KBN Kommunalbanken Norway

ANNUAL REPORT 2018

Kommunalbanken AS

KEY FIGURES

(Amounts in NOK 1 000 000)	2018	2017
RESULTS		
Net interest income	1 885	2 162
Core earnings[1]	1 194	1 517
Profit before tax	1 996	1 783
Profit for the year	1 496	1 429
Return on equity after tax[2]	11.9%	12.7%
Return on equity after tax (core earnings)[2]	9.8%	13.5%
Return on assets after tax[2]	0.4%	0.3%
Return on assets after tax (core earnings)[2]	0.3%	0.4%
LENDING		
New disbursements	55 749	55 021
Outstanding loans[3]	302 229	281 706
LIQUIDITY PORTFOLIO[3]	113 557	107 484
BORROWINGS		
New long-term borrowings	104 844	118 509
Repurchase of own debt	206	837
Redemptions	79 937	112 555
Total borrowings[3]	414 603	373 816
TOTAL ASSETS	457 701	412 854
EQUITY	15 421	14 667
Total capital adequacy ratio	22.9%	24.6%
Tier 1 capital adequacy ratio	20.3%	21.7%
Common equity Tier 1 capital adequacy ratio	17.4%	18.4%
Leverage ratio	3.6%	3.7%

	2018	2017
LIQUIDITY COVERAGE RATIO (LCR)[4]		
Total	349%	408%
NOK	56%	10%
EUR	625%	778%
USD	248%	749%
AUD	489%	Infinite
JPY	Infinite	534%
OTHER KEY FIGURES		
Green loans[5]	18 800	11 500
Green bonds	12 800	9 600
CO_2 reduced or avoided (tons of CO_2 equivalents)[6]	64 769	40 803
Percentage of women employed in KBN	44%	43%
Percentage of employees with nationality other than Norwegian	11%	10%
Customer satisfaction (score of 6)	5.17	5.24

*[1] Profit after tax adjusted for unrealised gain/(loss) on financial instruments after tax (NOK 1 496 million + (0.75*NOK 338 million) - NOK 48 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. The calculation method has been changed in the fourth quarter of 2018 and comparative figures for 2017 have been changed accordingly.

[5] Outstanding green loans according to KBN's set of criteria for green loans as at 31 December 2018. In addition, the bank has a small portfolio of green loans that were given before these criteria were established. These loans are no longer financed with green bonds.

[6] The estimated effects are related to the bank's green loans. The calculation is based on an European emission factor of 380g CO_2 per kWh (European energy mix) of electricity avoided or produced in an emission-free manner. For CO_2 results with other emission factors, please see the KBN Green Bond Impact Report 2018.

From left: Morten Hatlem, Kristine Falkgård, Lars Strøm Prestvik, Jannicke Trumpy Granquist, Tor Ole Steinsland, Ilse Bache, Sigbjørn Birkeland, Håvard Thorstad. Thomas Yul Hanssen and Nancy S. Paulsen. Photo: Jo Straube

KRISTINE FALKGÅRD
President & CEO, employed since 2013
Former director of market operations and analysis at Norges Bank. Experience from other Norwegian financial institutions and the European Commission in Brussels. She previously worked in KBN. Postgraduate Diploma in Economics (London School of Economics), MBA (BI Norwegian Business School) and Bachelor in Business and Management (University of Salford).

ILSE BACHE
Chief of Technolocy & Operations, employed since 2014
Came to KBN from position as director of Norges Bank's secretariat and has previously worked as IT Director of NBIM (the Norwegian oil fund) and administration director of in the department for monetary policy in Norges Bank. Bache holds an MBA from the Norwegian Business School (BI).

SIGBJØRN BIRKELAND
Chief Capital Markets Officer, employed since 2017
Birkeland heads both Treasury and Funding & IR. Previously, he held the position as Finance Director with the insurer Storebrand. He has also worked as a researcher at the Norwegian School of Economics and Business Administration. Birkeland also received his Ph.D. in Economics.

JANNICKE TRUMPY GRANQUIST
Chief Financial Officer, employed since 2014
Former head of valuation and accounting at NBIM (the Norwegian oil fund), Previously worked in banking and finance in EY and Simcorp. Has an MSc in accounting and finance from the London School of Economics and Political Science.

MORTEN HATLEM
Chief People and Strategy Officer, employed since 2017
He previously held the position as Chief of Staff and HR at The National Security Authority (NMS). He has experience as Chief of HR and Organizational Development in media companies such as Egmont and Schibsted, along with positions as Sales and Marketing Director. Holds a Master's degree from Norwegian School of Management.

THOMAS YUL HANSSEN
Chief Legal Officer, employed since 2015
Previously worked as a legal officer in the Financial Markets Department at the Norwegian Ministry of Finance. Hanssen has previously also held positions at the Norwegian Ministry of Trade and Industry and the Norwegian Tax Administration. He has a law degree from the University of Oslo, an economics degree from the London School of Economics and an MBA in finance from the Norwegian School of Economics and Business Administration.

TOR OLE STEINSLAND
Chief Communications Officer, employed since 2012
Previously worked as partner and advisor in PR agency Kreab Gavin Anderson. Steinsland has been employed as a financial journalist in various print and broadcast media. Steinsland has a finance degree in from Norwegian School of Economics and Business Administration.

NANCY S. PAULSEN
Personal assistant to the President & CEO, employed since 2013
Previously held a similar position in Atea and Ferd. Paulsen has a good knowledge of corporate communication in addition to working with governing bodies. Paulsen has intermediate and business studies from BI.

LARS STRØM PRESTVIK
Chief Lending Officer, employed since 2014
Previously Senior Relationship Manager in Nordea, responsible for public sector customers. Prestvik has held the position as head of treasury in several Corporates. He holds a Master's degree from Norwegian School of Management and has leadership development from Harvard Business School.

HÅVARD THORSTAD,
Chief Risk and Compliance Officer, employed since 2015
Former Deputy Head Risk Management at SIX Securities Services and Head of Risk Management at Oslo Clearing ASA, Norsk Hydro and Eksportfinans ASA and experience from Ministry of Finance and Norges Bank. He holds a Masters degree in Economics from Université de Fribourg, Switzerland.

Management as of 31. December 2018

CEO'S FOREWORD

KBN DELIVERS – REGARDLESS OF MARKET CONDITIONS

Photo: Jo Straube

Kommunalbanken (KBN) finances investment in important welfare services by municipalities and county authorities across Norway. KBN raises its funding in the global financial markets, meaning that events from across the world are of direct significance to the terms on which local communities in Norway can secure financing. KBN is today the largest Norwegian issuer of bonds.

2018 was at times characterised by big fluctuations in the world of finance. Turmoil in the Italian financial markets and in emerging economies, the Brexit negotiations, and the trade war between the USA and China contributed to uncertainty about future global growth. Stock markets fell, interest rates remained low, and the Norwegian krone weakened to record lows towards the end of the year.

Against this backdrop, KBN experienced a high level of demand for its lending products. Ensuring KBN's customers have stable access to debt financing regardless of market conditions is an important part of the role we play in society. This was of particular importance towards the end of the year, as KBN experienced a particularly high level of demand for financing in what was a period of demanding market conditions. KBN's ability to access capital from across the globe means it has a good basis for addressing at an early stage developments that will eventually reach Norway.

KBN is tasked with delivering on ambitious commercial targets in addition to fulfilling its sector-political function. In terms of earnings, 2018 was a very good year, with KBN operating efficiently, enjoying favourable funding terms and attracting a high level of demand for its products.

The long-term work KBN has undertaken in relation to investors, customers and political decision-makers helped make 2018 the strongest year in KBN's history in terms of growth in its green lending. This success reflects a greater level of awareness and the higher environmental ambitions of our customers. KBN is proud to be able to contribute to its customers succeeding in making the transition to a low-carbon society.

More and more people across politics, the business community and society in general are grasping the seriousness of the UN Intergovernmental Panel on Climate Change's 2018 report. Sweden's Greta Thunberg has inspired tens of thousands of school pupils across Europe and Australia to take to the streets on climate strikes. 15-year-old Greta emphatically put the world's leaders in their place at the UN's Climate Change Conference in 2018 when she stated: "Our leaders are behaving like children, we will have to take the responsibility they should have taken long ago". In the USA, congresswoman Alexandria Ocasio-Cortez is championing a "Green New Deal" that is intended to deliver a dramatic green restructuring of American society and to reduce economic inequality. These are two examples of young, strong thought leaders who will continue to show the way in the future.

Green finance and climate risk are climbing up the national and particularly the international agenda. The EU's Action Plan on sustainable finance, which was published in March, is intended to direct capital flows into sustainable investments and to integrate sustainability into financial risk management. In Norway, the government-appointed Climate Risk Commission recently published its assessment of how different risk factors will affect the country's economy. This shows that the local government sector will in all scenarios need to invest significantly.

In order for global warming not to exceed 1.5 C°, major investment is needed in restructuring measures, including investment in infrastructure and new technology in the local-government sector. In 2019 KBN will work with organisations including CICERO and the Norwegian Climate Foundation to increase municipalities' knowledge of climate risk, and we will help to put this on the agenda through our position on the Board of the European Association of Public Banks.

As part of the role it plays in society, KBN is also committed to sustainability in a financial sense. In 2019 we will share our expertise in areas such as debt management and climate risk to help ensure our customers have the best possible basis for making decisions about investing in projects that will last for decades into the future.

Digital technology is key to increasing the efficiency of numerous work processes, including financial work processes. Part of KBN's work in 2019 will be to invest significantly in further developing its digital tool for customer management, analysis and information dissemination. Our customers have made significant progress with digitalising the services they provide to the public as well as to business and industry, and they have high ambitions in terms of future-oriented welfare provision. New solutions and digital tools will be crucial to their delivering more for every krone spent. We will seek to support developments in this area.

The majority of public welfare services are provided by municipalities, and the sector has a crucial role to play in terms of helping to reduce inequality and creating trusting and productive local communities. KBN is a proud part of this welfare model.

KBN takes corporate social responsibility and sustainability seriously in all aspects of its activities, and we will continue to integrate information on these issues into our annual report.

ABOUT KBN NORWAY

Kommunalbanken AS (KBN) is the Norwegian state agency for local government funding. KBN is 100 per cent owned by the Kingdom of Norway (AAA/Aaa) and managed in accordance with the Central Government Maintenance Statement.

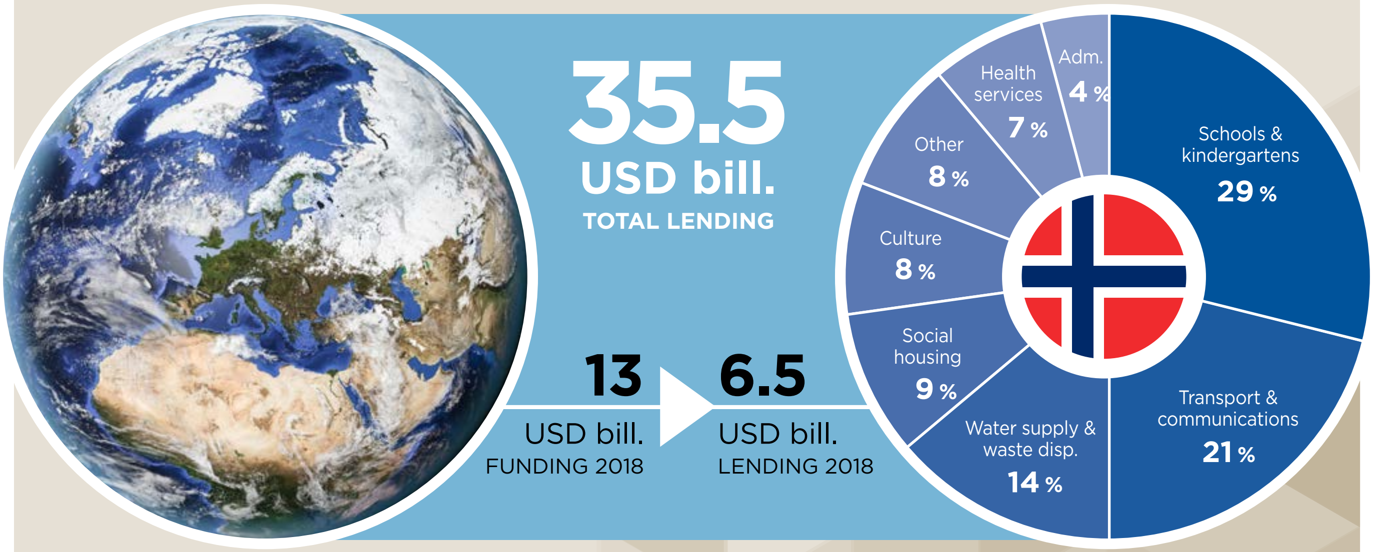
KBN's sole purpose is to grant loans to local and regional governments or inter-municipal companies in line with KBN's explicit public policy mandate. As an instrument of the state, KBN recognizes its critical role in enabling the local and regional governments to improve living standards across the country. 100 percent of Norwegian municipalities are KBN customers.

Through its Green Bond program, KBN aim to finance the Norwegian local sector's transition to a climate-resilient, low-carbon society. Proceeds from Green Bonds are disbursed as discounted Green Loans to climate- and environmentally conscious investments in the local sector. This reflects KBN's traditional, long-term focus on environmental, ethical and social impact.

KBN is guided by prudent financial and risk management policies. All financial transactions are fully hedged and KBN maintains liquidity in excess of policy requirements. KBN's focused, specialized monoline lending model has never suffered a loan loss.

Owing to full state ownership, the central public policy mission, a strong capital base, solid financial and operating performance and prudent financial and risk management policies, KBN is assigned Triple-A ratings by Standard & Poor's and Moody's.

KBN Kommunalbanken Norway



AAA
Standard & Poor´s
Moody´s

2.5 USD bill.
lending to climate-friendly municipal projects

100 %
of Norwegian municipalities are KBN customers

48.7%
of municipal debt is financed through KBN

*Investment expenditures local/regional sector per service area, average last 10 years.

Granly elementary school in Horten is built to the Passive House standard and has large, open spaces.
Photo: John Trygve Tollefsen

IN DEPTH – MUNICIPAL SECTOR FINANCES

GROWTH IN MUNICIPALITIES' BORROWING – LOOKING BEHIND THE FIGURES

The local government sector's outstanding borrowing has grown significantly over recent years, but growth in borrowing alone does not tell the whole story.

BY LARS LUDVIGSEN
SENIOR RELATIONSHIP MANAGER, KBN

The municipality sector's principal duty is to deliver good quality services to its citizens. Its specific duties are either defined by legislation or by political priorities decided centrally and locally. The new Local Government Act, which is expected to come into force during the course of 2019, explicitly confirms the legal right of self-determination for municipalities. The elected members of municipality councils have wide authority to prioritise and make decisions.

The responsibilities for important areas of welfare provision such as nurseries, schools, health and care facilities, water supply, wastewater treatment and waste management are delegated to the country's 422 municipalities. Sizeable financial resources are transferred to municipalities. The Norwegian National Budget for 2018 estimates the total income of the municipality sector to be in the order of NOK

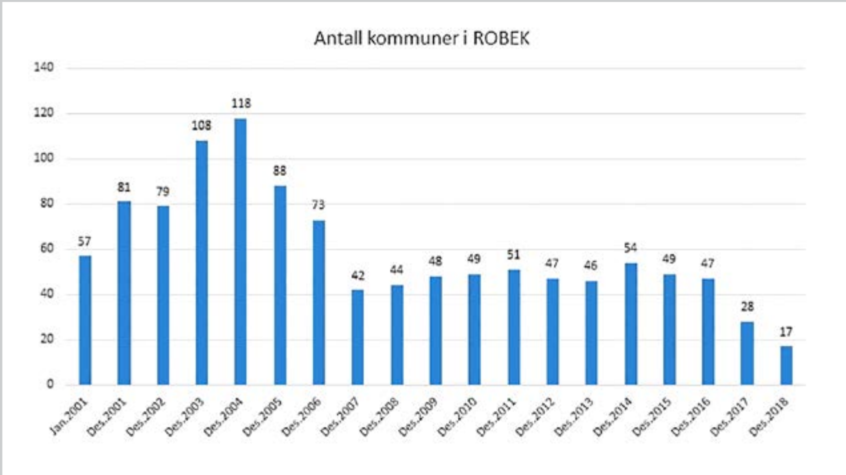


CHART 1

Number of municipalities on the ROBEK register. Source: [Regjeringen.no]

512 billion. Recent years have seen sound economic performance in the sector, and the number of municipalities on the Register for Governmental Approval of Financial Obligations (ROBEK) is currently at an historic low.

Sizeable growth in borrowing

In order to deliver welfare services, municipalities are dependent on the availability of appropriate and functional buildings and a robust and reliable infrastructure. Investment in these assets is largely financed by borrowing, and the sector's total borrowing has grown significantly over recent years in pace with both population growth and the increasing number of duties delegated to the sector. Statistics Norway reports that total indebtedness of the municipality sector at the close of 2017 was equivalent to 113% of the sector's total income, representing a marked increase from 67% in 2000.

Financial statements for municipalities are not available until June each year, but on the basis of Statistics Norway's credit indicator for the municipality sector, it is estimated that growth in outstanding borrowing in 2018 was in line with the two previous years. The credit indicator shows annual growth of 6.3% to NOK 512 billion. The rate of growth fell between 2015 and 2016, and has been relatively stable over the last three years.

Sensitivity to higher interest rates

A significant proportion of the local government sector's growth in total

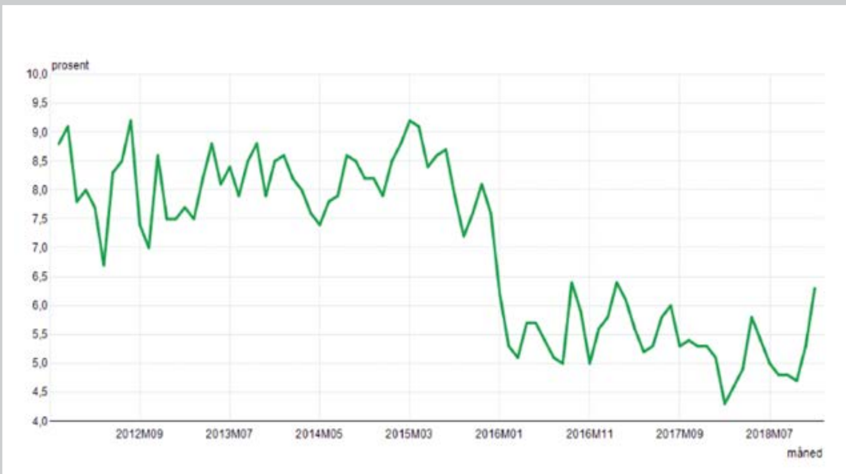


CHART 2

Growth in domestic borrowing, local government sector. Source: Statistics Norway borrowing was arranged at a time of historically low interest rates. However, the financial markets currently anticipate a moderate upward trend in interest rates over the next few years. The extent to which municipalities are sensitive to higher interest rates depends on a number of factors, of which two factors are most significant:

The first factor is that a large proportion of municipalities' borrowing is not directly exposed to changes in market interest rates. The proportion that is exposed is termed net interest-bearing debt and can be calculated by deducting the following elements from total outstanding borrowing:

- Lending
- Proceeds of borrowing that have not yet been used
- Borrowing related to full cost recovery areas such as water, wastewater and refuse collection
- Borrowing that is subject to interest rate compensation (loans for schools, churches, residential care and nursing homes)
- Liquidity not financed by borrowing

Carrying out this calculation often results in a figure which is less than half of total indebtedness, and therefore represents a significant reduction in interest risk. It is important to note that there are major differences between municipalities in terms of both total indebtedness and net interest-bearing debt. A study carried out by KBN concluded that the sector as a whole could withstand an increase in interest rates of 2 to 3 percentage points relatively well, but the municipalities with the highest level of debt would find it difficult to maintain their delivery of welfare services.

The second important factor is the proportion of borrowing with a fixed interest rate or interest rate hedging. Most municipalities have fixed interest rates on some of their borrowings in the form of either fixed rate loans or interest rate swaps. A typical finance guideline is that municipalities should have 25-30% of their borrowings on a fixed rate basis at any time. No figures for fixed interest borrowing and interest rate swaps are available for the municipality sector as a whole, but information from earlier surveys and analysis of KBN's loan portfolio provides the basis to estimate that at least 30% of the sector's total borrowings are on a fixed rate basis. This degree of interest rate hedging, taking into account the level of net interest-bearing debt, indicates that many municipalities are relatively well equipped to deal with an increase in interest rates while continuing to carry out their responsibilities. The sound financial performance seen for the local government sector over recent years has also generated significant growth in available reserves, which grew by NOK 16 billion between 2015 and 2017 and now stand at NOK 42.7 billion (these figures apply only to municipalities).

Well-equipped for the future

Norwegian municipalities make an important contribution to the Norwegian welfare model, and carry out a range of significant duties on behalf of society as a whole. Population growth and the addition of new services to the duties of municipalities have resulted in growth in borrowing, but at the overall level it does seem that the sector has the capacity to adjust to changes in its operating framework such as higher interest rates. The sector is characterised to a very large degree by prudence and a commitment to providing citizens with good services well into the future. KBN is committed to playing its role in helping municipalities to achieve these objectives.

The «Bybanen» is an important part of Bergen's collective transport system, and is financed with KBN's green loans.
Photo: Paul Sigve

KBNs 2018-2020 STRATEGY

LONG-TERM PARTNER FOR LOCAL WELFARE SERVICES

KBN plays an important role in Norwegian society as the largest financial institution of its type in the market. Its customers, owner and the authorities have clear expectations of it. KBN shall act in a long-term and responsible way and shall contribute to the availability of high-quality financial solutions for the local government sector. We are expected to be open, to have high ethical standards and to be a driver for the development of corporate social responsibility.

KBN's objective is to be a long-term partner to Norwegian municipalities and county authorities. We are committed to offering attractive financing solutions on the basis of efficient access to capital markets across the world. Through financial expertise, digital collaboration and insight into the local-government sector, we shall help our customers to succeed in their work to develop the best possible welfare services for the people they serve.

THE CUSTOMER FIRST

We are committed to helping our customers to succeed, and our target is to achieve a high level of customer satisfaction.

We shall create added value for our customers and earn their trust.

DIGITAL SOLUTIONS

Our digital solutions shall give customers the best customer experience.

We shall use new technology to simplify and automate.

SEEK INSIGHT

We shall continuously renew our expertise to stay ahead.

We shall collaborate across disciplines to make the best use of our combined expertise.

Together we will strengthen our customer insight.

STRONG MARKET PARTICIPANT

Efficient funding operations are the basis for the market's best lending products.

We shall have a strong position in the capital markets, nationally and internationally.

CLEAR ROLE IN SOCIETY

We shall finance local government sector investment in welfare services in the good times and the bad.

