensive funding. Liquidity risk is monitored and managed through the bank's liquidity policy set by the Board of Directors.

The policy requires that a portfolio of liquidity holdings should be held amounting to over time a minimum of 12 months' net redemptions, and at any time not below 10 months' net redemptions. This implies that the bank in a given situation may cover all its liabilities/ payables, including that related to the lending activities, during the next 12 months without new borrowing.

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

In 2016 a portfolio of highly liquid securities was established. These holdings shall be transferrable to cash without significant losses for KBN under severely stressed market conditions, either through direct sales or through the use of repurchase agreements in a recognised repurchase market.

The liquidity portfolio is managed using a conservative investment policy keeping both credit and market risk low. Surplus liquidity is invested in notes and bonds issued by sovereigns, local authorities, multilateral development banks and highly rated financial institutions.

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.

2015

Exposure by time to maturity	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	**19 428**	19 428	0	0	0	0	0
Instalment loans	**305 428**	2 761	10 054	11 713	43 527	237 374	0
Notes, bonds and other interest-bearing securities	**151 216**	17 944	23 879	41 399	67 701	293	0
Total assets	**476 072**	**40 133**	**33 933**	**53 111**	**111 228**	**237 666**	**0**
Loans from credit institutions	**7 167**	7 167	0	0	0	0	0
Senior securities issued	**430 526**	20 207	23 868	49 599	275 838	61 015	0
Other liabilities	**779**	15	708	7	0	0	49
Subordinated debt	**1 776**	0	0	1 776	0	0	0
Additional Tier 1 capital	**1 082**	0	7	20	1 056	0	0
Total liabilities	**441 330**	**27 389**	**24 582**	**51 401**	**276 893**	**61 015**	**49**
Financial derivatives	**20 579**	**5 225**	**2 020**	**(56)**	**6 693**	**6 697**	**0**
Net liquidity exposure	**55 321**	**17 970**	**11 371**	**1 654**	**(158 973)**	**183 349**	**(49)**

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

2015

Exposure by time to interest rate reset	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	**19 428**	19 428	0	0	0	0	0
Instalment loans	**305 428**	98 805	92 728	20 088	47 428	46 380	0
Notes, bonds and other interest-bearing securities	**151 216**	25 673	44 508	30 792	50 020	224	0
Total assets	**476 072**	**143 906**	**137 235**	**50 879**	**97 448**	**46 604**	**0**
Loans from credit institutions	**7 167**	7 167	0	0	0	0	0
Senior securities issued	**430 526**	49 107	81 968	50 047	194 371	55 033	0
Other liabilities	**779**	15	708	7	0	0	49
Subordinated debt	**1 776**	1 743	33	0	0	0	0
Additional Tier 1 capital	**1 082**	1 000	7	20	56	0	0
Total liabilities	**441 330**	**59 032**	**82 716**	**50 074**	**194 427**	**55 033**	**49**
Financial derivatives	**20 579**	**(32 336)**	**(96 448)**	**5 296**	**108 088**	**35 979**	**0**
Net liquidity exposure	**55 321**	**52 538**	**(41 929)**	**6 102**	**11 109**	**27 549**	**(49)**

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, hybrid Tier 1 capital and supplementary capital/subordinated debt. A satisfactory level of capital is seen as necessary for maintaining the AAA-rating and to ensure efficient market competition. The Board assesses the capital level on an ongoing basis and approves KBN's principles for capital management. KBN is subject to the capital adequacy regulations and shall have a sufficient capital level based on its risk profile and the market conditions. The capital management target is operationalised through the common equity Tier 1 capital adequacy ratio, the Tier 1 capital adequacy ratio and total capital adequacy ratio - the level of common equity Tier 1, Tier 1 and total capital relative to risk weighted assets. KBN's capital status is assessed against risk in a normal market situation and using stress tests. Regulatory requirements for common equity Tier 1 capital adequacy has been set at 13.5 percent including buffer requirements as at 31 December 2016, and KBN's pillar 2 requirement has been set at 1.5 percent by the Financial Supervisory Authority of Norway, in total 15.0 percent. KBN is compliant with all regulatory capital requirements as at 31 December 2016.

In order to maintain a sufficient capital level, KBN can, depending on market conditions, reduce or increase its total assets or enter into a dialogue with the owner regarding changing its capital structure by changes in dividend policy or issue of share capital. The common equity Tier 1 capital requirement including buffers increased from 12 to 13.5 percent from 1 July 2016. Corresponding to this, total capital requirements including buffers increased from 15.5 to 17 percent from 1 July 2016. In addition the countercyclical capital buffer requirement will increase by 0.5 percent from 31 December 2017. The minimum requirements regarding common equity Tier 1 capital and total capital are 4.5 and 8 percent respectively. KBN is well capitalised on the reporting date, and is adapting its capital structure to new capital requirements.