We shall operate efficiently in line with commercial principles.

We are proud of the important role we play in society.

LEADER IN GREEN FINANCE

We shall have the market's best green lending products and shall be a driver for investment in green projects.

Our green bonds shall contribute to the achievement of ambitious climate targets.

IN DEPTH – CLIMATE RISK

A CLIMATE RESEARCHER EXPLAINS WHY CLIMATE CHANGE WILL CAUSE RISKS FOR MUNICIPALITIES

Extensive flood damage in Tvedestrand.
Photo: Kristian Vabo, NTB-Scanpix

Flooding, landslides, droughts and fires, as well as the question of sufficient food and water for people and animals - these are some of the key topics that employees and politicians in the local government sector will encounter all the more often as climate change becomes more pronounced. This is the message from Bjørn H. Samset, a climate researcher at the CICERO Center for International Climate Research

Bjørn Hallvard Samset
Research Director,
CICERO Center for International Climate Research

BY THE NORWEGIAN CLIMATE FOUNDATION

"The climate in Norway and throughout the world is changing very quickly. We can expect more surprising developments because we can no longer say what will be "normal weather" in Norway. What we do know for certain is that the climate will become warmer and that we will see more extreme weather, particularly in the form of heavy rainfall. Municipalities that are already at the limit of their ability to cope with extreme rainfall need to be particularly aware of this. Flooding, avalanche and avalanche prevention are some key concepts here. In addition, warmer conditions increase evaporation, and this can lead to drought conditions", explains Bjørn H. Samset.

– Norwegian Water, the national association representing Norway's water industry, is encouraging municipalities to draw up new plans for water supply and wastewater treatment in order to ensure that they are sufficiently well prepared for heavy rainfall, warmer weather and drought. How might drought affect municipalities?

"The averages for the warm weather temperatures and rainfall we experience in Norway have changed as a result of global warming. All forms of use of Norwegian nature - such as fishery, agriculture and reindeer herding - will be affected by drought, changes in the seasons for plant growth and changing periods for snow melt. To take one example, the conditions that can lead to wild fires that we are used to at present will change. We have seen in recent years how we can suddenly experience winter months with no precipitation. Cold weather conditions with no snow are also very dry conditions. This increases the risk of fires. The major wildfire at Flatanger in January 2014 is an example of this."

– The Flatanger fire damaged or destroyed more than 60 buildings. What do municipalities need to be aware of in terms of climate change and fire risk?

"When we talk about climate risk, municipalities, drought and fires, I often think about the large developments of rural holiday homes that have been built around Norway in recent years. The forests around many of these developments grow quickly, and now we are also experiencing more periods of warm weather and dry periods. This increases the risk of fire. One example of the unforeseen aspects of climate risk is that these holiday home developments are now quite exposed to the risk of forest fires as a result of climate change."

– Only 3% of Norway is cultivated land. Elected politicians in municipalities can find themselves in a difficult position when they have to choose between allowing commercial and residential development on cultivated land or protecting it from development. How should they approach this difficult question?

"The most important thing that local politicians can do is to protect the food production that does take place in Norway, even if it is perhaps more profitable in financial terms to use the land for activities other than food production. Making food production a priority is an essential part of adaptation for climate change. Managing climate risk involves taking steps to ensure that we can at least meet our basic requirements, of which food and water are by far the most important."

– It is very clear from what you have said that people putting themselves forward as candidates in this year's municipal elections are facing some very big responsibilities. How would you go about tackling climate risk if you were an elected member of a local council or a key employee in a municipality's administration?

"The world is going through some of the biggest changes we have seen in recent history. Everyone involved in government today at everything from the global to the local level has a huge responsibility to make sure that we can work through these changes in a competent manner. In order to make good decisions, local politicians need to pay attention to what is happening internationally, not only what is happening to the climate but also how the world is coping with climate change. What happens with international policy decisions on climate change will also have an effect on municipalities in Norway. However, local politicians and municipal employees do have the advantage of possessing the most important knowledge of all, which is understanding how their particular municipality is most exposed to climate risk. This means that everyone involved in local decision-making carries a big responsibility for making sure that the right changes are made to deal with how the risks of climate change will affect their own municipality", concludes Bjørn H. Samset.

The forests surrounding large cottage areas are exposed to increased risk of wildfires. Photo: iStock

JANUARY – DECEMBER 2018

LOOKING BACK ON 2018

2018 was an eventful year for KBN. In a year when financial markets were at times very turbulent, KBN achieved strong growth in its lending. Norwegian municipalities are taking a more ambitious approach to responding to climate change, and this is demonstrated by strong growth for KBN's green lending product. KBN carried out a number of successful funding transactions in the international capital markets. Good access to funding markets is very important for KBN's ability to offer reasonably priced and stable financing for the Norwegian local government sector. KBN is committed to sharing its expertise, and carried out a number of courses and seminars for its customers and other stakeholders over the course of the year.

FEBRUARY

SECURITY IN A TURBULENT WORLD

KBN held its annual conference on 14 February at the Astrup Fearnley Museum in Oslo. The theme of this year's conference was "Being prepared", and it brought together around 150 politicians and executives from the local government sector.

FEBRUARY

MORE ENVIRONMENTAL IMPACT FOR EVERY NOK LENT

KBN published its environmental impact report for 2017. KBN financed 44 new climate-friendly projects which in total will result in the reduction or avoidance of 40,000 tonnes of CO_2.

APRIL

GREEN FINANCE

KBN and CICERO held a lunch seminar about the EU Commission's Action Plan for Sustainable Finance. The event was held at the Oslo House of Innovation and attracted around 100 participants.

JANUARY

MAJOR BOND ISSUE

KBN issued a USD 1.5 billion benchmark bond on 4 January. This was one of the most successful funding transactions KBN has ever carried out, with an orderbook dominated by central banks and institutional investors from around the world.

APRIL

KBN SKOLEN LAUNCHED

KBN Skolen, a training program for KBN's borrowing customers, started its first session. The course provides training in the fundamental principles of municipal debt management.

MAY

BEST ISSUER IN THE NORDIC REGION

KBN was awarded Best Issuer in the Nordic Region at the Global Capital Bond Awards dinner in London.

	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE
Green loans	220 693 000	266 241 000	615 041 000	1 071 019 000	1 086 619 000	1 368 367 000
Total	1 430 271 494	2 860 264 773	6 964 940 573	7 801 044 883	8 425 353 549	10 191 097 049

Total value of loans agreed in 2018
(Excluding short-term certificate loans)
NOK **33 649 444 621**

New green loans agreed in 2018
NOK **7 880 351 400**

AUGUST
GREEN BOND
KBN issued a green bond in the Australian dollar market for AUD 450 million. This was KBN's first green bond denominated in Australian dollars, and attracted a lot of interest from investors.

AUGUST
ARENDALSUKA
KBN attended Arendalsuka for the fourth year. Arendalsuka is a national annual event and the largest political gathering in Norway. Over the course of two days KBN arranged three debates about the financing of housing for senior citizens, climate risk and green finance.

DECEMBER
BOND DEAL OF THE YEAR
KBN's first green bond in the Australian dollar market was awarded the SSA Kangaroo Bond Deal of the year by KangaNews, a major finance industry publication for the Australian market.

MAY
KOMØK 2018
KBN was one of the joint organisers of the Municipality Finance Conference 2018 (Komøk). The conference is the largest of its type, and brought together around 400 finance managers from the local government sector for a two-day event.

AUGUST - SEPTEMBER - OCTOBER
FINANCE SEMINARS AROUND NORWAY
KBN arranged a series of nine seminars at locations across Norway. The seminars were designed for finance and accounting employees in the local government sector, and attracted in total some 200 participants.

DECEMBER
LARGEST GREEN LOAN AGREEMENT
KBN signed the largest green loan agreement of 2018 for Bærum municipality. The agreement provides for lending of up to NOK 900 million, and will be used to finance a number of climate-friendly building projects to be carried out by the municipality.

JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER
1 392 007 000	2 008 207 000	2 435 097 000	3 455 228 000	5 340 228 000	7 880 351 400
10 498 271 881	11 657 967 156	17 855 716 074	20 974 649 813	26 586 254 810	33 649 444 621

THE BOARD OF DIRECTORS' ANNUAL REPORT

KBN's ACTIVITIES IN 2018

Kommunalbanken AS (hereinafter KBN) is the most important provider of investment financing to the local government sector in Norway. 2018 was characterised by some periods of turbulence in the financial markets, resulting in a high level of demand for loans particularly towards the end of the year. KBN's role is to provide attractive and long-term debt financing regardless of market conditions. In 2018 KBN granted 661 new loans totalling NOK 55.7 billion. These loans financed investment in projects such as schools, health and care facilities, water and wastewater systems, and adaptations to climate change. KBN's robust financial results, efficient operations and continual presence as well as the strong growth in its lending for environmentally friendly projects demonstrate that KBN is fulfilling its role in society successfully.

KBN's lending grew by 7.3% in 2018 as compared to growth of 5.7% in 2017. Much of this growth reflects difficult financial markets towards the end of the year, causing high demand for loans in the final two months of the year. Lending for climate and environment projects grew by NOK 7.3 billion in 2018 and represented a sizeable 36% of KBN's lending growth. This strong growth means that approximately 25% of the sector's total funding needs in 2018 reflected investment in ambitious projects in the climate and environment area.

Profit for the year was NOK 1,496 million in 2018 as compared to NOK 1,429 million in 2017.

KBN's 2018 earnings are strong and in line with expectations. Net interest income was lower in 2018 due to especially low funding costs in 2017.

KBN's profit for the year for 2018 was higher than in 2017 due to unrealised gains from changes in the value of financial instruments, as compared with unrealised losses in 2017. KBN's return on equity after tax for 2018 was 11.9%, and its equity for 2018 increased by NOK 754 million.

STRATEGY AND OBJECTIVES

The Norwegian State Ownership Report 2017 states that "The aim behind the state's ownership in Kommunalbanken AS is to facilitate financing for the municipal sector and for the company to provide the state with a satisfactory return on invested capital". This description of the state's aims in owning KBN reflects both KBN's sector-political function and its commercial objective.

The state's sector-political aim in owning KBN is to provide the Norwegian local government sector with cost-effective and stable financing to enable investment in welfare services throughout the economic cycle.

The state's commercial aim entails KBN working on the basis of commercial principles, balanced with growth. KBN's owner's return requirement and dividend expectations guide KBN's financial plans. KBN's current business model is based on holding the highest possible credit rating, AAA.

KBN's Board of Directors has approved a strategy for the 2018-2020 period that involves a greater focus on customers. The strategy also states that KBN is to fulfil its role in society through responsible lending activities.

To achieve the objectives set out in the strategy, the Board of Directors has prioritised the following areas for the strategy period:

- **Customer first:** KBN shall be the most important financing partner for Norwegian municipalities and county authorities and shall put customers first in everything we do. KBN shall provide simple and flexible financing solutions that are adapted to each customer's needs. We shall engage in active dialogue with our customers. With the help of our insight, financial expertise and digital tools, we shall help our customers to assess their financial risk and to choose the financing solutions that best suit their needs.
- **Digital solutions:** KBN's digital solutions shall give customers the best customer experience. As the biggest lender to the local government sector, we shall digitise how we interact with our customers and help make processes simpler. New digital solutions shall ensure customers enjoy efficient services and shall increase their financial insight and understanding.
- **Strong market participant:** Through a strong position in the capital markets, nationally and internationally, KBN shall ensure Norwegian municipalities have access to efficient financing. Efficient funding operations are the basis for the market's best lending products. Having a good understanding of the markets and strong relationships with investors shall ensure that KBN enjoys its desired market position. KBN shall spread its funding across the most important currencies and across different groups of investors, and shall seek to ensure its funding has a smooth maturity profile that is adapted to the length of its loans. It will seek to secure the lowest possible transaction and hedging costs and low operational risk for its financing activities.
- **Green finance:** KBN shall help ensure its customers succeed in transitioning to a low-carbon society. KBN shall be among the leading financial institutions in the area of climate risk, sustainability and green finance solutions. Through our green lending, we shall be a driver for more investment in ambitious green projects. We shall seek to ensure climate risk is high on the agenda, and shall work to ensure that climate concerns are treated as a risk area for KBN's own activities as well as ensuring our customers focus on their own climate risk.
- **Seek insight:** KBN shall be a knowledge business with strong specialist teams and a culture characterised by learning and the desire to be at the forefront of developments. We shall emphasise collaboration and taking responsibility for achieving common objectives. To ensure KBN is a cost-efficient organisation, there shall be an emphasis on flexibility and internal mobility.
- **Clear role in society:** KBN shall act in a long-term and responsible way. KBN shall contribute to the sustainable development of society. We are expected to be open, to have high ethical standards and to be a driver for the development of corporate social responsibility. Our work on corporate social responsibility shall be concentrated around our core activities.

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 2018) 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 2018 provide an adequate description of KBN's financial position at year-end. The annual accounts have been prepared in accordance with International Financial Reporting Standards (IFRS).

Profit for the year was NOK 1,496 million in 2018 as compared to NOK 1,429 million in 2017.

TABLE 1
Profit for the year

	2018	2017
Profit for the year	**1 496**	**1 429**
Net interest income	1 885	2 162
Fees and commission expenses	34	32
Net unrealised gain/(loss) on financial instruments	338	-163
Expected credit loss	-1	0
Net trading income	17	9
Total operating expenses	209	193
Income tax	499	354

Amounts in NOK 1 000 000

Net interest income in 2018 totalled NOK 1,885 million as compared to NOK 2,162 million in 2017. The decrease was due to the fact that KBN's lending margins decreased in the first part of 2018 and then remained lower than in 2017. This development was due to lower credit spreads in the market throughout the year and to a lower contribution from converting borrowings into Norwegian kroner than in the previous year.

TABLE 2
Unrealised changes in value of financial instruments

	2018	2017
Net unrealised gain/(loss) on financial instruments recognised in the income statement	**338**	**-163**
Notes, bonds and other interest-bearing securities and related financial derivatives	-82	106
Instalment loans and related financial derivatives	66	488
Senior securities issued and related financial derivatives (for 2018 without changes in fair value that are due to changes in own credit risk)	354	-756
Unrealised changes in fair value of Senior securities issued and related derivatives due to changes in own credit risk recognised in the Statement of comprehensive income in 2018	**-365**	**0**

Amounts in NOK 1 000 000

The majority of the NOK 338 million in net unrealised gains on financial instruments included in the figure for profit for the year for 2018 stems from bonds issued by KBN and the hedging contracts associated with them. The gain arises from changes in the value of the contracts used to convert USD-denominated bonds into Norwegian kroner, and was due to a narrowing of USD-NOK basis swap spreads.

Changes in the value of KBN's borrowings resulting from a change in KBN's credit risk led to an unrealised loss of NOK 365 million.

TABLE 3
Comprehensive income for the year

	2018	2017
Total comprehensive income for the year	**1 223**	**1 428**
Profit for the year	1 496	1 429
Unrealised change in fair value of liabilities (and related financial derivatives) after tax due to changes in own credit risk in 2018	-365	0
Actuarial gain/(loss) on defined benefit plan	1	-1
Tax effect on positions in Statement of comprehensive income	91	0

Amounts in NOK 1 000 000

Changes in the value of KBN's borrowings due to changes in KBN's credit risk have been reclassified from ordinary profit and loss before tax to comprehensive income with effect from 2018 in connection with KBN's adoption of a new standard for financial instruments (IFRS 9). Total comprehensive income amounted to NOK 1,223 million in 2018, as compared to NOK 1,428 million in 2017.

KBN's financial instruments are normally held to maturity and the effects of unrealised gains and losses on KBN's profits reverse either when fluctuations in the market reverse or the instruments reach maturity.

Net trading income from market transactions in the form of KBN repurchasing its own bonds and selling securities held in its liquidity portfolio contributed NOK 17 million to profit for the year in 2018 as compared to NOK 9 million in 2017.

TABLE 4
Total operating expenses

	2018	2017
Total operating expenses	**209**	**193**
Salaries	80	76
Pension costs	9	7
Administrative expenses including employer contributions and other personnel benefits	53	50
Other expenses	46	40
Depreciation on fixed assets	22	21

Amounts in NOK 1 000 000

Total operating expenses were NOK 209 million in 2018 as compared to NOK 193 million in 2017. This increase was primarily due to an increase in personnel expenses associated with an increase in KBN's headcount, higher pension costs and the financial sector tax (value-added tax). Pension costs in 2017 included extraordinary non-recurring income due to KBN transitioning to a new pension scheme, and were therefore temporarily low. Furthermore, KBN's other operating costs were higher in 2018 than in 2017 due to higher consultancy and legal fees related to development activities.

At 31 December 2018 KBN had total assets of NOK 457.7 billion as compared to NOK 412.9 billion at 31 December 2017. The increase was primarily due to the weakening of the Norwegian kroner, which increases the value of KBN's borrowings and liquidity portfolio investments in NOK terms. Furthermore, KBN's holdings of cash and cash-equivalents in currencies other than the Norwegian krone were higher than at the end of 2017 due to higher short-term investments, and KBN's lending growth also contributed to the increase in total assets.

KBN's total primary capital at 31 December 2018 was NOK 17,433 million. Of this amount, NOK 13,244 million is total common equity Tier 1 capital. The common equity Tier 1 capital ratio at 31 December 2018 was 17.4%, the Tier 1 capital adequacy ratio was 20.3%, and the total capital adequacy ratio was 22.9%. The leverage ratio at 31 December 2018 was 3.6%

LENDING

KBN registered a high level of demand for financing in 2018. This trend was particularly strong toward the end of the year. KBN's market share increased from 47.9% in 2017 to 48.7% by the end of 2018. All Norway's municipalities and county authorities as well as Longyearbyen Community Council had loans from KBN at the end of 2018, along with a range of municipal and inter-municipal companies and companies with municipal or county-authority guarantees.

KBN's green lending for investment in climate and environment projects increased by 50% or NOK 7.3 billion in 2018, spread across 85 different projects. This is the highest ever rate of growth in green lending achieved by KBN, and is equivalent to 36% of total lending growth and approximately 25% of total local government sector debt growth in 2018. KBN's green loans, which are for projects that satisfy KBN's criteria set, are offered with an interest rate that is 0.1 percentage points lower than its normal loans. KBN's criteria set has been rated as 'Dark Green' by the CICERO Centre for International Climate Research, indicating that the portfolio is compatible with a low-emission society by 2050. KBN produces a separate report on the impact of its green loans each year. The growth in KBN's green lending must be seen in the context of KBN having worked more proactively and vigorously on raising customer awareness of its green lending and a marked increase in the scope of projects that qualify for green financing. KBN expects its green lending to continue to grow strongly in 2019.

KBN granted 661 new loans totalling NOK 55.7 billion in 2018. Its total lending to the local government sector at the end of 2018 was NOK 302.2 billion, an increase of NOK 20.5 billion or 7.3% from the end of 2017. KBN has 1,073 customers in its lending portfolio and Chart 1 shows an analysis of outstanding lending by customer category. Chart 2 shows an analysis of the number of customers by customer category, while Chart 3 shows a further analysis by type of the customers that are guaranteed by a municipality or county authority.

CHART 1

Analysis of KBN's outstanding lending in NOK by customer category

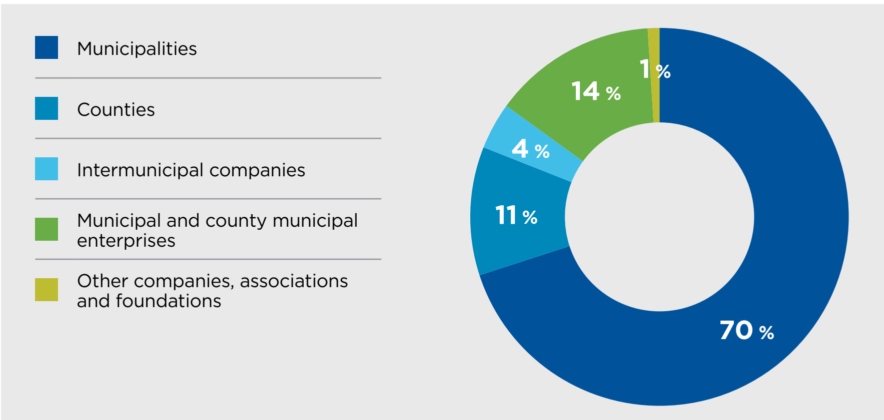


CHART 2

Analysis of the number of customers by customer category

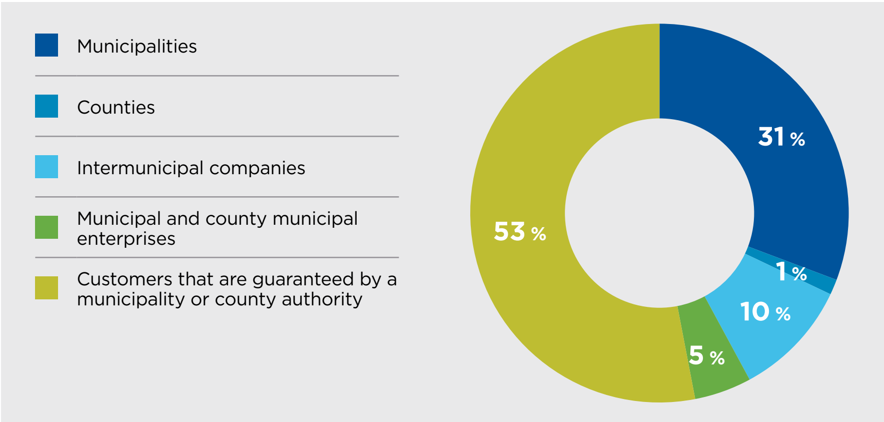
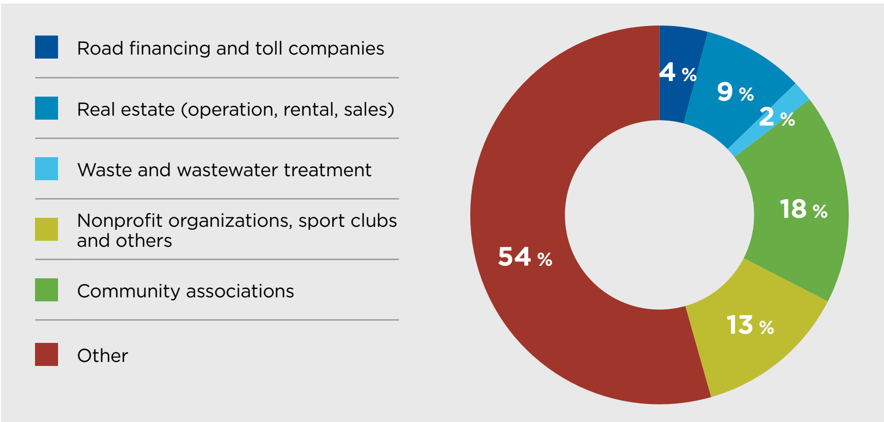


CHART 3

Further analysis by type of customers guaranteed by a municipality/county authority



At the end of 2018, loans to toll road companies accounted for NOK 29.6 billion of the NOK 42.6 billion in outstanding loans to companies with municipal and county-authority guarantees.

After a number of years of slowing debt growth in the local government sector (K3), debt growth in the sector was 7.2% in 2018. KBN expects future debt growth to be slower on the basis of expected interest rate rises and lower population growth. In short, these factors will contribute to slower growth in investment by the local government sector, although there will continue to be a significant need to invest, particularly in relation to the care sector as well as in the water and wastewater area.

KBN conducts an annual customer satisfaction survey. The results for 2018 show that, as in previous years, customers are satisfied with KBN, and the survey also revealed that customers value customer visits and the KBN Finans service. To ensure better customer follow-up changes have been introduced to the division of customer responsibility on the basis of the allocation of customers by segment.

No customer has defaulted or had problems with making payments, so there are no grounds to expect any loan losses in 2019.

The lending market

In 2018 the local government lending market was dominated by KBN and KLP and by municipalities making direct use of the capital market. KBN is the biggest provider of stable and long-term financing in the form of instalment loans. The sector's borrowing patterns have been changing for a number of years and in 2018 were divided approximately equally between new long-term, instalment loans and loans with no instalment repayment with maturities of between three months and ten years. After a number of years with increase in short-term loans, the use of this type of loan decreased slightly in 2018.

FUNDING

KBN's AAA/Aaa credit ratings ensure it has stable access to funding with favourable terms, which benefits the sector. KBN pursues a diversified funding strategy that ensures it has a broad investor base and low refinancing risk. New long-term borrowings amounted to NOK 104.8 billion in 2018, which is NOK 13.7 billion lower than in 2017. Asia, Europe and the USA were KBN's most important markets for funding in 2018. The total amount KBN borrowed in Japan was lower than in 2017 due to KBN ceasing to issue bonds with option elements, i.e. Uridashi bonds. KBN issued bonds in 14 different currencies in 2018. KBN issued four USD-denominated benchmark bonds with maturities of between two and five years totalling USD 5.3 billion. KBN attracted a high level of interest from investors, and all its benchmark bonds were significantly oversubscribed.

KBN is the largest issuer of green bonds and is one of the leaders in the development of green finance in the Nordic region. KBN is a member of the governing body of Green Bond Principles, which is the leading international industry standard for green bonds, and in 2018 it also organised and participated at a number of events designed to promote green finance solutions in order to drive forward the transition to a low-carbon society. In September 2018, KBN issued its first green bond in Australian dollars. The bond was significantly oversubscribed, with the total amount raised standing at AUD 450 million. The bond was the largest AUD-denominated bond ever issued by KBN and was crowned "SSA Kangaroo Bond Deal of the Year" by KangaNews, an Australian industry magazine.

KBN's total borrowings increased in 2018 from NOK 373.8 billion to NOK 414.6 billion.

Liquidity management

KBN's policy is to operate with cash and cash equivalents that match its capital requirements, including lending growth, for the subsequent 12 months at all times. KBN's liquidity portfolio is primarily held in zero-risk-weighted investments and is managed according to an investment strategy that is low risk in terms of both credit risk and market risk. KBN's liquidity portfolio investments are primarily denominated in foreign currencies, meaning that fluctuations in the NOK exchange rate lead to fluctuations in KBN's liquidity reserves when translated into NOK terms. The value of the liquidity portfolio in NOK terms at 31 December 2018 was NOK 113.6 billion, up from NOK 107.5 billion at the end of 2017. KBN had a total liquidity coverage ratio (LCR) of 349% at the end of 2018.

CORPORATE GOVERNANCE

KBN complies with the Norwegian Code of Practice for Corporate Governance in those areas that are relevant to its type of company, its ownership structure and its financial regulatory requirements. KBN is organised as a limited liability company that is 100%-owned by the Norwegian state. In its White Paper on Ownership Policy (Diverse and Value-Creating Ownership, White Paper No. 27 2013-2014), the Government classified KBN as a 'Category 3' entity, which means that it is an entity with commercial objectives and other specifically defined objectives that define the purpose of the state's ownership of it.

KBN helps to ensure that the market used to finance the local government sector is efficient by compensating for any effects of market deficiencies in the long-term end of the lending market, and by ensuring that municipalities have access to financing even when market turmoil reduces the capacity available in the capital markets. KBN's sector-political function is also expressed in the fact that it offers long-term cost-efficient financing with the same interest rate terms regardless of the size of the loan or municipality.

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 2019-2021 period having been set at 8%.

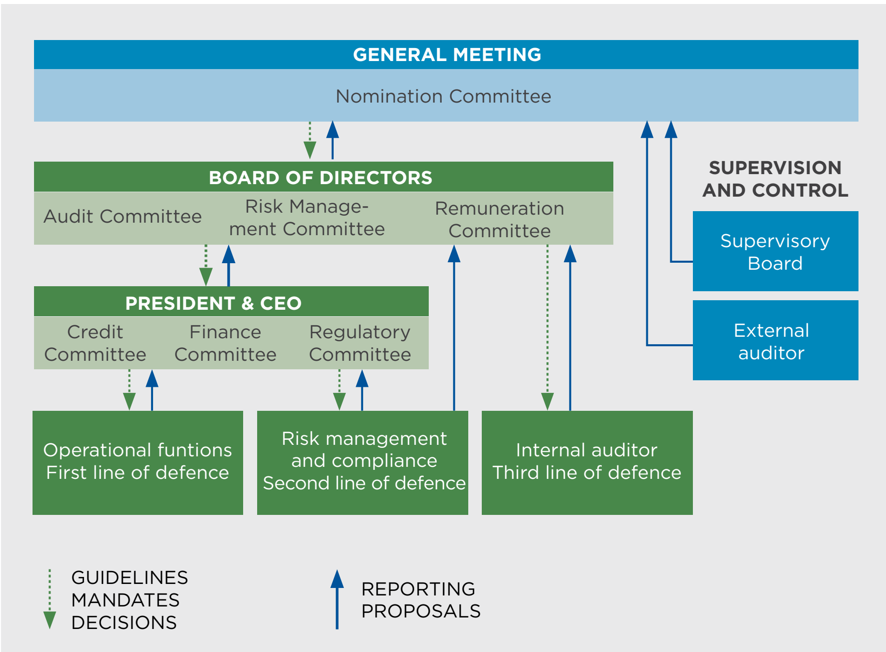
KBN's governing bodies are organised in accordance with the provisions of the Norwegian Public Limited Liability Companies Act and the Financial Undertakings Act, as well as KBN's Articles of Association. The Board of Directors and the Supervisory Board are elected by the Annual General Meeting. The Supervisory Board is a governing body required by KBN's Articles of Association, and its purpose is to produce statements on issues that concern the company and to be particularly focused on corporate governance.

The Board of Directors is responsible for the management of KBN's activities, which includes appointing the CEO, approving the mandate for the CEO, decisions on borrowing and authorising delegated borrowing authority, and appointing the internal auditor. The Board of Directors has set up three committees that prepare cases for its consideration and whose members are elected by and from amongst its own members, namely the Audit Committee, the Risk Management Committee, and the Remuneration Committee. The Audit Committee's role is to help the Board of Directors supervise the company's financial reporting and control systems by preparing issues related to these areas and advising the Board on them. The Risk Management Committee's role is to help the Board of Directors oversee and manage the overall level of risk at KBN by preparing issues related to this area and advising the Board accordingly. The Remuneration Committee's role is to help the Board assess the company's remuneration arrangements by preparing issues related to this area and advising the Board accordingly.

The CEO manages KBN's day-to-day operations in accordance with the mandate issued by the Board of Directors. The Risk Management department and the Compliance department have overall responsibility for risk management and compliance at KBN respectively. These departments report to the CEO but have a direct reporting line to the Board of Directors.

CHART

KBN's Governing Bodies



RISK MANAGEMENT AND INTERNAL CONTROL

KBN's Board of Directors has approved guidelines on risk management and internal control, and has determined a risk appetite framework for KBN. The risk management and internal control guidelines, the risk appetite framework and the policies and limits for KBN's operational activities are reviewed by the Board of Directors annually. The Board of Directors considers the CEO's assessment of internal control on a yearly basis.

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

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

KBN operates three lines of defence. KBN's operational activities represent the first line of defence and are responsible for monitoring and controlling whether KBN's activities are carried out within the approved limits and in accordance with internal and external regulations. The second line of defence monitors, guides and helps to improve and report on the first line checks. This responsibility comprises risk management and compliance control in relation to both internal and external regulations. KBN's financial control function, risk management function and compliance function comprise the second line of defence. All second-line functions report directly to the CEO. Compliance risk is an operational risk and has a dotted line to the risk management function to provide broader specialist involvement. The risk management and compliance functions have direct reporting lines to the Board. The third line of defence is provided by the Board's independent supervisory and control function, which is carried out by Deloitte as the internal auditor.

Credit risk

Credit risk in the lending portfolio is limited to payments being deferred as payment obligations cannot be cancelled. Section 55 of the Local Government Act stipulates that municipalities and county authorities may not be declared insolvent. The Local Government Act also contains provisions regarding the procedures that must be followed if payments have to be deferred. This in practice protects lenders from any losses in relation to debt and accrued interest.

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

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

Liquidity risk

KBN has a very limited risk appetite with regard to liquidity risk. The Board of Directors has approved an internal framework for liquidity management. KBN shall ensure that it can at all times meet its liabilities when they fall due without incurring any significant extra costs.

Interest rate risk and exchange rate risk/market risk

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

Operational risk

The purpose of operational risk management is to identify risk across the organisation and to ensure there are sufficient risk-reduction measures (controls) in place to prevent losses. Annual risk reviews are undertaken for all critical functions. The operational risk management process is a tool for prioritising resources and balancing the costs associated with risk and risk-reduction activities.

Climate risk

While climate reporting is a question of how a company affects the climate through its activities, climate risk reporting is a question of analysing how climate change and climate change politics affect a company's activities. The most widely recognised framework for climate risk reporting has been produced by the Task Force on Climate-related Financial Disclosures (TCFD). TCFD was established by the G20 countries' Financial Stability Board in 2015, and it published its recommendations in 2017. The framework consists of four categories with a total of 11 sections. In 2019 KBN will work on mapping its own climate risk with the objective of reporting in accordance with the TCFD framework.

THE BOARD OF DIRECTORS' STATEMENT ON THE REMUNERATION OF SENIOR EXECUTIVES

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

CORPORATE COMMUNICATIONS AND PUBLIC RELATIONS

The Board of Directors regards active, continuous dialogue 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. High-quality, open communication is important for maintaining the trust of KBN's owner, the Norwegian Parliament, customers, employees and wider society.

KBN's external communication activities are intended inter alia to help highlight issues that constitute potential obstacles to its framework conditions or that affect its customers. Green finance, including KBN's green bonds and green lending products, climate risk in the local government sector and interest rate changes were central topics in KBN's external communication activities in 2018. The importance of a sustainable approach to borrowing by the local government sector was emphasised in the communication activities KBN conducted directly with its customers, including at its finance seminars, KBN Skolen and in the further development of KBN Finans.

Ethics and corporate social responsibility

KBN has based its priorities in the area of corporate social responsibility on the extensive dialogue in which it engages with its most important stakeholders, and it has separate guidelines for corporate social responsibility. KBN's corporate social responsibility work represents an important part of its strategy work and is integrated into its ordinary activities. KBN follows the Global Reporting Initiative (GRI) standard in its reporting of its corporate social responsibility work.

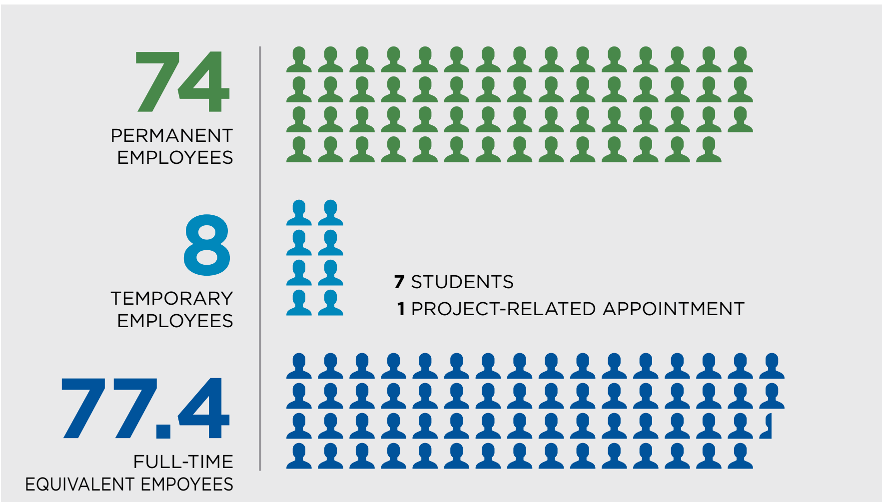
KBN elected to prioritise green finance, expertise sharing and responsible lending, diversity and equality, its expectations for suppliers, ethics and stakeholder dialogue as the main themes for corporate social responsibility work in 2018.

ORGANISATION AND EMPLOYEES

KBN is a knowledge business that needs to recruit and develop skilled employees across a range of specialist areas in order to fulfil its aims. Greater competitive, technological and regulatory complexity in combination with greater demands and higher expectations from KBN's customers, owner, stakeholders and employees are affecting how KBN is organised and managed.

In order for it to carry out its strategy, it became necessary for KBN to strengthen collaboration between departments and for its organisation to become more flexible and less hierarchical. In 2018, a key principle consisting of department directors being responsible for personnel matters in their department was adopted. This gives middle managers more time and space to further develop their specialist leadership skills and also means that employees are followed up in a more uniform way across fewer managers. Employee surveys are conducted at KBN on a regular basis, with the latest one completed in December 2018.

FIGURE
Staffing at
31. December 2018



Diversity and equality

KBN works in a systematic and targeted way on diversity and equality across the organisation and on following 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 so that there is at least a 40% representation of each gender.Both when recruiting new employees and when making changes to the composition of management groups and organisational units, KBN pays particular attention to gender balance. Recruitment processes are always carried out in such a way that the best-qualified female and male candidates are identified and assessed before any decision is taken. All candidates are treated equally, and no consideration is given to gender, disability, age, or cultural or geographic background when candidates' professional and personal qualifications are being assessed.

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

The target for succession planning for management positions and other critical roles is for internal candidates of both genders to be identified and developed in order to reduce vulnerability and to develop expertise.

At the end of 2018 the proportion of women on the Board of Directors was 56%, while the equivalent proportions for the CEO's management team and for all employees (permanent and temporary) were 40% and 44% respectively. The average age of KBN employees was 41. A total of eight employees work on a part-time basis, including seven students. None of these eight employees are working part-time involuntarily. A total of 11% of KBN's employees are citizens of a country other than Norway, with eight different nationalities represented.

Health, safety and the working environment

KBN is committed to ensuring all its employees have high-quality working conditions. At the end of 2018, a decision was taken to enter into a collective wage agreement that will strengthen employee involvement and collaboration. The Working Environment Committee's aim is to actively contribute to the creation of a good working environment and the promotion of good physical health by building a culture characterised by well-being and collaboration. The Committee has held regular meetings and carried out risk assessments in relation to health, safety and environmental issues. Workplace assessments and medical checks were carried out.

Regular health-promoting and social activities, including exercise activities, were offered for all employees in collaboration with KBN's various activity groups. In 2018 a gym was built for KBN's employees.

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

The sickness rate was 2.5% in 2018 as compared to 2.7% in 2017. KBN's target is for the sickness rate to be below 2.5%. KBN works actively on health, safety and the working environment, on preventing and following up sick leave, and on facilitating a swift return to work for employees following leave of absence and sickness. Staff turnover in 2018 was 6.8%.

ALLOCATION OF PROFIT

The Board of Directors of Kommunalbanken AS proposes the following allocation of the profit for the 2018 financial year: NOK 481 million is to be paid to KBN's owner as a dividend and NOK 1,015 million is to be transferred to retained earnings.

FUTURE PROSPECTS

The Norwegian economy grew in 2018, with GDP (mainland Norway) estimated to have increased by 2.3% and the unemployment rate standing at 3.8% (Statistics Norway's Labour Force Survey). Norwegian municipalities' finances are benefiting from the Norwegian economy's good general progress and the strong income growth they have enjoyed in recent years. In the 2009-2018 period, the local government sector saw its total real average income grow by 2.3% per year. The positive trend seen for local government finances is expected to continue in 2019.

Great Britain's withdrawal from the EU means that changes have to be made to agreements with external parties in order for KBN to comply with regulatory requirements and to be able to conduct its business as today. The possibility that British organisations may lose the right to provide financial services to Norwegian professional customers/qualified counterparties has made it necessary for KBN to set up connections with new derivative counterparties that are based in the EU. In order to meet the regulatory requirements under EMIR, KBN is also setting up a connection to an EU-based central counterparty to ensure it complies with the clearing obligation, as well as to an EU-based transaction register to ensure it complies with the reporting requirement.

The local government sector will continue to have significant investment needs. An ageing population will necessitate significant investment in health and care services in the years ahead. Continuing strong population growth in some areas of Norway will necessitate continuing growth in investment in schools and nursery facilities. Water supply and wastewater management facilities will require regular renewal and improvement, which means that the financing requirement for this type of investment will continue to grow. Greater awareness of climate risk and the need for measures to adapt to climate change are expected to increase the level of investment in preventative measures in areas such as the management of surface run-off.

KBN has worked with the analysis firm Menon Economics to produce a forecast of the local government sector's investment and borrowing needs in the years ahead. This analysis indicates that borrowing by the local government sector will increase by 2.1% per year in the period up to 2040. This is approximately one-third the rate of growth seen in the previous 12 years and is more in line with growth in the sector's income.

The transition to a low-carbon society means that an increasing proportion of local government investment projects will incorporate targets which mean that they qualify for the green lending offered by KBN. 2018 marked a clear change of approach, with a significant proportion of the local government sector's construction projects now working with energy efficiency and climate targets that are more ambitious than the standard building regulations require. Zero emission solutions and electrification of the transport sector require a wide range of investments, and this is particularly the case in the areas for which the local government sector is responsible.

KBN's customers seek financing terms ranging from three months to over 30 years. KBN is committed to being a reliable and stable provider of financing, particularly long-term financing that is appropriate to the time horizon for the investment that is being carried out. While customers are expected to continue to seek a wide range of financing terms, the main emphasis is expected to be on long and medium term maturities.

KBN can report a high level of customer satisfaction. Our most satisfied customers are those that use our debt management tool. KBN will continue to invest in 2019 in digitising the customer experience it offers, both through an increased level of self-service for customers and through providing relevant and specific information and expertise that represent added value for our customers' own decision processes. Digitalisation, changing customer expectations and new regulatory requirements represent major challenges that will require KBN to change and adapt. Investment in new technology, developing and renewing our expertise and adopting new work processes will be central elements of our work to respond to these challenges.

KBN is a political instrument of the state with a low-risk business model. In designing its regulations, the EU has to some extent taken low-risk financial institutions such as KBN into account. Several countries have issued suitably adapted regulations for financial institutions that lend to the public sector, for example by classifying them as "promotional banks". A predictable environment and framework conditions that are adapted to KBN's distinctive nature are important to KBN's ability to fulfil the major role it plays in building a better society.

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

Oslo, 31 December 2018

28 February 2019

The Board of Directors of Kommunalbanken AS

Brit Kristin Sæbø Rugland
CHAIR OF THE BOARD

Martin Skancke
VICE CHAIR

Jarle Byre
EMPLOYEE REPRESENTATIVE

Nanna Egidius
MEMBER OF THE BOARD

Marit Urmo Harstad
EMPLOYEE REPRESENTATIVE

Ida Espolin Johnson
MEMBER OF THE BOARD

Rune Midtgaard
MEMBER OF THE BOARD

Petter Steen Jr.
MEMBER OF THE BOARD

Martha Takvam
MEMBER OF THE BOARD

Kristine Falkgård
PRESIDENT & CEO

THE BOARD OF DIRECTORS OF KBN

From left: Petter Steen Jr., Nanna Egidius, Martin Skancke, Brit Kristin Sæbø Rugland, Jarle Byre, Martha Takvam, Marit Urmo Harstad and Rune Midtgaard. Ida Espolin Johnson was not present when the picture was taken.

Photo: Jo Straube

BRIT KRISTIN SÆBØ RUGLAND

Chair since June 2018, member of the Board since 2016.

Bachelor of Business Administration, Master of Management. Chair, KBN Remuneration Committee. Member, KBN Risk Committee. Chair, Figgjo AS. Member of the Board, Norfund. Member of Council on Ethics for the Norwegian Government Pension Fund Global. Participated in ten board meetings in 2018.

MARTIN SKANCKE

Member since 2013, Vice Chair since 2015.

Master of Business. Owner and general manager, Skancke Consulting AS. Chair, KBN Risk Committee. Chair, Principles for Responsible Investment. Member of the Board, Storebrand ASA, Storebrand Livsforsikring AS, Summa Equity AB and Norfund. Chair, Norway's Climate Risk Commission and member of the FSB Task Force on Climate-related Financial Disclosures (TCFD).
Participated in ten board meetings in 2018.

JARLE BYRE

Employee representative since 2015.

Master of Business and Economics. Business Developer, KBN. Member, KBN Remuneration Committee
Personal alternate is Harald Jacobsen.
Participated in nine board meetings in 2018.

NANNA EGIDIUS

Member of the Board since 2004.

MBA. Director of Strategic Planning and Development, Lillehammer municipality. Member, KBN Audit Committee. Chair, LGE Holding AS. Member of the Board, Ikomm AS.
Participated in ten board meetings in 2018.

MARIT URMO HARSTAD

Employee representative since October 2018.

Bachelor of Management. Senior Relationship Manager, KBN. Currently following a master programme in green growth as part of an Executive MBA at BI. Personal alternate is Anne Jenny Dvergsdal.
Participated in three board meetings in 2018.

IDA ESPOLIN JOHNSON

Member of the Board since June 2018

Lawyer, partner at Arntzen de Besche AS. Member, KBN Audit Committee. Participated in five board meetings in 2018.

RUNE MIDTGAARD

Member of the Board since 2014.

MBA and Authorised Financial Analyst (AFA). CEO, Norsk Luftambulanse AS. Member, KBN Remuneration Committee and KBN Audit Committee. Participated in nine board meetings in 2018.

PETTER STEEN JR.

Member of the Board since 2015.

Teacher. Consultant/advisor to Sveio Municipality. Member, KBN Remuneration Committee. Chair, Haugaland Kraft AS.
Participated in ten board meetings in 2018.

MARTHA TAKVAM

Member of the Board since 2005.