Capital adequacy	2016			2015		
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Carrying amount	Risk-weighted assets	Minimum capital requirements
Credit risk						
Sovereigns and central banks	26 833	0	0	20 413	0	0
Regional governments and local authorities	323 397	54 347	4 348	311 119	52 443	4 195
Of which are Norwegian municipalities	*267 481*	*54 245*	*4 340*	*256 769*	*52 298*	*4 184*
Public sector entities	10 647	0	0	12 944	0	0
Multilateral development banks	16 125	0	0	20 395	0	0
Financial institutions	27 918	4 999	400	36 922	7 015	561
Of which counterparty exposure on derivatives	*11 492*	*1 714*	*137*	*14 627*	*2 542*	*203*
Claims secured by residential property	40	40	3	46	46	4
Covered bonds	11 371	1 137	91	42 839	4 284	343
Other assets	15	15	1	17	17	1
Securitisation	21	13	1	69	29	2
Credit Valuation Adjustment	140	1 750	140	175	2 193	175
Total credit risk	**416 507**	**62 302**	**4 984**	**444 940**	**66 026**	**5 282**
Market risk	**0**	**0**	**0**	**0**	**0**	**0**
Operational risk - Basic Indicator Approach		**2 909**	**233**		**2 814**	**225**
Minimum capital requirements		**65 211**	**5 217**		**68 840**	**5 507**
Total capital ratio			**21.45 %**			**18.81 %**
Tier 1 capital adequacy ratio			**18.39 %**			**16.53 %**
Common equity Tier 1 capital adequacy ratio			**16.86 %**			**15.09 %**

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)	**2016**	**2015**
Common equity Tier 1 capital		
Share capital	3 145	3 145
Retained earnings previous years	7 624	6 193
Profit for the year included in Tier 1 capital	689	1 870
Pension funds above pension commitments	0	0
Deferred tax asset*	0	0
Intangible assets	(138)	(124)
Dividends payable	(390)	(417)
Other additions/deductions in common equity Tier 1 capital	65	(281)
Share of nulled unamortised estimate differences	0	0
Total common equity Tier 1 capital	**10 996**	**10 385**
Other approved Tier 1 capital	994	994
Total Tier 1 capital	**11 989**	**11 379**
Supplementary capital		
Ordinary subordinated debt	2 000	1 571
Total supplementary capital	**2 000**	**1 571**
Total primary capital	**13 989**	**12 950**

*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 2016 have been examined by the Supervisory Board.

The Supervisory Board recommends that the Board of Directors' proposals for the income statement and the statement of financial position as well as the application of profit, NOK 689,144,995 is adopted by the Annual Shareholders' Meeting.

Oslo, 21 April 2017
Supervisory Board for Kommunalbanken AS

Svein Ludvigsen
Chair

Building a better
working world

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 2016, 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 of Kommunalbanken AS have been prepared in accordance with laws and regulations and present fairly, in all material respects, the financial position of the Company as at 31 December 2016 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 of the current period. 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 70 653 million and liabilities of NOK 99 197 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, and the increased risk of errors, 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 as well as management's review of valuations provided by internal experts. We also assessed pricing model methodologies 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 Group'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 Director (management) is 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 determine 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 have fulfilled their 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.

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 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.

§ 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.

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

§ 15 The Supervisory Board shall 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.
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.

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.

GOVERNING BODIES

BOARD OF DIRECTORS

Else Bugge Fougner, Chair
Martin Skancke, Vice Chair
Nanna Egidius
Rune Midtgaard
Brit Kristin Rugland (from June 2016)
Martha Takvam
Petter Steen Jr.
May-Iren Walstad Wassås, employee representative (from June 2016)
Jarle Byre, employee representative

Alternates to the employee representatives
Marit Urmo Harstad
Andreas Aleström

SUPERVISORY BOARD

Svein Ludvigsen, Chair, former County Governor, Troms county
Berit Flåmo, Vice Chair, Mayor, Frøya municipality
Alfred Bjørlo, Mayor, Eid municipality
Rigmor Brøste, ass. County Governor, Møre og Romsdal county
Ane Marie Braut Nese, Mayor, Klepp municipality
Arne Johansen, former CEO, Harstad municipality
Anita Orlund, CEO, Kunnskapsbyen Lillestrøm
Bjørn Ropstad, Mayor, Evje og Hornnes municipality
Ida Stuberg, Mayor, Inderøy municipality
Leif Harald Walle, CEO, Stor-Elvdal municipality
Lene Conradi, Mayor, Asker municipality
Terje Dalby, employee representative, Senior Relationship Manager, KBN

Alternates
Berit Koht, CFO, Troms county
Hans Seierstad, former Mayor, Østre Toten municipality
Johnny Stiansen, former CFO, Hordaland county
Torger M. Jonasen, 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

AUDITOR

Ernst & Young AS
Einar Hersvik, State Authorised Public Accountant

INTERNAL AUDITOR

KPMG AS
Svein Arthur Lyngroth, State Authorised Public Accountant

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.

ORGANISATION

As of 31.12.2016

- THE BOARD OF DIRECTORS
  - PRESIDENT & CEO — Kristine Falkgård
    - *PA* — Nancy Sørlie Paulsen
    - **Lending department** — Lars S. Prestvik, *Chief Lending Officer*
    - **Financial Markets department** — *Chief Financial Markets Officer*
      - **Funding & Investor Relations** — Thomas Møller, *Head*
      - **Treasury** — Ellen E. Scavenius, *Head*
    - **Risk Management and Compliance** — Håvard Thorstad, *CRO*
      - **Middle Office** — Frank Øvrebø, *Head*
      - **Legal & Regulatory Affairs** — Thomas Yul Hanssen, *Head*
      - **Compliance** — Christina Jakobsen, *Head*
    - **Finance & Accounting department** — Jannicke T. Granquist, *CFO*
    - **Corporate Communications & Public Relations** — Tor Ole Steinsland, *CCO*
    - **Staff & Operations** — Ilse Bache, *Chief of Staff & Operations*
      - **Loan administration & Settlement** — Roald Fischer, *Head*
      - **Business Management** — Aleksander Larsen, *Head*
      - **IT** — Knut Andresen, *Head*
      - **HR & administration** — Ola Melby, *Head*

Kommunalbanken Norway

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