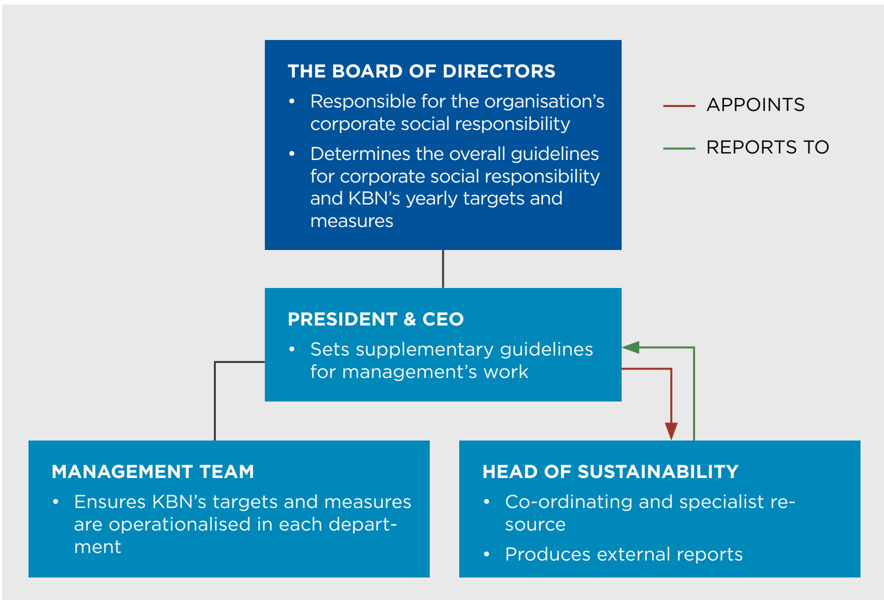
Master of Business and MBA in Finance. Former Director Group Internal Audit and Group Treasurer, Telenor ASA. Chair, KBN Audit Committee. Member, KBN Risk Committee. Vice Chair of the Board of Fontenehuset Asker. Participated in ten board meetings in 2018.

CORPORATE SOCIAL RESPONSIBILITY

OUR CORPORATE SOCIAL RESPONSIBILITY WORK

KBN's Overall Guidelines for Corporate Social Responsibility state that KBN shall work systematically on corporate social responsibility and that one of its ambitions shall to be a leader for corporate social responsibility in its area of activity. The Guidelines also state that KBN's aims and measures in the area of corporate social responsibility shall be integrated into its ordinary activities, and that as part of these activities KBN shall maintain regular dialogue with its stakeholders.

ROLES AND RESPONSIBILLITIES



KBN bases its corporate social responsibility work on engaging in extensive dialogue with its stakeholders, including both stakeholders who are affected by KBN's activities and those who can influence our activities in a material way. These stakeholders include KBN's customers, employees, owner, Board of Directors, the authorities, investors and society in general.

As part of KBN's objective to be a leader in our selected areas of corporate social responsibility, it continually maps any new initiatives and expectations from its owner, changes to national and international standards that affect best practice, and developments in respect of norms and attitudes of significance to its stakeholders.

KBN follows the recommendations contained in the OECD's Guidelines for Multinational Enterprises and the principles of the UN's Global Compact insofar as they are relevant, and it follows the guidelines of the Global Reporting Initiative (GRI) in its corporate social responsibility reporting. With effect from 2018, KBN reports in accordance with the GRI Standards.

Stakeholders

Openness is one of KBN's core values. As a knowledge-based organisation, we wish to share information with our stakeholders and to exchange views with them within the framework permitted by legislation.

KBN strives to contribute to best practice for financial management in the local government sector, including by sharing our knowledge of the borrowing situation in the local government sector with local and national decision makers.

The input provided by regular contact with stakeholders forms the basis of KBN's overall strategy and communications work as well as of its corporate social responsibility work. We regularly review our priorities for corporate social responsibility in relation to the expectations of our most important stakeholders.

KBN's objectives and measures in the dialogue with stakeholders area in 2019 are presented in the "Governance matters" sub-section of this report.

2018 Customer Survey

KBN carries out a customer satisfaction survey each year. The results show that KBN's customers are generally very satisfied with KBN, and the 2018 survey did not reveal any significant change in customer satisfaction from 2017.

CUSTOMER SURVEY, 2018

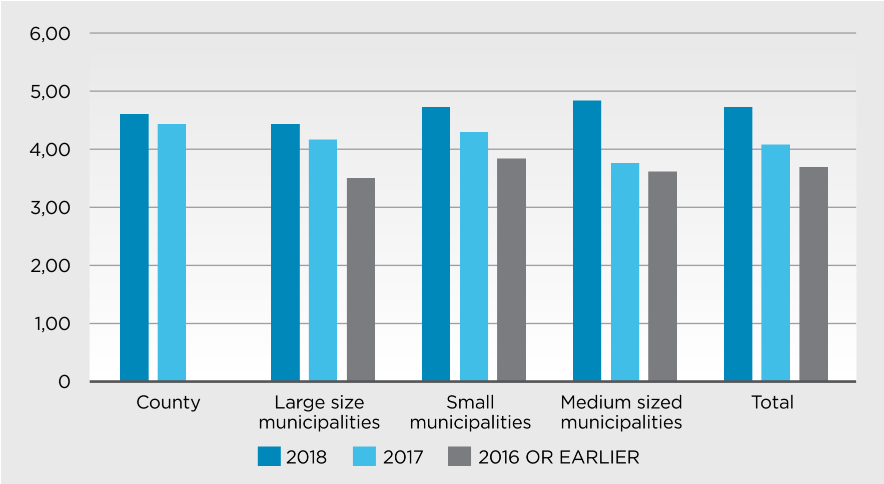
Just under half of Norway's municipalities and two thirds of its county authorities took part in the customer satisfaction survey

5.17 Satisfaction - all municipalities	**5.14** Satisfaction - smallest municipalities	**5.15** Satisfaction - largest municipalities
5.06 KBN offers simple and flexible lending products	**5.02** KBN is an expert in municipal finance	**6** IS THE BEST SCORE **1** IS THE LOWEST SCORE

The results from the 2018 survey show that there has been a significant increase in awareness about KBN's green loans as well as in the proportion of respondents who say they are considering using a green loan over the next twelve months.

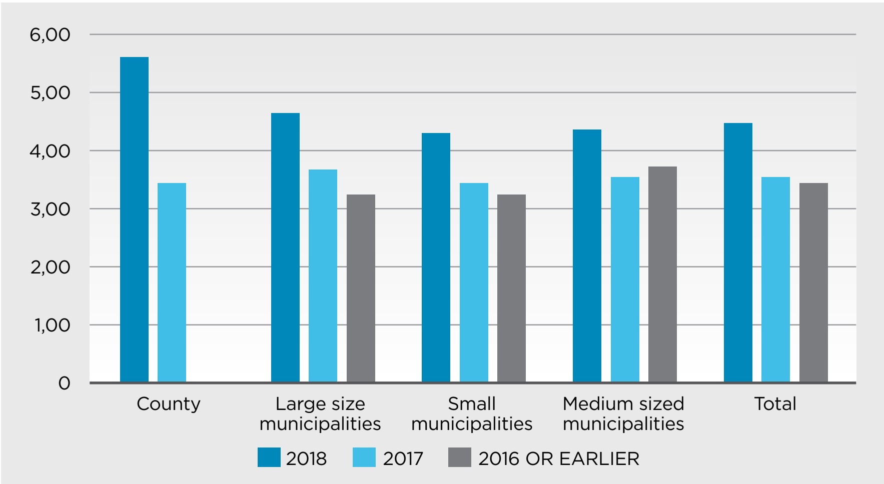
I AM VERY FAMILIAR WITH KBN'S GREEN LOANS

2018 Customer Survey



MY MUNICIPALITY IS CONSIDERING USING KBN'S GREEN LOANS OVER THE NEXT TWELVE MONTHS.

2018 Customer Survey



LIST OF STAKEHOLDERS

Our stakeholders are parties that can influence our operations and parties that can be affected by our operations to a significant extent.

Customers

Our customers are municipalities and county authorities, in addition to a range of municipal and inter-municipal companies and companies with a municipal or county-authority guarantee. KBN held 125 customer meetings in 2018. Nine finance seminars were held and the KBN skolen (KBN School) program was run twice, attracting a total of over 200 customers participating. The aim of KBN's finance seminars and of KBN skolen is to increase the local government sector's insight into financial risk management and debt management. Fixed vs. floating interest rates, e-signature and integration of Husbanken-loans in the KBN Finans system are among the topics our customers have bought up in meetings. The two latter are projects initiated in 2018, which will be completed in 2019.

KBN organised a separate week-long conference on the topic of "Being prepared" in municipalities (around 170 attendees) and also co-organised the Municipality Finance Conference 2018 (Kommuneøkonomikonferansen), which is Norway's largest conference of its type with around 400 attendees. KBN also ran two events at the Arendalsuka conference on topics of relevance to the local government sector. KBN also sent its customers 16 newsletters and produced one edition of its customer magazine, KBN Dialog.

KBN's Supervisory Board is appointed by KBN's owner and consists of representatives from KBN's various customer groups. It is tasked with focusing on KBN's role in society and its corporate social responsibility work. KBN's corporate social responsibility work was a main theme at the Supervisory Board's meeting in April.

Employees

All KBN's employees work at its premises in Oslo. In 2018 KBN organised monthly 'lunch & learn' talks on topics such as corporate social responsibility, IT security, big data, digital programs and GDPR. A kick-off meeting, a staff walk, two company-wide meetings and three assemblies on the topic of green finance were held in 2018.

The employee survey shows that particularly more user-friendly technical equipment was requested by the employees. A project "Future workspace" has been launched to improve work processes and tools.

Owner

KBN is a limited company 100%-owned by the Norwegian state, with the Ministry of Local Government and Modernisation acting as KBN's owner. KBN held quarterly meetings with its owner in 2018 and corporate social responsibility was one of the topics. In connection with the forthcoming ownership report, the owner asked for input from KBN. This was sent in July.

Authorities

KBN is subject to legislation, regulations and supervision in the same way as other financial institutions. KBN met with inter alia the Norwegian Ministry of Finance, the Financial Supervisory Authority of Norway, the Standing Committee on Local Government and Public Administration of the Parliament of Norway, the Ministry of Climate and Environment, The Ministry of Transport, the Agency for Public Management and eGovernment (Difi), the Norwegian Environment Agency and the Norwegian Directorate for Civil Protection. Corporate social responsibility and sustainability were topics at a number of these meetings.

Investors

We refer to the buyers of the bonds we issue as investors. Our investors are participants in the capital markets such as commercial banks, central banks and pension funds from around the world. KBN held over 150 investor meetings in 2018, both in the form of physical one-to-one meetings and conference calls. In addition, KBN distributed quarterly updates to over 300 investors. KBN's investors showed great interest in green finance, especially in Australia, and this contributed to KBN's first green bond in the Australian dollar market in 2018.

KBN paid special attention to marketing its green bonds in 2018.

Society in general

KBN's activities affect Norwegian society and we are therefore in close dialogue with interest groups. In 2018 we regularly held meetings with the Norwegian Association of Local and Regional Authorities, the Norwegian Association of Local Government Treasurers and

Finance Managers (Norges Kemner- og Kommuneøkonomers Forbund), the Zero Emission Resource Organisation (ZERO) and the CICERO Center for International Climate Research. KBN also held more sporadic meetings with Enova and Norwegian Water.

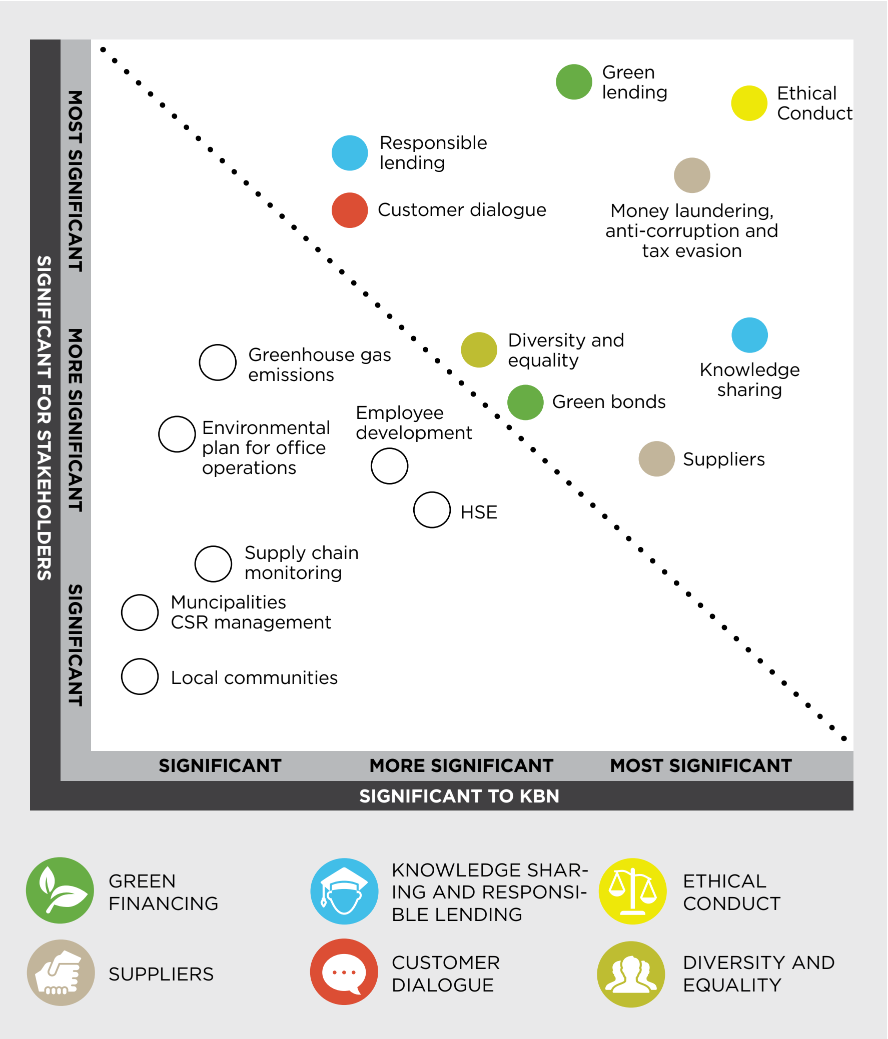
KBN organised three open lunch seminars on green finance/climate risk and delivered a guest lecture on green finance to economics students, upon request from the students, in addition to contributing keynote speakers and panel members at a range of conferences. KBN's publication "Klimakunnskap – globalt og lokalt" (Climate Knowledge – globally and locally) is also provided free for teaching purposes in elementary and secondary schools. The booklet discusses topics related to environmental challenges and climate change, and 21,000 copies were printed and distributed in 2018.

MATERIALITY ANALYSIS

A materiality analysis identifies the themes that are relevant to an entity and also determines boundaries for both its activities and reporting. KBN carried out a materiality analysis in 2016 and revised this in 2017. Six categories were prioritised, and objectives and KPIs were produced for these areas for 2018. KBN's performance relative to the objectives set for each of these categories is described in the next sub-section of this report. KBN's objectives and activities for 2019 have been sorted according to whether they are environmental, social or governance-related in nature, and can be found in the next section.

MATERIALITY ANALYSIS

Six categories are prioritised from the materiality analysis, and objectives are produced for these categories.



PERFORMANCE IN 2018

Green financing

The objectives for our work on green financing in 2018 were:

- We shall contribute to the achievement of national targets regarding the transition to a low-carbon society by increasing the proportion of lending that we provide to projects with clear climate ambitions.
- We shall contribute to the development of the market for green finance by issuing green bonds and assisting with the development of international standards.

Objective	Status	Outcome
Increase the proportion of loans that we provide are for environmentally friendly projects by offering attractive lending products		• Green lending grew by 50%. Proportion of customers who say they are considering using a green loan over the next twelve months has increased significantly
Ensure that climate concerns are regarded as a financial risk by the local government sector when making investment decisions		• KBN collaborated in 2018 with the Norwegian Climate Foundation and the CICERO Center for International Climate Research on developing and communicating knowledge about municipalities' exposure to climate risk. This work will be continued in 2019, including via publications and a digital guide to climate matters targeted at local-government decision makers
Influence development of international standards for green bonds		• KBN contributed through committee work to the development of the current Green Bond Principles. KBN chairs the technical working group that produced the "Nordic Public Sector Issuers' Position Paper on Green Bonds Impact Reporting", which is now used by issuers in several locations in Europe
Clearer ambitions for green finance and international development		• KBN issued its first green bond in Australian dollars, which attracted significant investor interest
Environmentally friendly operations at KBN		• KBN has been certified as an Eco-Lighthouse since 2009 and was re-certified in 2018

Knowledge sharing and responsible lending

The objectives for our work on knowledge sharing and responsible lending in 2018 were:

- We shall actively contribute to greater insight into financial risk management and debt management in the local government sector, which will include disseminating relevant information.
- We will ensure our lending activities support customers to manage their borrowings in a long-term, sustainable way.

Objective	Status	Outcome
Support customers in managing their borrowings in a long-term and sustainable way		• Long-term loans represent 94.8% of KBN's lending portfolio. The number of customers under special observation decreased from five in 2017 to three in 2018
Create a comprehensive and uniform plan for competence development in relation to debt management and financial risk management		• Nine finance seminars were organised in 2018 with approximately 170 attendees on topics that included debt management and financial communication. The KBN skolen program was run twice, with a total of 40 attendees
Ensure KBN's credit approval model is transparent and communicable, and is recognised as a tool for customers		• Deferred pending completion of a digital platform for customers
Help increase level of insight into debt management in the sector by sharing expertise		• Score of 4.8/6 in response to the assertion "KBN is an open organisation that actively shares its expertise" on the 2018 customer satisfaction survey

Diversity and equality

The objectives for our work on diversity and equality in 2018 were:

- We shall be an equal organisation and have diversity among our employees.
- We shall expect suppliers and customers to work systematically on diversity and equality at their organisations and in relation to their sub-contractors.

Objective	Status	Outcome
Maintain a gender balance in all units and at all levels of the organisation		• Target of overall gender balance of 40% achieved. A few departments, however, have not yet achieved a 60/40 gender balance
Qualified candidates/ applicants with non-Norwegian national origins or cultural backgrounds to be included in all recruitment processes		• Equal treatment practiced in all recruitment processes, with professional and personal qualifications considered independently of cultural and geographic background etc.
Both genders to be represented in the final stage of recruitment processes		• Both genders were represented in the final stage of the recruitment process in relation to 11 out of 12 external appointments. There were no male candidates with the requisite qualifications in one instance
Attach importance to the documented results achieved by suppliers in their work on diversity and equality when procuring goods and services		• 73% of significant* suppliers with whom agreements were signed in 2018 have reported on diversity and equality. • 41% of total number of significant suppliers have documented their work on diversity and equality
KBN's diversity to be highlighted when KBN represented externally		• Equal gender distribution among authors in KBN's publications, speakers, lecturers and other forms of representation

* Significant: 1) service delivery lasting more than one year 2) high financial value 3) Implementation is particularly time-consuming and resource-intensive 4) the service has a high inherent risk

Ethical conduct

The objectives for our work on ethical conduct in 2018 were:

- We shall maintain high ethical standards.
- We expect KBN employees to behave ethically in line with our Code of Conduct in meetings with customers, colleagues, suppliers and others.
- We expect KBN employees to exercise caution and to behave ethically in public arenas, including on social media.

Objective	Status	Outcome
All employees to be familiar with KBN's rules on ethical conduct		• All new employees in 2018 were trained in KBN's rules on ethical conduct
KBN's Code of Conduct to be updated and adjusted in line with developments in society		• Postponed until 2019
Produce an awareness poster regarding communication in public and on social media		• Awareness poster produced, disseminated and published on KBN's intranet
Low threshold for reports expressing concern and for whistle-blowing reports regarding harassment or discrimination		• Management training in routines for dealing with reports expressing concern and whistle-blowing reports postponed until 2019. No whistle-blowing reports were received through either the internal or external channels

Suppliers

The objectives for our work on suppliers in 2018 were:

- KBN has a zero-tolerance policy on corruption and money laundering and expects the same of its suppliers and their collaboration partners.
- We seek to contribute to greater transparency regarding questions of ownership and money flows.
- We expect our suppliers' work on corporate social responsibility, including in relation to the environment, ethical conduct, and diversity and equality, to have a documentable impact, and we expect our suppliers and their collaboration partners to work actively to combat corruption and money laundering and to protect against cyber criminality.

Objective	Status	Outcome
Make KBN's expectations clearer to its suppliers		• New procurement guidelines continue to be under development and will be completed in 2019. KBN's Overall Guidelines for Corporate Social Responsibility as well as its Code of Conduct have been published
Risk-assess KBN's finance supply chains		• The securities firms KBN uses have been subject to checks • KBN has not been notified that any such companies are being investigated • KBN has further investigated ATEA and Danske Bank as a result of allegations of corruption and money laundering
Attach importance to the documented results of suppliers' work in respect of anti-corruption, money laundering, and the prevention of cyber criminality at their own organisation and in relation to their collaboration partners when carrying out procurement processes of significant scope		• Information was requested and assessed for key suppliers as part of the tender process for a digital project, and further information was requested and assessed in the final phase of this process
Attach importance to the documented results of suppliers' corporate social responsibility work, including in relation to the environment, ethical conduct, and social matters, both at their own organisation and in relation to their collaboration partners when carrying our procurement processes of significant scope		• Information was requested and assessed for key suppliers as part of the tender process for a digital project, and further information was requested and assessed in the final phase of this process. The supplier selected must change its practice to comply with our requirements
Work to increase transparency in the Norwegian capital market		• Waiting for legislation that addresses the right to know the identity of bondholders in the Norwegian bond market to be put in place

Costumer dialogue

The objective for our work on costumer dialogue in 2018 was:

- We will complete a process of systematic dialogue with our stakeholders.

Objective	Status	Outcome
We will regularly update KBN's materiality analysis in accordance with GRI reporting		• Revised in 2018 in a process involving the Board and management team. Complete materiality analysis to be carried out in 2019
We will carry out an annual customer satisfaction survey		• Survey carried out, with a score of 5.17/6 in response to the assertion "I am satisfied with KBN"

THE UN'S SUSTAINABLE DEVELOPMENT GOALS

The UN's Sustainable Development Goals are the world's shared blueprint for eradicating poverty, fighting inequality and stopping climate change by 2030. The Goals were approved in 2015 by 193 countries, including Norway, and comprise 17 goals and 169 targets.

More and more Norwegian municipalities have developed their own plans for the Sustainable Development Goals. On a poll carried out in 2018,* 84% of municipalities surveyed stated that they regard the Sustainable Development Goals as 'important' or 'very important' to their municipality. As an important partner to Norwegian municipalities, KBN also wishes to actively engage with the UN's Sustainable Development Goals. KBN can support the work of municipalities on the Sustainable Development Goals through its knowledge and financing solutions.

There are various different levels for how companies can implement the Sustainable Development Goals into their activities:

1. Align and communicate their efforts
2. Stimulate efforts
3. Innovation

It will be natural for KBN to set its level of ambition at the first level and in some areas at the second level. This means that we will communicate how KBN's current initiatives relate to the Sustainable Development Goals, and that some of our activities will contribute to achieving these goals.

In 2018, KBN reviewed the Sustainable Development Goals in order to identify those which are most affected by our activities and those where we can make a difference through our activities.

As a result of this work, we have decided to highlight four of the Sustainable Development Goals that are of particular relevance to our operations: Clean Water and Sanitation, Sustainable Cities and Communities, Climate Action and Partnerships for the Goals.

UN's SUSTAINABLE DEVELOPMENT GOALS
Sustainable Develpment Goals of particular relevance for KBN.

The Sustainable Development Goals that KBN has decided to highlight relate to KBN's various priorities for 2019 in the area of corporate social responsibility (see the section on our corporate social responsibility priorities). In addition, KBN has also mapped its green lending portfolio to identify the connections between its financing of green lending and the Sustainable Development Goals. In our presentation of KBN's priorities for its 2019 corporate social responsibility work, we indicate which of these four development goals are relevant for each category.

* Deloitte, From global goals to local action, Nordic report 2018

2019 OBJECTIVES

Sustainable investment and ESG analysis have been part of the financial sector's activities for many years, with investment organisations taking such factors into consideration when assessing companies' risk exposure and potential for value creation. The assumption is that companies with a high ESG score will be more profitable over time than companies with a low score.

KBN has chosen to systematise its corporate social responsibility priorities in accordance with whether they are environmental, social or governance-related. KBN's updated priorities for its 2019 corporate social responsibility work have accordingly been sorted into the following three categories:

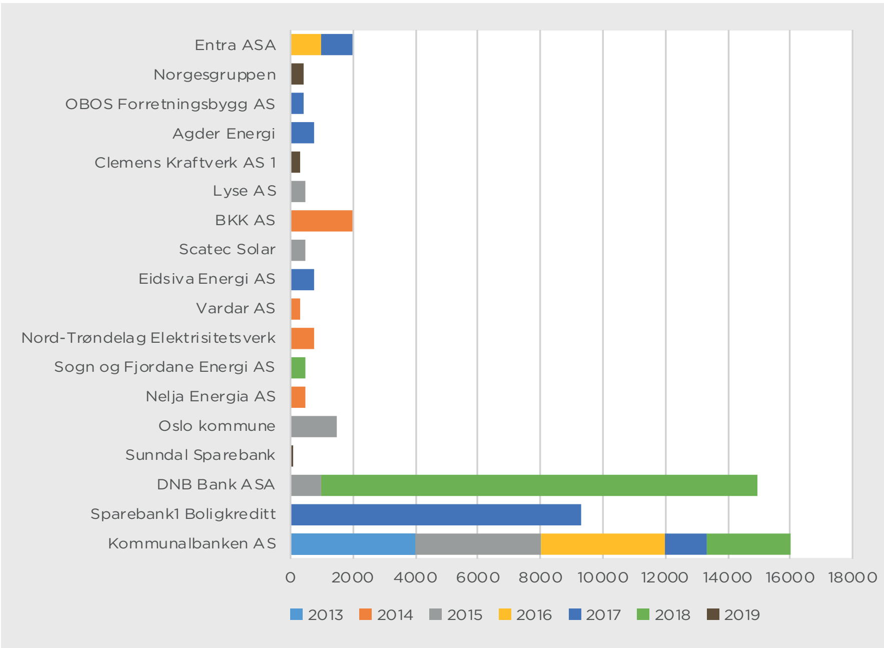
- Environmental matters **(E)**
- Social matters **(S)**
- Governance matters **(G)**

E

ENVIRONMENTAL MATTERS

Green finance

One of KBN's ambitions is to be a leader in green finance in Norway, and it strives to contribute to the transition to a low-carbon society. KBN raised its first green funding in 2010, and in 2013 it became the first financial institution in the Nordic region to issue a public green bond. KBN is Norway's most active green issuer.



CHART

Norwegian green bonds issuances, per 28. February 2019 (Source: Oslo Børs. KBN)

KBN follows the International Capital Market Association's (ICMA) Green Bond Principles (GBP) and has contributed to their development as a member of the ICMA GBP Executive Committee. KBN led the technical working group behind the Nordic Public Sector Issuers' Position Paper on Green Bonds Impact Reporting, which is now used by issuers in a number of locations across Europe.

KBN's green bonds are issued in the international capital markets and finance climate-friendly projects carried out by Norwegian municipalities through loans from

KBN. Green loans with lower interest rates are granted for projects that reduce energy consumption or greenhouse gas emissions or that contribute to local adaptations to climate change. Applications for green loans must provide information that satisfies KBN's criteria set, and KBN produces a separate environmental impact report each year on the projects that have been granted green loans.

KBN's Green Bond Framework has achieved the best rating, 'Dark Green shading', from the independent climate research centre CICERO. This means that investors and other stakeholders can be certain that KBN's green bonds finance investment in projects that are in line with Norway's national targets for the country to become a low-carbon society by 2050.

Oslo Economics, working in collaboration with CICERO and Inventura, produced a benefit analysis of green procurement on assignment for the Norwegian Agency for Public Management and eGovernment and the Norwegian Environment Agency. This analysis shows that setting climate requirements for procurement can successfully deliver significant environmental gains including reductions in greenhouse gas emissions, local air pollution and noise. The 10 procurement exercises investigated by the study cost on average 6% more than a standard reference project, but generated a notable 70% reduction in emissions relative to the relevant standard reference project.

KBN's green loans help reduce the additional cost of green projects for the Norwegian local government sector by giving borrowers a discount of 10 basis points. For example, the reduction in the interest rate on a loan of NOK 100 million borrowed over thirty years has a present value of NOK 1.22 million using a discount rate of 3%, which is equivalent to 20% of the initial additional cost. The state also provides other forms of assistance, e.g. Enova grants and Klimasats subsidies, that can further reduce the costs of investing in climate friendly projects.

KBN's outstanding green loans amount to about 7% of the total loans, and the share is expected to increase in the future. For 2019, lending growth is estimated to about NOK 15 billion, and the goal for 2019 is that at least one third of this should be green loans.

KBN is also committed to increasing knowledge and awareness of climate and environmental issues internally at its own organisation. One example is the establishment in 2019 of a cross-departmental climate and environment group that will work on raising awareness regarding our own carbon footprint – as employees and as private individuals – and on increasing knowledge internally at the bank about climate and environmental issues and green solutions.

GREEN FINANCE

OBJECTIVE

- Contribute to the achievement of national targets for the transition to a low-carbon society through an increase in green lending
- Contribute to the development of the market for green finance by issuing green bonds
- Actively work to influence the development of international standards in green finance
- Increase KBN's expertise and awareness of employees about climate and environmental issues

Climate risk

Climate risk has become an increasingly topical subject for the finance industry in recent years. The Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), led by Michael R. Bloomberg, delivered its final report and accompanying recommendations in June 2017. Members of the working group included Martin Skancke, who was subsequently appointed Chair of Norway's

Climate Risk Commission. The Commission delivered its report, Climate Risk and the Norwegian Economy, in December 2018. Martin Skancke is also the Vice Chair of KBN's Board of Directors.

In 2018 KBN worked on expertise sharing in relation to climate risk, with an emphasis on the local government sector, including through events it organised itself as well as in collaboration with the CICERO research foundation and the Norwegian Climate Foundation.

In 2019, KBN will work on climate risk along two tracks:

1. Help increase our customers' knowledge in the area of climate risk and put them in a better position to manage their own climate risk.
2. Identify KBN's own exposure to climate risk.

CLIMATE RISK

11 SUSTAINABLE CITIES AND COMMUNITIES

13 CLIMATE ACTION

17 PARTNERSHIPS FOR THE GOALS

OBJECTIVE

- Produce and launch guidelines on climate risk for municipalities
- Work systematically to identify climate risk in KBN's own lending portfolio
- Incorporate climate and environment risk into KBN's own credit assessment processes
- KBN to operate in a more climate-friendly way

S SOCIAL MATTERS

Expertise sharing and responsible lending

Through expertise sharing, dialogue with customers and digital tools, KBN raises awareness about financial issues and contributes to strong and sustainable debt management in the local government sector. KBN's aim is to be the best source of information to support decision-making on financing and debt management.

KBN has developed its own credit assessment model that is at the heart of its lending processes. Customers who are classified red or orange according to the model have to undergo a separate assessment by KBN's internal Credit Committee when they apply for a loan. KBN wants its credit assessment methodology to be open and accessible in order to increase transparency of our assessments and to provide customers with valuable insight into their own financial situation.

TABLE 1

Number of customers in the red, green, light yellow, yellow and orange categories of KBN's credit assessment model

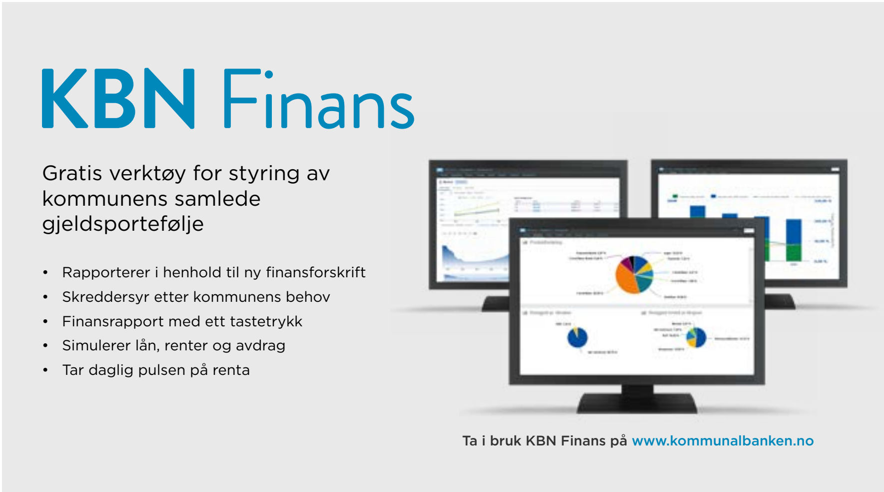
Year	Red	Orange	Yellow	Light yellow	Green	No. of customers in total	No. of customers on the ROBEK* register
2015	0	7	57	32	332	428	49
2016	0	5	25	11	387	428	47
2017	1	2	17	10	396	426	27

*) Register for Governmental Approval of Financial Obligations

KBN launched a debt management system known as KBN Finans in 2016. This is a web-based tool that helps our customers with their transaction history and analysis and reporting relating to their loans and interest rate fixings, and it allows customers to evaluate their municipality's borrowing position and exposure to financial risk. The tool will be further developed in 2019, including automatically including any loans that a municipality has from the Norwegian State Housing Bank in its overview on KBN Finans.

ADVERT

Since the launch of KBN Finans in 2016, many municipalities have started using our borrowing management system. This advert is one of several used in the marketing campaign.



KBN contributes to the sharing of expertise by organising regional finance seminars and through the KBN skolen programs. In 2019, KBN skolen II will be held for the first time. The objective will be to increase customer knowledge in the areas of financial risk management and debt management.

SHARING EXPERTISE AND RESPONSIBLE LENDING

11 SUSTAINABLE CITIES AND COMMUNITIES

17 PARTNERSHIPS FOR THE GOALS

OBJECTIVE

- Help increase the level of insight into financial risk management and debt management in the local government sector
- Support our customers in managing their borrowings in a long-term, sustainable way through our lending activities
- Promote openness and transparency of capital markets, nationally and internationally.

Diversity and equality

KBN works in a systematic and targeted way on diversity and equality across the organisation and on following 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 so that there is at least a 40% representation of each gender.

Both when recruiting new employees and when making changes to the composition of management groups and organisational units, KBN pays particular attention to gender balance. Recruitment processes are always carried out in such a way that the best-qualified female and male candidates are identified and assessed before any decision is taken. All candidates are treated equally, and no consideration is given to gender, disability, age, or cultural or geographic background when candidates' professional and personal qualifications are being assessed.

FACTS

Corporate diversity in KBN.

SHARE OF WOMEN	**56%** Board of directors (56)	**44%** Employees (43)	**40%** CEO and management (40)	**50%** Next management level (38)
AGE	**41** Mean age men (41)	**42** Mean age women (43)	**16** Employees 30 years or younger (14)	**19** Employees over 50 years (19)
INTERNATIONAL	**11%** Other citizenship than Norwegian (10)	**8** Nationalities (8)	**15%** International work experience, more than one year (16)	**33%** Education abroad, more than one year (35)

AVERAGE SALARIES WOMEN

All employees	**88%** of men's salary
CEO and executive management	**136%** of men's salary
Management team (excluding CEO)	**107%** of men's salary

DIVERSITY AND EQUALITY

OBJECTIVE

- Be a company with a commitment to equality and ensure diversity among our employees
- To expect that the work of our suppliers on corporate social responsibility, including in relation to the environment, ethical conduct, diversity and equality, to have a documentable impact

Environmental, social and governance (ESG) requirements in KBN's core activities

KBN is committed to working continuously to integrate sustainability into its core activities. An important element of KBN's activities is its liquidity management, which involves holding liquidity equivalent to at least 12 months' financing requirements, taking into account growth in lending. KBN's work on ESG in 2019 will include reviewing how it applies ESG criteria in its liquidity management.

APPLICATION OF ESG REQUIREMENTS TO CORE ACTIVITIES

OBJECTIVE

- Ensure that KBN applies ESG requirements to its core activities to at least as high a standard as recognised good practice in its sector

13 CLIMATE ACTION

17 PARTNERSHIPS FOR THE GOALS

G
GOVERNANCE MATTERS

Ethical conduct

A key element in KBN's corporate social responsibility is its work on ethical conduct. All employees and managers are required to act in accordance with KBN's Code of Conduct. KBN's Code of Conduct will be updated in 2019. Training sessions on ethical conduct and dilemma training are provided for employees annually. All new employees, suppliers and customers are required to familiarise themselves with KBN's Code of Conduct, which is available on KBN's website in English, Norwegian and Japanese.

KBN has a zero-tolerance approach to bullying, harassment and discrimination. KBN has procedures in place for anyone who is concerned about unacceptable conduct or circumstances to report this (whistle-blowing), and has rules and procedures in place for processing such reports. To reduce the threshold for whistle-blowing, KBN has set up an external whistle-blowing channel. This arrangement makes it easier for external parties to whistle-blow, and also makes it possible for both external parties and employees to whistle-blow anonymously if they consider this to be preferable or essential. KBN received no whistle-blowing notifications in 2018.

In 2019 the measures KBN will take in this area will include developing and running a program on ethical conduct for employees, including external lectures, dilemma-based learning and plans for self-development.

ETHICAL CONDUCT

OBJECTIVE

- KBN employees to exhibit ethical behaviour in line with our Code of Conduct in meetings with customers, colleagues, suppliers and in other relationships
- KBN employees to exercise caution and exhibit ethical conduct in public spaces, including on social media
- Low threshold for reports expressing concern and for whistle-blowing reports regarding harassment and discrimination

Supply chain

KBN purchases goods and services for about NOK 40 million anually and wishes to use its purchasing power to encourage suppliers to act in more sustainable ways. KBN has a zero-tolerance policy on corruption and money laundering, and expects its suppliers and their collaboration partners to have the same policy.

We expect the work carried out by our suppliers on corporate social responsibility, including in relation to the environment, ethical conduct, diversity and equality, and social matters, to have a documentable impact. When procuring goods or services, KBN attaches importance to its suppliers' commitment to such work and to the results they achieve – both within their own organisation and in relation to their collaboration partners. This also applies to suppliers' own work to prevent fraud by cybercriminals.

In 2019, KBN will strengthen its expertise in procurement and produce new procurement guidelines and a memo for suppliers setting out KBN's expectations.

SUPPLY CHAIN

13 CLIMATE ACTION

17 PARTNERSHIPS FOR THE GOALS

OBJECTIVE

- To expect that suppliers and their collaboration partners work actively to prevent corruption, money laundering and cyber-crime

Dialogue with stakeholders

A detailed description of KBN’s stakeholders and its dialogue with them can be found in the "Stakeholders" section. KBN’s 2019 objectives and measures in this area are as follows:

DIALOGUE WITH STAKEHOLDERS

17 PARTNERSHIPS FOR THE GOALS

OBJECTIVE

- Engage in active, continuous dialogue with KBN’s most important stakeholders
- Report on our sustainability work in accordance with international standards (GRI)

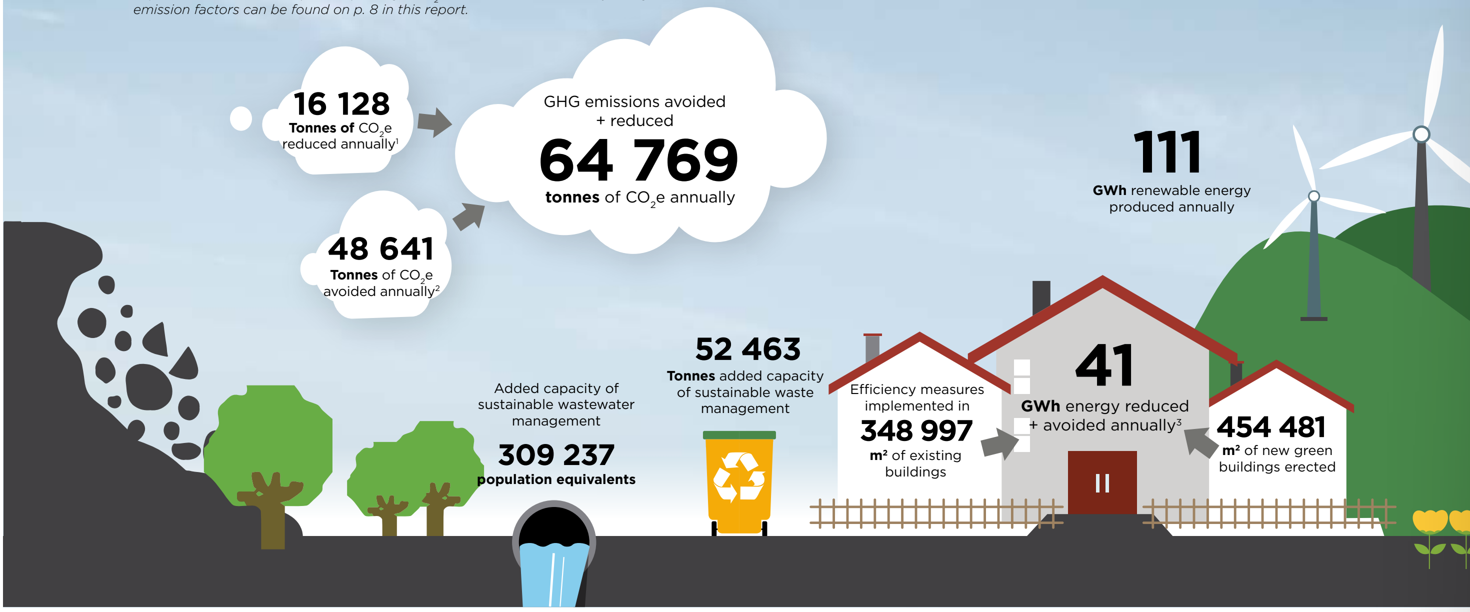
GREEN LOANS
—FINANCED WITH GREEN BONDS

KBN is the most active Norwegian issuer of Green Bonds and issued its first Green Bond in the Australian dollar market in 2018.

Proceeds from our Green Bonds are disbursed as discounted Green Loans to climate- and environmentally conscious investments in the local sector. Eligible investments are defined by our Green Loans Selection Criteria and our Green Bond Framework, which has been rewarded a Dark Green shading by external reviewer CICERO. At the end of 2018, KBN had NOK 18.8 billion outstanding in Green Loans to such investments. KBN reports annually on the effects of the Green Loans in its Impact Report. The report provides investors with extensive information on the projects financed by Green Bonds, such as CO2 reduced or avoided. A summary of the 2018 results follows. The [Impact Report can be downloaded here.]

ESTIMATED ENVIRONMENTAL IMPACT FROM KBN'S GREEN LOANS:

All CO_2 calculations are based on an emission factor of 380 g CO_2 per kWh of electricity, which is the emission factor recommended in the «Nordic Public Sector Issuers' Position Paper on Green Bonds Impact Reporting». CO_2 calculations for electricity using other emission factors can be found on p. 8 in this report.



1. From projects within categories Energy Efficiency & Low-carbon Transportation, as well as projects within the category Waste management that have a direct emission-reducing impact.

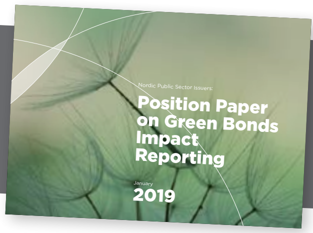
2. From projects within categories New Green buildings & Renewable Energy, as well as projects within the category Waste management that reduce the use of, or produce, energy.

3. 24,233 MWh energy reduced from energy efficiency measures; 16 763 MWh energy avoided in new green buildings, when compared to reference building built according to the national building code.

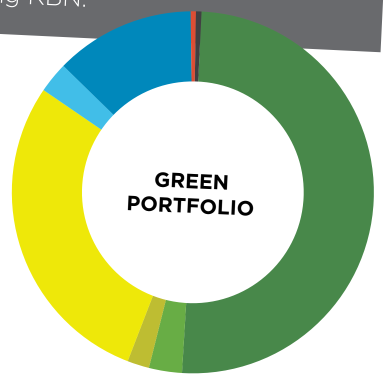
KBN Kommunalbanken Norway

IMPACT REPORT – IN SHORT

31 DECEMBER 2018

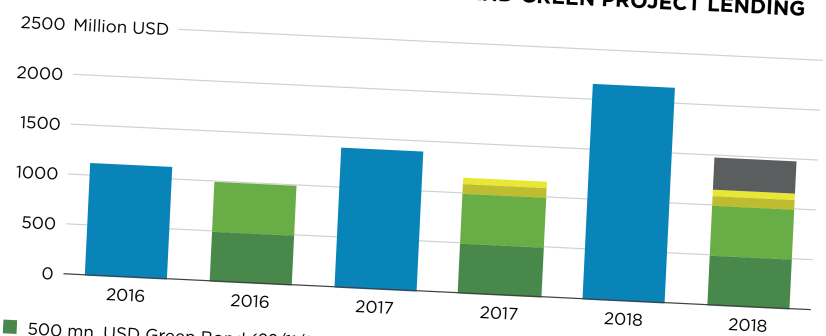


KBN Norway's impact reporting is conducted according to the principles and methodology presented in the *Position Paper on Green Bonds Impact Reporting* developed by a group of Nordic public sector green bond issuers, including KBN.



■	New green buildings	50.2%
■	Renewable energy	2.9%
■	Energy efficiency	2.0%
■	Low-carbon transportation	28.7%
■	Waste management	2.7%
■	Water and wastewater management	12.5%
■	Sustainable land use	0.5%
■	Climate change adaptation	0.5%

OUTSTANDING GREEN BOND ISSUANCES AND GREEN PROJECT LENDING



■ 500 mn. USD Green Bond (02/11/2025)
■ 750 mn. NOK Green Bond (11/29/2027)
■ 450 mn. AUD Green Bond (09/05/2023)
■ 500 mn. USD Green Bond (10/26/2020)
■ 600 mn. NOK Green Bond (11/29/2032)
■ Outstanding green lending

PROJECT PORTFOLIO & IMPACT OVERVIEW

Project category	Outstanding amounts to projects, in NOK	CO_2 emissions avoided/ reduced annually	Impact, tonnes CO_2e per million NOK
New green buildings	9 430 727	7 086	0.8
Renewable energy	554 036	40 855	73.7
Energy efficiency	367 321	9 206	25.1
Low-carbon transportation	5 389 633	6 892	1.3
Waste management	517 287	30	15.0
Water and wastewater management	2 348 562		N/a
Sustainable land use	87 655		N/a
Climate change adaptation	92 332		N/a
TOTAL	**18 787 553**		

Impact attributable to green bond investors Total outstanding green bonds divided by total outstanding disbursed to projects	**68%**
Where of impact attributable to Green Bond USD 500 mn (02.11.2025)	**23%**
Where of impact attributable to Green Bond USD 500 mn (10.26.2020)	**23%**
Where of impact attributable to Green Bond NOK 750 mn (11.29.2027)	**4%**
Where of impact attributable to Green Bond NOK 600 mn (11.29.2032)	**3%**
Where of impact attributable to Green Bond AUD 450 mn (09.05.2023)	**15%**

USE OF PROCEEDS

KBN's Green Project portfolio exclusively consists of loans to Norwegian municipalities and county councils/regions. Each loan is selected according to KBN's Green Bond Framework and the supplementary Selection Criteria.

KEY REPORTING METHODOLOGY

A project's impact is calculated based on the disbursed and outstanding green loan to a project as a share of the total project cost. For the share of green loans financed with green bonds, please refer to the table "Impact attributable to green bond investors". KBN reports on a portfolio basis, and in Norwegian Kroner (NOK). For this document, the reporting period ends on 31 December 2018.

! READ KBN'S IMPACT REPORT IN FULL

CLIMATE RISK
— WHAT DO THE CAPITAL MARKET PARTICIPANTS SAY?

Dialogue with KBN's stakeholders is an important part of our work to meet their expectations. Contact with capital market participants provides valuable insight in to market developments and investor preferences. In 2018 climate risk in the financial sector was a hot topic on the national and international agenda, e.g. through the EU Commission's action plan on sustainable finance and the publication of the final report from Norway's Climate Risk Commission.

As part of KBN's work on climate risk we asked two leading asset managers UBS Global Asset Management and UniSuper some questions about how they address this issue:

When facilitating the issuance of bonds, do you consider climate risk when determining the value and riskiness of the issuer?

UBS Global Asset Management

For corporate credits we have integrated ESG considerations into our analysis and investment decision-making. This means that look more closely where we see climate change risks are materially relevant to an issuer. This is informed by work we have done on the materiality of ESG issues and particularly focuses our attention where climate change transition could lead to business model disruption, regulation costs, product positioning (both advantages and disadvantages), and capex/balance sheet issues. As such we particularly focus on fossil fuel producers, large GHG emitters, makers of high carbon/energy intensity product makers, and makers of products that contribute to improving energy efficiency.

UniSuper

We consider climate risk as part of the holistic ESG risks facing a company/issuer. We routinely survey our external portfolio managers with respect to ESG and ask them to provide examples of how they consider ESG risks in their portfolio - however, we do not require them to report specifically on climate related financial risks, and do not have any restrictions on mandates.

In the current market, and in light of the Prudential Regulation Authority's recent focus on climate change (for example in the Consultation Paper on 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'), do you find it challenging to find reliable data for estimating climate risk relevant to a client?

UBS Global Asset Management We are able to source data from a variety of service providers on the carbon emissions of enterprises that we invest in at the level of GHG Protocol Scope 1 (direct), Scope 2 (electricity purchases), and Scope 3 (upstream). While much of the data from the largest enterprises is based on corporate disclosure, there is still a sizeable proportion that is estimated, and this is especially the case for Scope 3. However, we also recognize carbon emissions are a proxy measure for a specific kind of regulatory risk. At this stage other forms of risk – and the response of individual issuers to manage it – can only be measured in more qualitative terms. We are signatories to CDP Climate Change and we use the data that they collect. We use qualitative data in our Climate Aware rule-based equity strategies and have been looking at whether this is applicable in the fixed income arena. When it comes to more fundamental analysis however it is more challenging to find better data to quantify climate risks in a looking forward manner, such as in the form of exposure to country level commitments and regulatory trends, and potential impacts on cost and product competitiveness.

UniSuper UniSuper considers climate risk on its portfolio from a range of angles – carbon intensity (to estimate preparedness to carbon pricing), industry resilience/substitutes (including stranded assets), physical resilience, and company preparedness/response. As we invest in 1000's of companies (and most of these investments are in equities) we try to determine what companies/sectors present the most risk (both financially and with respect to member attention), considering our exposures to the sectors and companies across our portfolios (combining debt and equity exposures).

We try not to rely on any particular data source with respect to this analysis – rather using multiple data sources to determine if any particular company/sector presents a material risk to our portfolios and will then engage with the companies to assess if the risk is being managed.

Given that including climate risk in credit models is still at a stage of infancy, are there any data items or information points that you deem positive if an issuer is able to present?

UBS Global Asset Management Where we consider carbon emissions to be potentially financially material we expect issuers to disclosure their emissions at least at the levels of Scope 1 & 2. As such we regard any absence of this data as negatively differentiating the issuer. We are more encouraged by issuers who are able to report in line with the Taskforce on Climate-related Financial Disclosure (TCFD), and especially where they are able to demonstrate a good grasp of the impacts of climate change on their strategy and capital allocation, are able to provide relevant targets and can communicate how they expect to achieve them.

UniSuper We view it as a positive if a company has reported in line with the TCFD and/or if they are able to articulate and report on how they are managing their material climate related risks (e.g. energy efficiency, adapting assets to be more resilient to a variable (hotter/wetter/drier etc.) climate etc.). This is positive as it demonstrates that the company is proactive in responding to risks within its operations.

It is also a positive with respect to how they are managing the reputational risks associated with climate activism – which is relevant to UniSuper as an investor as well.

FINANCIAL STATEMENT 2018

NOTES TO THE FINANCIAL STATEMENTS

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	2018	2017
Interest income from assets measured at amortised cost		*3 738*	*1 754*
Interest income from assets measured at fair value		*3 017*	*4 089*
Total interest income		6 755	5 843
Interest expense		4 871	3 681
Net interest income	**1**	**1 885**	**2 162**
Fees and commission expenses	**2**	34	32
Net unrealised gain/(loss) on financial instruments	**3**	338	(163)
Expected credit loss	**16**	1	-
Net trading income	**4**	17	9
Total other operating income		**320**	**(186)**
Salaries and administrative expenses	**5,6,7**	142	132
Depreciation on fixed assets		22	21
Other expenses	**9**	46	40
Total operating expenses		**209**	**193**
Profit before tax		**1 996**	**1 783**
Income tax	**8**	499	354
Profit for the year		**1 496**	**1 429**
Portion allocated to shareholder		1 448	1 395
Portion allocated to owners of additional Tier 1 capital		48	34

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	2018	2017
Profit for the year		1 496	1 429
Other comprehensive income			
Items which will not be reclassified to profit or loss			
*Change in fair value of liabilities due to changes in own credit risk**	**20**	(365)	0
Actuarial gain/(loss) on defined benefit plan		1	(1)
Tax effect		91	0
Total other comprehensive income		**(273)**	**(1)**
Total comprehensive income for the year		**1 223**	**1 428**

**Change in fair value of liabilities due to changes in own credit risk shall, after transition to IFRS 9 from 1 January 2018, be presented in the Statement of comprehensive income. Under previous accounting rules, the corresponding amount was included in the line Net unrealised gain/(loss) on financial instruments in the Income statement. For 2017, the change in fair value of liabilities due to changes in own credit risk amounted to NOK –607 million (before tax), which was presented on the line Net unrealised gain/(loss) on financial instruments and included in the ordinary Income statement.*

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	**Note**	**2018**	**2017**
Assets			
Deposits with credit institutions	**10,11,12,14,22**	22 987	10 400
Instalment loans	**10,11,12,15**	303 571	283 396
Notes, bonds and other interest-bearing securities	**10,11,12,13,17**	116 519	107 445
Financial derivatives	**10,12,13,21,22**	14 497	11 476
Deferred tax asset	**8**	0	0
Other assets	**18**	127	137
Total assets		**457 701**	**412 854**
Liabilities and equity			
Loans from credit institutions	**10,12,19,22**	12 085	4 714
Senior securities issued	**10,11,12,13,20**	402 916	369 482
Financial derivatives	**10,12,13,21,22**	24 051	21 082
Other liabilities	**18**	34	86
Current tax liabilities	**8**	0	214
Deferred tax liabilities	**8**	1 164	551
Pension liabilities	**7**	47	50
Subordinated debt	**10,12,23**	1 982	2 008
Total liabilities		**442 279**	**398 187**
Share capital	**24**	3 145	3 145
Additional Tier 1 capital	**25**	2 189	2 189
Retained earnings		10 088	9 333
Total equity		**15 421**	**14 667**
Total liabilities and equity		**457 701**	**412 854**

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)

2018

	Note	Share capital	Additional Tier 1 capital	Value changes on liabilities due to changes in own credit risk	Retained earnings	Total equity
Equity as of 31 December 2017		3 145	2 189	0	9 333	14 667
Effects 1 Januray 2018 due to transition to IFRS 9		0	0	(360)	383	23
Equity as of 1 January 2018		3 145	2 189	(360)	9 716	14 691
Profit for the year		0	0	0	1 496	1 496
Other comprehensive income - value change on liabilities due to changes in own credit risk		0	0	(274)	0	(274)
Other comprehensive income - actuarial gain/loss		0	0	0	(1)	(1)
Interest paid on Tier 1 capital	**25**	0	0	0	(48)	(48)
Dividends for 2017		0	0	0	(443)	(443)
Equity as of 31 December 2018	**24**	**3 145**	**2 189**	**(634)**	**10 720**	**15 421**

A dividend to the owner for the financial year 2018 of NOK 481 million has been decided in the national budget for 2019. This will be paid out in 2019, subject to a decision by the Annual General Meeting. This is not deducted from equity as at 31.12.18 in the table above.

2017

	Note	Share capital	Additional Tier 1 capital	Value changes on liabilities due to changes in own credit risk	Retained earnings	Total equity
Equity as of 1 January 2017		3 145	994	0	8 314	12 452
Profit for the year		0	0	0	1 429	1 429
Total other comprehensive income		0	0	0	(1)	(1)
Interest paid on Tier 1 capital	**25**	0	0	0	(18)	(18)
Issued additional Tier 1 capital	**25**	0	1 195	0	0	1 195
Dividends for 2016		0	0	0	(390)	(390)
Equity as of 31 December 2017	**24**	**3 145**	**2 189**	**0**	**9 333**	**14 667**

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	**2018**	**2017**
Cash flows from operating activities		
Interest received	6 529	5 830
Interest paid	(3 899)	(3 310)
Fees and commissions paid	(34)	(32)
Receipts from repurchase of issued securities	17	9
Cash payments to employees and suppliers	(209)	(172)
Income taxes paid	0	404
Net disbursement of loans to customers	(20 525)	(15 148)
Net (increase)/decrease in deposits with credit institutions	(4 492)	3 527
Net (increase)/decrease in notes, bonds and other interest-bearing securities	(6 370)	14 406
Net (increase)/decrease in other assets	8	13
Net increase/(decrease) in other liabilities	(55)	36
Net (increase)/decrease in financial derivatives	3 489	(12 094)
Net cash flows from operating activities	**(25 542)**	**(6 531)**
Cash flows from investing activities		
Net (purchase)/sales of property and equipment	2	(18)
Net cash flows from investing activities	**2**	**(18)**
Cash flows from financing activities		
Proceeds from issuance of commercial paper	0	0
Repayment of commercial paper	0	0
Proceeds from issuance of debt securities	104 845	118 509
Repayment of debt securities	(79 004)	(112 676)
Proceeds from issuance of additional Tier 1 capital	0	1 195
Interest paid on Tier 1 capital	(65)	(25)
Proceeds from issuance of subordinated debt	0	0
Repayment of subordinated debt	0	0
Dividends paid	(443)	(390)
Net cash flows from financing activities	**25 333**	**6 614**
Net cash flows	**(208)**	**65**
Effects of foreign exchange differences	396	(54)
Net cash flows after foreign exchange differences	**189**	**11**
Cash and cash equivalents at 1 January	87	76
Net change in cash and cash equivalents	189	11
Cash and cash equivalents at 31 December	**276**	**87**
Whereof		
Deposits with credit institutions without agreed time to maturity	*276*	*87*
Loans from credit institutions without agreed time to maturity	*0*	*0*

See note 20 for a reconciliation of changes in the carrying amount of liabilities that are part of financing activities. Such liabilities are Senior securities issued and Subordinated debt.

ACCOUNTING POLICIES

REPORTING ENTITY

Kommunalbanken AS ("the Company" or "KBN") is a limited company providing loans to counties, municipalities, intermunicipal companies and other companies that carry out tasks at a municipal level. KBN's registered office is in Haakon VIIs gate 5B, Oslo. The financial statements for the year ended 31 December 2018 were approved by the Board of Directors on 28 February 2019.

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 measured at amortised cost, either based on the business model "hold to collect contractual cash flows" and where terms for Fair Value Option are not met, or instruments that are hedged items in fair value hedges. In the latter case, the financial instruments are measured at amortised cost, and the change in fair value that is attributable to the risks that are being hedged, adjusts the carrying amount of the instrument and is recognised in the Income statement.

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, except for 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

IFRS 9 *Financial Instruments replaced IAS 39 Financial Instruments – Recognition and Measurement and KBN reports in accordance with IFRS 9 from 1 January 2018 onwards. Accounting principles for financial instruments within IFRS 9 Financial Instruments are as follows:*

RECOGNITION AND DERECOGNITION

Financial assets and liabilities are recognised in the Statement of financial position when KBN becomes a party to the contractual provisions of the instrument. At initial recognition, all financial assets and liabilities are measured at fair value. For financial assets that are not categorised as at fair value through profit or loss, the value at initial recognition includes transaction costs that are directly attributable to acquisition. Recognition and derecognition of financial instruments takes place on the settlement date. For a regular way purchase or sale of a financial asset, the value changes of the asset are recognised from the trade date. Financial assets are derecognised when the contractual rights to the cash flows expire or are transferred.

Financial liabilities are derecognised when the contractual obligation has been discharged, cancelled or has expired. When issued debt securities are repurchased, the liability is derecognised. Any difference between the settlement amount and the carrying amount is recognised in the income statement as gain or loss at the transaction date.

CLASSIFICATION AND MEASUREMENT

Classification of financial instruments takes place at initial recognition and determines the subsequent measurement of the carrying amount. Classification of financial instruments is determined by the characteristics of the financial instrument and by the business model for the management of financial assets.

Financial assets measured at amortised cost

KBN's business model for Instalment loans and Notes, bonds and other interest-bearing securities is to "hold financial assets in order to collect contractual cash flows". When the assets' cash flows only consist of principal and interest payments, and instruments with mainly offsetting value changes are not present, the assets are measured at amortised cost. New Instalment loans and Notes, bonds and other interest-bearing securities are subject to an assessment of whether the cash flows of the asset are only repayment, principal or interest payments. If this is not the case, the asset shall be classified as measured at fair value. KBN's p.t. and Nibor loans are measured at amortised cost. Notes, bonds and other interest-bearing securities without related financial derivatives are also measured at amortised cost, as well as Deposits from credit institutions (cash deposits, money market deposits and cash collateral pledged). Measurement of amortised cost is performed using the effective interest rate method.
Hedge accounting may apply to assets classified as measured at amortised cost. 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" or "Instalment loans" and in the Income statement as "Net unrealised gain/(loss) on financial instruments".

Financial assets designated at fair value through profit or loss (FVO)

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

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 same applies to floating rate notes issued in USD or EUR, and loans from credit institutions (cash collateral received or money market loans). The majority of financial 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 liabilities designated at fair value through profit or loss (FVO)
Selected bonds with fixed interest and that are not subject to hedge accounting are designated as at fair value through profit or loss at initial recognition, in order to achieve similar treatment as related derivative contracts, which are measured at fair value. This leads to a reduction in measurement inconsistency between issued bonds on one hand and financial derivatives on the other hand. For Senior securities issued that are measured at fair value, the part of changes in fair value of liabilities that is attributable to changes in KBN’s own credit risk is recognised in Other comprehensive income. The remaining part of the change in fair value of liabilities is recognised in the Income statement.

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

FAIR VALUE OF FINANCIAL INSTRUMENTS

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

Level 1
For securities traded in an active market with frequent market observations quoted prices on the reporting date are used in the measurement of fair value. Quoted prices are provided by international vendors (Reuters/Bloomberg), and are classified as Level 1-inputs when they represent actual market transactions. Of the bank’s financial instruments, a larger share of Notes, bonds and other interest-bearing securities and issued benchmark bonds are allocated to Level 1.

Level 2
For financial instruments without available quoted prices in an active market, KBN will either use quoted prices of similar instruments in active markets, where possible, or valuation techniques where significant inputs are based on observable market data (provided by Reuters).

Level 2-inputs might include:
· Observable interest rate yield curves, basis swap spreads, FX-rates, equity indices, commodity indices and volatilities
· Quoted prices and credit spreads at the reporting date for similar instruments issued by the same issuer but with a different tenor, so that an adjustment for maturity is necessary
· Quoted prices and credit spreads at the reporting date for similar instruments issued by the same issuer but denominated in a different currency, so that an adjustment for basis swap spread is necessary
· Actual market transactions in identical instruments before or after the reporting date, so that an adjustment for events between the date of transaction and the reporting date is necessary
· More liquid instruments issued by the same issuer with identical maturity, but an adjustment for liquidity risk is necessary
· Prices on potential new issues in similar instruments from the same issuer
Of the bank’s financial instruments Deposits with credit institutions and a larger share of Instalment loans, Notes, bonds and other interest-bearing securities, Financial derivatives and Senior securities issued are allocated to Level 2.

Level 3
Level 3 is relevant for financial instruments that are not traded in an active market and fair value is determined using valuation techniques where significant input is based on unobservable data. Financial instruments classified as Level 3 include notes and bonds with low liquidity, fixed rate loans to customers, issued debt securities not traded in an active market and where inputs are to a large extent unobservable, and OTC-derivatives with option elements.

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

Fair value disclosures
For financial instruments categorised in the fair value hierarchy at several period ends a reconciliation of movements between the levels is done at the end of each reporting period. The valuation technique used to determine fair value of financial instruments categorised in Level 2 or Level 3 is determined based on the instruments’ features. Fair value of financial instruments without embedded option-elements is determined using the discounted cash flows method, where discount rates are derived from the relevant observable money market interest rates and other risk factors that may significantly affect the fair value of the instruments. When such factors cannot be reliably observed at a reporting date, management may make assumptions and use estimates when determining the fair value.

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

PRESENTATION OF FINANCIAL ASSETS AND LIABILITIES

KBN does not offset any financial assets and liabilities in the Statement of financial position. Standard master netting agreements do not qualify for offsetting and net presentation. Therefore, the related assets and liabilities are presented gross in the Statement of financial position. Cash collateral received or pledged as additional security for derivative exposure is subject to ISDA-agreements that give right to offsetting of assets and liabilities in the event of default, but do not qualify for offsetting in the Statement of financial position under IAS 32. Cash collateral is presented on a gross basis in the Statement of financial position.

The part of changes in fair value of liabilities that is attributable to changes in KBN’s own credit risk is recognised in Other comprehensive income, while the remaining part of the value changes is recognised in the Income statement.

EXPECTED CREDIT LOSS

A provision for expected credit losses is recognised for all financial assets that are measured at amortised cost. This applies to Instalment loans and Notes, bonds and other interest-bearing securities that are not measured at fair value.

At each reporting date, an allocation to stages 1, 2 or 3 is performed for all Instalment loans and Notes, bonds and other interest-bearing securities that are measured at amortised cost. All assets are allocated to stage 1 at initial recognition. On subsequent reporting dates, stage 1 allocation means that there has been no significant increase in credit risk since initial recognition for that particular asset. An allocation to stage 2 on a subsequent reporting date represents a significant increase in credit risk since initial recognition, while stage 3 implies that the asset is credit impaired. Stage 1 requires the calculation of a 12-month expected credit loss that is recognised in the Income statement and Statement of financial position. Assets allocated to stages 2 and 3 require the calculation of a lifetime expected credit loss, which also will be recognised in the Income statement and Statement of financial position. The recognition of interest income for assets allocated to stages 1 and 2 is based on the asset’s principal amount, while the recognition of interest income for assets allocated to stage 3 is based on the asset’s amortised cost, meaning after deduction of the provision for the expected credit loss. Expected credit loss is calculated per loan/instrument, based on exposure at default, probability of default and loss given default, all estimated at the reporting date.

KBN uses three different scenarios in its model for the calculation of expected credit loss. Furthermore, the normalized values for probability of default are adjusted for market cycles in line with current market conditions at reporting times. The period's change in total expected credit loss is recognised in the Income statement as "Expected credit loss". Within stage 1 a 12-month probability of default and lifetime losses based on default within the next 12 months are used, while stages 2 and 3 use lifetime probability of default and losses resulting from this.

Major changes in the issuer's rating or a significant move under KBN's internal credit rating assessment are used as indicators of significant increase in credit risk since initial recognition. These will lead to an allocation of the asset to stage 2. For lending customers, consideration shall be given to whether such deterioration has taken place if a payment stop is decided under the Municipality Act. An assessment as credit impaired or allocation to stage 3 for loans to customers includes events that result in actual credit losses, or payment delays of at least 90 days over a certain threshold amount. Actual credit losses have never taken place during KBN's history. For Notes, bonds and other interest-bearing securities this will be triggered by events such as late payment, bankruptcy or restructuring due to financial problems.

HEDGE ACCOUNTING

Interest rate and cross currency swaps are used to hedge interest rate and currency risk in assets and liabilities. KBN applies IFRS 9 for hedge accounting. 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 portfolios of Instalment loans, Notes, bonds and other interest-bearing securities, as well as Senior securities issued, are classified as measured at amortised cost.

The hedge relationship is documented at designation, including the hedging strategy, and hedge effectiveness is measured on an on-going basis using Dollar-offset method. Any ineffective part of the hedge is recognised in the income statement.

Hedging instruments are measured at fair value through profit or loss, and carrying amounts are adjusted accordingly. The value change of the hedged items that is attributable to the hedged risk, is recognised as part of the carrying amount of the item and in the income statement as "Net unrealised gain/(loss) on financial instruments".

STATEMENT OF CASH FLOWS

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

RECOGNITION OF REVENUES

Interest and commissions are recognised in the income statement as they are earned or accrued, and interest is presented as interest income or interest expense independent of underlying assets and liabilities. Interest income for assets and liabilities measured at amortised cost is recognised in the income statement using the effective interest method. For items measured at fair value, including interest rate derivatives, interest is recognised as it accrues either as income or expense. Unrealised gains and losses on financial instruments at fair value and value changes attributable to the hedged risk on hedged items under hedge accounting are recognised in the income statement as "Net unrealised gain/(loss) on financial instruments". Other commission expenses and charges are recognised as expenses in the period when the service is provided.

FIXED ASSETS

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

INTANGIBLE ASSETS

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

PENSIONS

From 1 January 2018, the bank's pension scheme was changed from a defined benefit pension scheme to a defined contribution pension scheme. The new scheme applies to all employees who were under 55 years at the time of transition. The defined contribution pension scheme implies that the bank is paying a fixed percentage deposit as savings to each employee's pension account, depending on the size of the employee's salary.

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

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

LEASES

A lease, that does not transfer substantially all the risks and rewards related to ownership of the asset, is classified as an operating lease. Leases that are not operating are classified as finance leases. Lease payments under an operating lease are recognised on a straight-line basis over the lease term. Under finance leases, assets and liabilities are recognised in the Statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payment.

TAXES

Taxes are recognised in the income statement as they accrue, i.e. the income tax is based on profit before tax. Temporary and permanent differences are adjusted for before the year's tax base for current taxes is calculated. Deferred tax liabilities and deferred tax assets are calculated on the basis of temporary differences between the accounting and tax values at the financial year end. The nominal tax rate is used for this calculation. Tax increasing and tax-reducing differences within the same period are offset. Income tax consists of current taxes (tax on the taxable profit or loss for the year), changes in net deferred tax and adjustment to taxes payable in respect of previous years. The corporate income tax rate in Norway was reduced from 27 per cent to 25 per cent, effective from 1 January 2016, and is unchanged in 2018.

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 implemented IFRS 9 *Financial Instruments* on 1 January 2018.

CHANGES IN ACCOUNTING POLICIES

Changes in the accounting policies are presented in the chapter "Effects from transition to IFRS 9 *Financial Instruments"* below.

ACCOUNTING STANDARDS ISSUED BUT NOT YET EFFECTIVE

IFRS 16 *Leases* replaces the current IAS 17 *Leases* as of 1 January 2019. The new standard requires the recognition of all leases in the balance sheet, since the right to lease an asset represents an asset, while the lease obligation represents a liability. There are no material effects on KBN's accounts in connection to the transition to IFRS 16.

EFFECTS FROM TRANSITION TO IFRS 9 FINANCIAL INSTRUMENTS

KBN has not restated comparative information for 2017 for financial instruments in the scope of IFRS 9. Therefore, the comparative information for 2017 is presented according to IAS 39 *Financial Instruments: Recognition and Measurement* and is not directly comparable to the information presented for 2018. See the Annual Report 2017 for accounting policies for financial instruments under IAS 39.

Differences arising from the transition to IFRS 9 have been recognised directly in retained earnings as of 1 January 2018 and are disclosed in the Statement of changes in equity. Please refer to the table below for information about the effects in equity due to the transition to IFRS 9.

In principle, IFRS 9 introduces new rules in three areas:
1. Classification and measurement of financial instruments
2. Hedge accounting
3. Impairment of financial assets based on expected credit losses.

New accounting policies for these areas are described above.

1. Classification and measurement

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

KBN's business model for managing financial assets is considered to be "hold to collect" for both the lending and liquidity portfolios. Upon transition, KBN has evaluated all cash flows of the assets in these portfolios in regards to their nature and found that they all consist of only interest and principal payments, so that they all can be measured at amortised cost. KBN will, however, continue using Fair Value Option to a significant extent for assets and liabilities in order to avoid inconsistencies (accounting mismatch) that otherwise would arise.

The rules for classification and measurement of financial liabilities are mainly unchanged in IFRS 9 compared to IAS 39, except for the treatment of changes in the fair value of liabilities that are attributable to changes in credit risk for liabilities measured at fair value (Fair Value Option). Under IAS 39, these changes were presented in profit or loss, while IFRS 9 requires these to be presented in Other comprehensive income (OCI). KBN has implemented this change as part of the transition, and the method for calculating this part of the value change is described in Note 20, Senior securities issued.

2. Hedge Accounting

KBN's management has decided to implement IFRS 9 also for hedge accounting. In addition to fair value hedging of Senior securities issued, which already is established, it has been decided to introduce portfolio hedging of interest rate risk for parts of the lending portfolio (Instalment loans with fixed interest rate), for Instalment loans granted after the system solution for portfolio hedge is in place. Portfolio hedging is according to IAS 39 since the new standard does not include such rules yet.

3. Expected credit losses

IAS 39 only required recognition of impairment in case of objective evidence of impairment (credit loss events). KBN did not have impairment losses under IAS 39. IFRS 9 is forward-looking and requires recognition of expected credit losses for all financial assets measured at amortised cost (including those hedge accounted).

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

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

A significant increase in credit risk is mainly based on an increase in the Probability of Default (PD) since initial recognition. KBN uses an internal credit assessment model to determine whether there has been a significant increase in credit risk for lending customers. If a payment stop has been decided under the Municipality Act for a municipality it shall be assessed whether a significant deterioration has taken place. This is expected to be very unlikely given the preventive follow-up system of the municipal sector as laid out by the Municipality Act. Payment delays of at least 90 days are also used as an additional indicator for lending customers including companies with municipal guarantees. Credit impairment (Stage 3) is defined for lending as events that result in actual credit losses (has never happened) or as late payments (at least 90 days) above a certain threshold amount.

For issuers in the liquidity portfolio, a rating fall below investment grade is regarded as a significant increase in credit risk. Credit impairment (Stage 3) is defined as payment delays, bankruptcy or restructuring due to financial problems.

KBN has developed models and IT system solutions for the calculation of ECL, both for loans to customers and bond holdings. Expected credit losses are calculated per loan/instrument, based on the exposure at default (EAD), PD and the loss given default

(LGD), all estimated at the reporting date.

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

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

Transition to IFRS 9 leads to KBN recognising and presenting provisions for credit losses for the first time in its history. However, the recognised provisions are very small due to the quality of the portfolio. Loss provisions reduce equity and will increase the volatility of profit or loss going forward, especially if a significant increase in credit risk is seen to occur. All relevant exposures are considered to be in stage 1 as of 31 December 2018. See also the table below for measurement categories for relevant balance sheet items under IAS 39 and IFRS 9 and related carrying amounts. Categories with changes in the carrying amount are marked in italics. The transition effect for changes on liabilities that are due to changes in own credit risk entails no change in the carrying amount of the bond debt affected.

(Amounts in NOK 1 000 000)

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

The following table shows transition effects:

(Amounts in NOK 1 000 000)

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

*Changes in the fair value of liabilities that are attributable to credit risk comprise changes in the USD price of issued bonds, in the form of a spread above the USD Libor interest rate. This includes value changes for derivative contracts directly associated with issued bonds, based on KBN issuing debt converted to US dollars. The amount is reclassified from Retained earnings to Value changes on liabilities due to changes in own credit risk in the Statement of changes in equity at the time of transition. The transition effect does not entail any change in the carrying amount that amounts to NOK 154 billion on 1 January 2018.

NOTE 1

NET INTEREST INCOME

(Amounts in NOK 1 000 000)

2018 (IFRS 9)	Total	At fair value				
		Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	Amortised cost
Deposits with credit institutions	**37**	0	0	0	0	37
Instalment loans	**5 000**	1 616	0	0	1 616	3 384
Notes, bonds and other interest-bearing securities	**755**	437	0	0	437	317
Financial derivatives	**964**	0	964	0	964	0
Total interest income	**6 755**	**2 053**	**964**	**0**	**3 017**	**3 738**
Loans from credit institutions	**3**	1	0	0	1	1
Senior securities issued	**10 707**	6 124	0	0	6 124	4 583
Financial derivatives	**(5 900)**	0	(6 017)	117	(5 900)	0
Subordinated debt	**61**	61	0	0	61	0
Total interest expenses	**4 871**	**6 186**	**(6 017)**	**117**	**286**	**4 584**
Net interest income	**1 885**	**(4 133)**	**6 981**	**(117)**	**2 731**	**(846)**

2017 (IAS 39)	Total	At fair value through profit or loss			Held to	Loans and	Other
		Fair value option	Held for trading	Fair value hedge	maturity	receivables	liabilities
Deposits with credit institutions	**(3)**	(4)	0	0	0	1	0
Instalment loans	**4 844**	3 123	0	0	0	1 721	0
Notes, bonds and other interest-bearing securities	**423**	391	0	0	0	32	0
Financial derivatives	**579**	0	594	(15)	0	0	0
Total interest income	**5 843**	**3 510**	**594**	**(15)**	**0**	**1 754**	**0**
Loans from credit institutions	**1**	1	0	0	0	0	0
Senior securities issued	**8 818**	6 326	0	0	0	0	2 492
Financial derivatives	**(5 198)**	0	(4 591)	(607)	0	0	0
Subordinated debt	**60**	60	0	0	0	0	0
Total interest expenses	**3 681**	**6 387**	**(4 591)**	**(607)**	**0**	**0**	**2 492**
Net interest income	**2 162**	**(2 877)**	**5 185**	**592**	**0**	**1 754**	**(2 492)**

NOTE 2

FEES AND COMMISSION EXPENSES

(Amounts in NOK 1 000 000)

	2018	2017
Expenses of banking services	19	20
Other transaction costs	15	13
Total fees and commission expenses	**34**	**32**

NOTE 3

NET UNREALISED GAIN/(LOSS) ON FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

2018 (IFRS 9)	Total	At fair value			Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	
Instalment loans	**(420)**	(420)	0	0	0
Notes, bonds and other interest-bearing securities	**44**	43	0	0	1
Financial derivatives	**(8 084)**	0	(7 851)	(233)	0
Loans from credit institutions	**0**	0	0	0	0
Senior securities issued	**8 771**	8 585	0	0	187
Subordinated debt	**27**	27	0	0	0
Net unrealised gain/(loss) on financial instruments	**338**	**8 234**	**(7 851)**	**(233)**	**187**

2017 (IAS 39)	Total	At fair value through profit or loss			Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge		
Instalment loans	**760**	760	0	0	0	0
Notes, bonds and other interest-bearing securities	**71**	60	0	0	11	0
Financial derivatives	**2 270**	0	3 050	(779)	0	0
Loans from credit institutions	**0**	0	0	0	0	0
Senior securities issued	**(3 231)**	(4 046)	0	0	0	815
Subordinated debt	**(34)**	(34)	0	0	0	0
Net unrealised gain/(loss) on financial instruments	**(163)**	**(3 260)**	**3 050**	**(779)**	**11**	**815**

As from Q1 2018, changes in fair value of liabilities due to changes in own credit risk are not included in the line Net unrealised gain/(loss) on financial instruments in the Income statement. From 2018, such fair value changes are recognised in Other comprehensive income in the Statement of comprehensive income on the line Change in fair value of liabilities due to changes in own credit risk. The change is due to the transition to IFRS 9 Financial Instruments. See Note 20 Senior securities issued for information on calculation of such value changes. The change in fair value arising from Senior securities issued presented in the above table is due to changes in parameters other than credit, such as interest rates.

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

Of net unrealised gains in 2018 amounting to NOK 338 million, Senior securities issued and related financial derivatives contribute with a gain of NOK 354 million. The gain is primarily due to the increase in 3m USD Libor and a tightening of USD-NOK basis swap spreads which affect the value of derivatives used to convert USD funding to NOK. Instalment loans contribute further with a gain of NOK 66 million, while Notes, bonds and other interest-bearing securities and related financial derivatives reduce the overall unrealised gain with NOK 82 million. Net unrealised losses amounting to NOK 163 million in 2017 came from Instalment loans and Senior securities issued and related financial derivatives. In cases where the changes in fair value are realised on sale, repurchase or termination before maturity, the resulting gain or loss is presented as "Net trading income" in the income statement.

Financial derivatives in fair value hedges, see Note 13 Hedge accounting, are measured at fair value through profit or loss. The related hedged items comprise NOK 176.4 billion in "Senior securities issued", that are classified as 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.

	2018	2017
Gain/(loss) from repurchase of securities issued	1	3
Gain/(loss) from sales of bond investments and derivatives terminations	16	6
Net trading income	**17**	**9**

NOTE 5

SALARIES AND ADMINISTRATIVE EXPENSES

(Amounts in NOK 1 000 000)

	2018	**2017**
Salaries	80	76
Employer contributions	18	15
Pension costs	9	7
Other personnel benefits	3	2
Administrative expenses	31	33
Total salaries and administrative expenses	**142**	**132**
Average number of man-years	*77*	*74*

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

NOTE 6

REMUNERATION

(Amounts in NOK 1 000)

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

THE REMUNERATION SCHEME FOR SENIOR EXECUTIVES

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

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

Remuneration for all employees, including senior executives, consists of a fixed salary, variable salary payments, pensions and other benefits, including personnel insurance, newspapers, mobile telephone and a residential mortgage scheme. KBN does not operate share-based remuneration programs or options. Fixed salary is the main element of remuneration received. The Board of Directors sets quantitative criteria each year for variable salary payments for the next financial year and can award payments in the following financial year of up to 1.5 times one month's salary for all employees. The variable pay scheme is intended to motivate the employees and be a factor in promoting efforts and results that draw KBN into a positive direction. The scheme is in line with the exemptions stipulated in The Financial Supervisory Authority of Norway: Circular 15/2014[3], which refers to the description in the remuneration regulations, currently included in the Financial Undertakings Regulation[2].

All employees' fixed salaries are adjusted each year with effect from 1 January based on 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, as shown in the table below.

MANAGEMENT SYSTEM AND DECISION-MAKING PROCESS

The Board of Directors has appointed an advisory committee - the Remuneration Committee - which carries out preparatory work on the principles applicable to remuneration, guidelines for variable salary, and guidelines for the remuneration of senior executives and for the remuneration of the CEO. The Board has issued a mandate for the work of the Remuneration Committee.

Minutes of the meetings of the Remuneration Committee are circulated to the Board. The Remuneration Committee has four members, who are appointed annually by and among the members of the Board. At year end 2018, the Committee's members are Brit Rugland (Chair), Rune Midtgaard, Petter Steen jr. and Jarle Byre (employee representative). 5 meetings were held in 2018.

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

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

The CEO determines the remuneration of the other senior executives within the limits set by the Board's guidelines and takes into account the Board's views when making final decisions on such remuneration. The CEO's decisions on the remuneration of senior executives are subsequently submitted to the Board for information.

REMUNERATION OF KBN's SENIOR EXECUTIVES IN 2018

Fixed salary

Fixed salary payable in 2018 included the normal annual salary increase, as well as a compensation for the transition to a new pension scheme for relevant senior executives.

Variable salary

In line with the guidelines for variable salary and achieved results in 2017, all employees were granted a variable salary corresponding to 1.5 monthly salaries, paid out in 2018.

Other benefits

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

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

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

Pension benefits

KBN's pension scheme changed on 1 January 2018 from a defined benefit pension scheme administered by KLP for salaries below 12 times the National Insurance base amount (G) to a defined contribution scheme administered by Storebrand Livsforsikring AS.

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

The defined contribution pension scheme was established with a deposit rate of 7% for salaries between zero and 7.1G and 18% for salaries between 7.1 and 12G. A contractual pension plan (AFP) in the private sector associated with the joint scheme is entered into as part of the collective agreement. Related insurance coverings are included in the scheme and include disability pension scheme with child allowance without the right to paid-up policies, child pension and group life insurance / death benefit. The scheme applies to all employees, except for those who were 55 years or older as of 1 January 2018 and employees who were partially or fully disabled with the right to sickness benefits as of 1 January 2018. These are covered by the previous scheme administered by KLP, which entitles its members 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. This scheme also includes disability and life pensions and contractual early retirement.

Employees who are estimated to receive a lower expected retirement pension at the age of 67 according to the new scheme compared to the defined benefit plan, have been granted a partial compensation (30%), paid monthly over two years, provided they are still under KBN employment during the payout period.

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[1] *The Financial Undertakings Act*
[2] *The Financial Undertakings Regulation*
[3] *The Financial Supervisory Authority of Norway: Circular 15/2014*
[4] *Guidelines for remuneration of senior executives in companies with state ownership, adopted by the Ministry of Trade, Industry and Fisheries with effect from 13. February 2015.*

2018

Remuneration to senior executives	**Agreed fixed salary**	**Paid fixed salary***	**Variable salary accrued in the period****	**Other benefits**	**Pension costs**
Kristine Falkgård (President & CEO)	3 056	3 248	127	209	222
Sigbjørn Birkeland (Chief Capital Markets Officer)	2 010	2 106	84	33	190
Jannicke Trumpy Granquist (CFO)	1 900	2 143	79	28	160
Tor Ole Steinsland (Chief Communications Officer)	1 283	1 439	53	44	208
Håvard Thorstad (CRO)	1 757	2 011	73	29	201
Ilse Margarete Bache (Chief of IT and Operations)	1 465	1 523	61	24	93
Lars Strøm Prestvik (Chief Lending Officer)	1 585	1 771	66	107	200
Morten Hatlem (Chief People, Strategy and Digital Development Officer)	1 400	1 443	58	13	139
Thomas Yul Hanssen (Chief Legal & Regulatory Affairs Officer)	1 340	1 585	56	39	187
Total remuneration to senior executives	**15 796**	**17 269**	**657**	**526**	**1 599**
Total remuneration to employees whose professional activities affect the risk position of the institution		**18 610**	**665**	**532**	**2 097**
Total remuneration to the employees in the independent control functions		**23 488**	**880**	**416**	**3 054**

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

2017

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

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

Remuneration to Board of Directors	2018	2017
Chairman Else Bugge Fougner (until 4 June2018) [1) 3)]	210	414
Chairman Brit K. S. Rugland (from 4 June 2018) [1) 3)]	318	202
Vice-chairman Martin Skancke [3)]	278	270
Board member Nanna Egidius [2)]	207	202
Board member Martha Takvam [2) 3)]	325	317
Board member Rune Midtgaard [1) 2)]	250	244
Board member Petter Steen jr [1)]	191	187
Board member Ida Espolin Johnson (from 4 June 2018) [2)]	105	0
Board member employees' representative Jarle Byre [1)]	191	161
Board member employees' representative May-Iren Walstad Wassås (unitil 4 June 2018)	74	145
Board member employees' representative Cathrine Lorvik Segerlund (from 4 June 2018 until 1 October 2018)	38	0
Board member employees’ representative Marit Urmo Harstad (from 1 October 2018)	38	0
Alternate Board member employees' representative Andreas Alestrøm (from 5 June 2017 to 30 September 2018)	0	6
Total remuneration to Board of Directors	**2 225**	**2 148**

[1)] Member of remuneration committee

[2)] Member of audit committee

[3)] Member of risk committee

Remuneration to Supervisory Board	2018	2017
Chairman Svein Ludvigsen (until 4 June 2018)	12	24
Chairman Alfred Bjørlo (from 4 June 2018)	16	0
Board members	71	70
Total remuneration to Supervisory Board	**99**	**94**

Fees to the statutory auditor	2018	2017
Statutory audit fees	900	866
Other financial audit and attestation services	1 288	1 156
Tax services	661	490
Other services not related to audit*	67	1 087
Total fees excl. VAT	**2 917**	**3 599**

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

NOTE 7

PENSIONS

(Amounts in NOK 1 000)

As of 1 January 2018, Kommunalbanken's pension scheme has changed from KLP's defined benefit pension scheme for salary under 12G to a defined contribution plan with Storebrand Livsforsikring AS.

The defined contribution pension scheme has been established with deposit rates of 7% for salaries 0-7.1 G and 18% for salaries between 7.1 G and 12 G. A collective agreement is entered into, and AFP is offered in the private sector related to the joint scheme. Insurance coverage is included in the pension scheme and includes disability pension with child supplement without paid-up policy, child pension and group life insurance / death compensation. The new scheme applies to all employees, except for those who were 55 years or older on 1 January 2018, as well as partially or fully disabled employees entitled to sickness benefit at the time of transition. These individuals are still covered by the defined benefit plan with KLP, that, with a service period of 30 years, gives the right to retire-ment pension of 66 per cent of base salary at the time of retirement. The scheme also includes disability pension and pensions for spouses and dependent children as well as contractual early retirement. The assets in this benefit pension scheme are placed in a collective portfolio and cannot be specified for asset classes.

Employees who are estimated to receive a lower expected retirement pension at the age of 67 according to the new scheme compared to the defined benefit plan, have been granted a partial compensation (30%) that is being paid out monthly over the course of two years, provided that the employee still works at KBN during the payout period. The compensation is being paid out as salary and is included on the line Salaries in Note 5 Salaries and administrative expenses. It is therefore not included in the pension costs below.

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

The defined benefit plan covering salaries over 12x Base amount (G) has been closed as of 1 April 2011, and was terminated in 2015 for current employees that were part of the plan.

Pension costs and pension obligations for the defined benefit scheme include employer contributions. For the defined contribution scheme, employer contributions are presented as this in note 5 Salaries and adminitrative expenses and are thus not included in the pension costs below.

Economic estimates used in calculation of pension costs and defined benefit obligation	**31.12.2018**	**31.12.2017**
Discount rate	2.60 %	2.40%
Estimated wage growth	2.75 %	2.50%
Estimated growth in Base amount	2.50 %	2.25%
Expected growth in benefit levels	1.73 %	1.48%

KBN has used Norwegian covered bonds as input when determining the discount rate for 2018 and 2017. 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**	
	2018	**2017**	**2018**	**2017**
Defined benefit pension scheme				
Net periodic pension cost	1 663	9 877	0	0
Net interest	795	1 099	419	438
Service cost	141	271	0	0
Employer contributions	367	1 586	59	62
Plan change at transition to defined contribution scheme	0	(6 791)	0	0
Total pension cost defined benefit scheme	**2 966**	**6 041**	**479**	**499**
Defined contribution pension scheme				
Pension cost for the year	5 823	0	-	-
Total pension costs (both benefit and contribution scheme)	**8 789**	**6 041**	**479**	**499**
Actuarial gain/(loss) recognised in other comprehensive income	667	320	121	506
Net pension costs	**9 456**	**6 361**	**600**	**1 005**

Pension liabilities	**Funded plan**		**Unfunded plan**	
	2018	**2017**	**2018**	**2017**
Defined benefit obligation	120 969	117 487	17 877	17 598
Plan assets	(98 041)	(91 700)	0	0
Employer contributions	3 233	3 636	2 521	2 481
Net pension liabilities	**26 161**	**29 424**	**20 398**	**20 079**

Movement in pension liabilities	**Funded plan**		**Unfunded plan**	
	2018	**2017**	**2018**	**2017**
Net pension liabilities as of 1 January	29 424	33 031	20 079	19 349
Net pension costs	3 633	6 361	600	1 005
Contribution to the pension scheme	(6 896)	(9 969)	(280)	(275)
Net pension liabilities as of 31 December	**26 161**	**29 424**	**20 398**	**20 079**

Movement in the fair value of plan assets	Funded plan		Unfunded plan	
	2018	**2017**	**2018**	**2017**
Fair value of plan assets as of 1 January	91 700	78 422	0	0
Net interest	2 047	1 931	0	0
Actuarial gain/(loss)	(100)	4 320	0	0
Service cost	(141)	(271)	0	0
Contribution to the pension scheme	6 044	8 737	246	241
Benefits paid	(1 507)	(1 440)	(246)	(241)
Fair value of plan assets as of 31 December	**98 041**	**91 700**	**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.

	2018	**2017**
Payable taxes on income for the period*	0	220
Change in deferred tax	317	539
Change in deferred tax as a result of changes in tax return for previous years	182	(315)
Effect of reduced tax rate as a result of changes in tax return for previous years	0	(89)
Total income tax	**499**	**354**

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

Reconciliation of effective income tax rate	2018	2017
Profit before tax	1 996	1 783
Calculated tax expense	499	446
Effect of reduced tax rate as a result of changes in tax return for previous years	0	(89)
Effect of change in tax rate	0	(2)
Tax expense	**499**	**354**
Effective income tax rate	25 %	20 %

Deferred tax liability/(asset)	2018	2017
Deferred tax liability/(asset) as at 1 January	551	12
Change in deferred tax	317	539
Changes in deferred tax on items recognised in other comprehensive income	91	0
Changes in deferred tax on items recognised in equity (additional Tier 1 capital)	(16)	0
Changes in deferred tax from items recognised in equity (transition effects IFRS 9)	8	0
Previous years' losses carried forward offset against payable tax for 2017	214	0
Deferred tax liability/(asset) as at 31 December (25%)	**1 164**	**551**

Temporary differences	2018	2017
Fixed assets	(4)	(6)
Pension liabilities	(47)	(50)
Provisions	(5)	(11)
Financial derivatives	1 879	1 055
Premiums/discounts on financial instruments	(3 307)	(4 734)
Unrealised gain/loss on financial instruments	(558)	(574)
Currency gain/loss on financial instruments	10 471	9 905
Losses carried forward for tax purposes	(3 774)	(3 384)
Total temporary differences	**4 655**	**2 202**
Deferred tax liability/(asset)	**1 164**	**551**

KBN received a decision in November 2017 regarding changes in the tax return for the tax year 2014, and in continuation of this, KBN received in June 2018 a notification of change of tax return for the years 2015 and 2016. The amendment relates to the tax treatment and periodisation of financial instruments, principally regarding the use of the realisation principle on the currency element of financial instruments. According to the tax autorities' decision, KBN has recognised changes in ending temporary differences for financial instruments in the financial statements for 2017 and 2018.

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

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

NOTE 9

LEASES

(Amounts in NOK 1 000 000)

Future minimum lease payments	**2018**	**2017**
Under 1 year	7	7
1-5 years	27	6
Over 5 years	5	0
Total future minimum lease payments	**39**	**13**
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

CLASSIFICATION OF FINANCIAL INSTRUMENTS

(Amounts in NOK 1 000 000)

2018 (IFRS 9)	Total	At fair value: Fair value option	At fair value: Mandatory at fair value	At fair value: Fair value hedge	Amortised cost
Deposits with credit institutions	**22 987**	0	0	0	22 987
Instalment loans	**303 571**	87 296	0	0	216 275
Notes, bonds and other interest-bearing securities	**116 519**	87 670	0	0	28 849
Financial derivatives	**14 497**	0	13 838	659	0
Total financial assets	**457 574**	174 966	13 838	659	268 111
Loans from credit institutions	**12 085**	0	0	0	12 085
Senior securities issued	**402 916**	167 949	0	0	234 967
Financial derivatives	**24 051**	0	22 322	1 730	0
Subordinated debt	**1 982**	1 982	0	0	0
Total financial liabilities	**441 035**	**169 931**	**22 322**	**1 730**	**247 052**

2017 (IAS 39)	Total	At fair value through profit or loss: Fair value option	At fair value through profit or loss: Held for trading	At fair value through profit or loss: Fair value hedge	Held to maturity	Loans and receivables	Other liabilities
Deposits with credit institutions	**10 400**	**1 228**	**0**	**0**	**0**	**9 172**	**0**
Instalment loans	**283 396**	**168 777**	**0**	**0**	**0**	**114 619**	**0**
Notes, bonds and other interest-bearing securities	**107 445**	**107 435**	**0**	**0**	**10**	**0**	**0**
Financial derivatives	**11 476**	**0**	**10 805**	**671**	**0**	**0**	**0**
Total financial assets	**412 717**	**277 440**	**10 805**	**671**	**10**	**123 791**	**0**
Loans from credit institutions	**4 714**	**0**	**0**	**0**	**0**	**0**	**4 714**
Senior securities issued	**369 482**	**211 390**	**0**	**0**	**0**	**0**	**158 092**
Financial derivatives	**21 082**	**0**	**19 720**	**1 362**	**0**	**0**	**0**
Subordinated debt	**2 008**	**2 008**	**0**	**0**	**0**	**0**	**0**
Total financial liabilities	**397 286**	**213 398**	**19 720**	**1 362**	**0**	**0**	**162 806**

NOTE 11

FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE

(Amounts in NOK 1 000 000)

2018	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	0	0	**0**
Instalment loans	0	15 800	71 496	**87 296**
Notes, bonds and other interest-bearing securities	61 334	22 720	3 616	**87 670**
Financial derivatives	0	13 218	1 279	**14 497**
Total financial assets measured at fair value	**61 334**	**51 738**	**76 391**	**189 462**
Loans from credit institutions	0	0	0	**0**
Senior securities issued	11 205	80 922	75 822	167 949
Financial derivatives	0	5 666	18 385	24 051
Subordinated debt	0	0	1 982	1 982
Total financial liabilities measured at fair value	**11 205**	**86 588**	**96 190**	**193 983**

Holdings of NOK 12 billion kroner are transferred from Level 2 to Level 1 for Notes, bonds and other interest-bearing securities per 31 December 2018

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

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

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 are measured at amortised cost after transition to IFRS 9.

Instalment loans

Level 2 includes short-term debt certificates issued by municipalities. 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 (Bloomberg), which represent actual transactions in an active market. Such third-party prices are also partially used within Level 2, where the price is not considered to reflect sufficient liquidity to allocate the position to level 1.

The fair value of notes and bonds where quoted prices are not sufficiently available on the reporting date, is determined using the discounted cash flow method, where discount rates are derived from observable money market interest rate yield curves (parts of Level 2 and Level 3). 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 public (quoted) 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, where third-party prices are not used, 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 2017	**69 313**	**574**	**80 159**	**2 008**	**(10 183)**
Purchase	0	0	0	0	4 553
Sale	0	0	(33)	0	0
Issue	27 165	1 466	13 956	0	0
Settlement	(18 900)	(187)	(20 892)	0	4 611
Transfer into Level 3	1 922	2 189	0	0	0
Transfer out of Level 3	(3 272)	(287)	0	0	0
Gain/(loss) recognised in the period	(4 732)	(138)	2 632	(26)	(16 087)
Carrying amount at 31 December 2018	**71 496**	**3 616**	**75 822**	**1 982**	**(17 106)**

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

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 2018 vary from –72 bp to +56 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 –27 bp to +67 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 2018, Notes, bonds and other interest-bearing securities amounting to NOK 1 902 million were transferred to Level 3 from Level 1 or 2, based on somewhat lower liquidity 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	**2018**		**2017**	
	Carrying amount	**Impact of changes in key assumptions**	**Carrying amount**	**Impact of changes in key assumptions**
Instalment loans	71 496	(238)	69 313	(277)
Notes, bonds and other interest-bearing securities	3 616	(60)	574	(1)
Financial derivatives	(17 106)	(483)	(10 183)	(16)
Senior securities issued	(75 822)	487	(80 159)	352
Subordinated debt	(1 982)	16	(2 008)	21
Total	**(19 798)**	**(278)**	**(22 463)**	**79**

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 238 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 60 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 487 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	**2018**		**2017**	
	Carrying amount	**Impact of changes in key assumptions**	**Carrying amount**	**Impact of changes in key assumptions**
Senior securities issued - with option element linked to equities or equity indices	(6 036)	545	(7 730)	298
Financial derivatives - with option element linked to equities or equity indices	(1 026)	(545)	(228)	(298)
Total	**(7 061)**	**0**	**(7 958)**	**0**

The table below shows total unrealised gain/(loss) recognised in the income statement in 2018 and 2017 for assets and liabilities allocated to Level 3.

Level 3 unrealised gain/(loss) in the period

	2018		**2017**	
	Carrying amount	**Unrealised gain/ (loss)**	**Carrying amount**	**Unrealised gain/ (loss)**
Instalment loans	71 496	443	69 313	(747)
Notes, bonds and other interest-bearing securities	3 616	13	574	(18)
Senior securities issued	(75 822)	8 328	(80 159)	(3 978)
Financial derivatives	(17 106)	(8 509)	(10 183)	3 771
Subordinated debt	(1 982)	26	(2 008)	(34)
Total	**(19 798)**	**301**	**(22 463)**	**(1 006)**

Amounts in the 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)

	2018		2017	
	Carrying amount	Fair value	Carrying amount	Fair value
Deposits with credit institutions	22 987	22 987	9 172	9 172
Instalment loans	216 275	216 275	114 619	114 712
Notes, bonds and other interest-bearing securities classified as amortised cost (IFRS 9)	28 849	28 858	0	0
Notes, bonds and other interest-bearing securities classified as Held to maturity (IAS 39)	0	0	10	9
Total financial assets measured at amortised cost	**268 111**	**268 120**	**123 801**	**123 893**
Loans from credit institutions	12 085	12 085	4 714	4 714
Senior securities issued	234 967	234 986	158 092	158 041
Total financial liabilities measured at amortised cost	**247 052**	**247 070**	**162 806**	**162 755**

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

2018	Level 1	Level 2	Level 3	Total
Instalment loans	0	178 812	37 463	216 275
Notes, bonds and other interest-bearing securities	25 811	1 802	1 245	28 858
Total fair value of financial assets, measured at amortised cost	**25 811**	**180 614**	**38 706**	**245 131**
Senior securities issued	171 684	63 302	0	234 986
Total fair value of financial liabilities, measured at amortised cost	**171 684**	**63 302**	**0**	**234 986**

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

INFORMATION ABOUT FAIR VALUE

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

For liabilities that are part of hedging relationships as hedged items (Senior securities issued classified measured at amortised cost, 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).

Deposits with and loans to credit institutions
Deposits with and loans to credit institutions include short-term money market deposits or loans with agreed maturities with other financial institutions, as well as pledged and held cash collateral, and deposits with banks without agreed maturity. The fair value of these positions is approximately equal to their principal amount due to their short-term nature.

Level 2: P.t. loans and Nibor-loans with floating margin and Nibor-loans with fixed 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 as well as floating rate notes (FRN) without corresponding financial derivative contracts.

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. Hedged risk is the value change of fixed-rate bonds due to changes in market interest rates (long-term interbank swap rates). 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	**2018**	**2017**
Notes, bonds and other interest-bearing securities	0	0
Senior securities issued	176 412	158 092
Financial derivatives	(1 071)	(691)
Total	**175 341**	**157 402**

Recognised value changes on financial instruments in fair value hedges	**2018**	**2017**
Notes, bonds and other interest-bearing securities	0	11
Senior securities issued	187	815
Financial derivatives	(233)	(779)
Total	**(46)**	**46**

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

Maturity profile carrying amount of Senior securities issued in fair value hedges

	0-1 years	**1-3 years**	**3-5 years**	**> 5 years**	**Total**
Carrying amount at amortised cost	51 233	79 157	26 116	21 210	177 716
Value change (hedged risk)	(195)	(481)	(616)	(13)	(1 304)
Total carrying amount	**51 039**	**78 676**	**25 501**	**21 196**	**176 412**

Accumulated ineffectivity amounts to NOK –12 million as of 31 December 2018.

NOTE 14

DEPOSITS WITH CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2018	**2017**
Deposits with credit institutions without agreed time to maturity	276	87
Deposits with credit institutions with agreed time to maturity	7 066	1 228
Cash collateral pledged	15 646	9 085
Total deposits with credit institutions	**22 987**	**10 400**

NOTE 15

INSTALMENT LOANS

(Amounts in NOK 1 000 000)

	2018 (IFRS 9)	2017 (IAS 39)
Principal amount	302 199	281 668
Accrued interest	1 121	1 023
Fair value adjustment	229	667
Expected credit loss	(11)	-
Total loans to customers	**303 538**	**283 358**
Other loans	33	38
Total instalment loans	**303 571**	**283 396**
Transition effect Expected credit loss on 1 January 2018		(10)
Transition effect reclassification on 1 January 2018		(18)
Carrying amount on 1 January 2018 (IFRS 9)		**283 367**

Geographic distribution	2018	2017
Østfold	11 874	11 027
Akershus	30 284	26 613
Oslo	9 064	6 507
Hedmark	13 844	12 902
Oppland	10 528	8 732
Buskerud	30 877	31 417
Vestfold	10 859	10 764
Telemark	9 693	9 623
Aust-Agder	6 725	6 659
Vest-Agder	12 935	12 581
Rogaland	25 090	23 850
Hordaland	35 597	34 014
Sogn og Fjordane	9 635	9 354
Møre og Romsdal	15 644	15 581
Trøndelag	28 762	24 738
Nordland	20 377	18 960
Troms	11 951	10 666
Finnmark	8 335	7 548
Svalbard	123	133
Loans to customers, principal amount	**302 199**	**281 668**

NOTE 16

EXPECTED CREDIT LOSS

The below table shows expected credit loss as part of the carrying amount of Instalment loans and Notes, bonds and other interest-bearing securities at the end of the period, as well as a specification of the period's change in expected credit loss that is recognised in the Income statement.

	31 December 2018	1 January 2018	2018	31 December 2018
(Amounts in NOK 1 000 000)	Expected credit loss	Expected credit loss	Expected credit loss	Carrying amount
Instalment loans	(11)	(10)	(1)	216 275
Notes, bonds and other interest-bearing securities	(1)	(1)	0	28 849
Total	**(12)**	**(11)**	**(1)**	**245 124**

The following table shows an allocation of KBN's expected credit losses as at 31 December 2018 to stage 1, 2 and 3. Stage 1 implies no significant increase in credit risk since recognition of the asset. Stage 2 implies such a significant increase, while stage 3 implies that the asset is credit-impaired. See the Accounting Policies for a description of the allocation to stages and the model for calculation of expected credit loss.

	Stage 1	Stage 2	Stage 3
Instalment loans	(11)	0	0
Notes, bonds and other interest-bearing securities	(1)	0	0
Total expected credit loss	**(12)**	**0 0**	

NOTE 17

NOTES, BONDS AND OTHER INTEREST-BEARING SECURITIES

(Amounts in NOK 1 000 000)

Notes, bonds and other interest-bearing securities by type of issuer	2018	2017
Domestic		
Issued by other borrowers	15 274	5 938
Foreign		
Issued by public bodies[1]	98 567	96 696
Issued by other borrowers	2 679	4 809
Total notes, bonds and other interest-bearing securities	**116 519**	**107 445**
Transition effect Expected credit loss on 1 January 2018		(1)
Transition effect reclassification on 1 January 2018		**(23)**
Carrying amount on 1 January 2018 (IFRS 9)		**107 421**

[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	2018	2017
Under 1 year	76 078	68 980
1-5 years	33 224	33 073
> 5 years	7 217	5 391
Total notes, bonds and other interest-bearing securities	**116 519**	**107 445**

NOTE 18

OTHER ASSETS

(Amounts in NOK 1 000 000)

	2018	2017
Intangible assets	116	125
Fixed assets	8	11
Other assets	2	1
Prepaid, non-accrued expenses and accrued income	0	0
Total other assets	**127**	**137**

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

OTHER LIABILITIES

(Amounts in NOK 1 000 000)

	2018	2017
Accounts payable	2	11
Public fees	8	1
Other short term liabilities	7	13
Accrued expenses and received, not yet accrued interest	18	62
Total other liabilities	**34**	**87**

NOTE 19

LOANS FROM CREDIT INSTITUTIONS

(Amounts in NOK 1 000 000)

	2018	2017
Cash collateral received	12 085	4 714
Total loans from credit institutions	**12 085**	**4 714**

NOTE 20

Senior securities issued

(Amounts in NOK 1 000 000)	2018 (IFRS 9)	2017 (IAS 39)
Senior securities issued (nominal amounts) as at 1 January	**373 816**	**376 785**
New issuance	104 844	118 509
Redemptions*	(80 143)	(113 392)
Amortisation**	1 138	716
Translation differences	14 947	(8 802)
Senior securities issued (nominal amounts) as at 31 December	**414 603**	**373 816**
Accrued interest	4 474	3 336
Fair value adjustment	(16 160)	(7 670)
Of which value change that is due to change in own credit risk	*845*	*0*
Of which value change that is due to other reasons	*(17 005)*	*0*
Total senior securities issued	**402 916**	**369 482**
Transition effect on 1 January 2018 due to reclassification***		(84)
Carrying amount on 1 January 2018 (IFRS 9)		**369 399**

* *Redemptions in 2018 include buybacks of NOK 206 million.*

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

*** *See further information on the transition effect in the Accounting Policies*

As at 31 December 2018 there are no breaches of debt covenants.

The value change on liabilities that is due to changes in own credit risk is calculated as the change in the credit spread that KBN pays on issued bonds in the form of a spread above the floating USD interest rate. This includes value changes for swaps in funding packages based on the fact that the bank issues debt that is converted from other currencies to USD. Value changes on liabilities that are due to changes in own credit risk are recognised in Total comprehensive income, while value changes on liabilities that are due to changes in other market parameters are recognised in the Income statement on the line Net unrealised gain/(loss) on financial instruments. Value changes in the table above are before tax.

RECONCILIATION OF CHANGES IN LIABILITIES THAT ARE PART OF FINANCING ACTIVITIES

	Senior securities issued	Subordinated debt
Carrying amount 31 December 2017	**369 482**	**2 008**
Cash flows		
Proceeds from issuance of debt securities	104 845	0
Repayment of debt securities	(79 004)	0
Changes that are not related to cash flows		
Change due to accrued interest and amortisation	1 137	1
Changes in fair value	(8 490)	(27)
Translation differences	14 947	0
Carrying amount 31 December 2018	**402 916**	**1 982**

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

NOTE 21

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 22 and note 26 for information on ISDA agreements, collateral transfers and clearing, that reduce counterparty risk. Counterparty risk is measured and monitored on an ongoing basis.

(Amounts in NOK 1 000 000)		2018			2017	
	Notional amount	**Positive market values - assets**	**Negative market values - liabilities**	**Notional amount**	**Positive market values - assets**	**Negative market values - liabilities**
Mandatory at fair value:						
Interest rate derivatives	150 119	757	2 552	128 577	795	2 084
Currency derivatives	503 779	13 067	18 721	470 355	9 888	17 281
Equity related derivatives	7 130	14	1 048	8 012	122	355
Commodity related derivatives	0	0	0	0	0	0
	661 027	**13 838**	**22 322**	**606 944**	**10 805**	**19 720**
Fair value hedges:						
Interest rate derivatives	173 862	425	1 730	155 541	230	1 362
Currency derivatives	3 011	234	0	3 078	441	0
	176 873	**659**	**1 730**	**158 619**	**671**	**1 362**
Total financial derivatives	**837 900**	**14 497**	**24 051**	**765 563**	**11 476**	**21 082**

All financial derivatives are measured at fair value through profit and loss. Most contracts are categorised as mandatory at fair value according to IFRS 9. The remaining contracts are designated as hedging instruments in fair value hedges. As standard master netting agreements (ISDA) do not fulfil the requirements for offsetting in the Statement of financial position even if they imply the right to offset in case of default, financial derivatives are presented on a gross basis in the Statement of financial position, such that contracts with a positive fair value are presented as assets and contracts with a negative fair value are presented as liabilities.

NOTE 22

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 offset 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 21 for additional information about financial derivatives.

(Amounts in NOK 1 000 000)	**2018**	**2017**
Cash collateral received	12 085	4 714
Cash collateral pledged	(15 646)	(9 085)
Total cash collateral	**(3 561)**	**(4 371)**

Effect of offsetting and collateral

KBN only has offsetting rights for exposures in financial derivatives, and for these, legally binding master agreements are used both for offsetting and for collateral. Financial derivatives are presented gross in the Statement of Financial Position because the netting agreements do not meet the conditions for offsetting in the Statement of Financial Position, and payments are normally not netted under normal market conditions. The table below shows the carrying amounts of financial derivatives. Since these are presented gross in the Statement of Financial Position, the financial significance of the offsetting right, that is agreed on in the master netting agreements with the derivative counterparties, as well as held or pledged cash collateral, is quantified and highlighted in separate columns. In the event of default of a derivative counterparty it will be possible to enforce the offsetting right as well as make use of the cash security. The value after offsetting and cash security shows the remaining credit risk for the derivative positions.

(Amounts in NOK 1 000 000)

				Amounts that may not be offset in the statement of financial position but that are subject to a netting agreement			
2018	**Gross fair value**	**Amounts that are offset in the statement of financial position**	**Carrying amount**	**Offsetting effect for counterparties with both asset and liabilities items**	**Amount after offsetting**	**Cash collateral**	**Amounts after offsetting and collateral**
Assets							
Financial derivatives	14 497	0	14 497	5 215	9 282	12 085	0
Liabilities							
Financial derivatives	24 051	0	24 051	5 215	18 836	15 646	3 191

(Amounts in NOK 1 000 000)

				Amounts that may not be offset in the statement of financial position but that are subject to a netting agreement			
2017	**Gross fair value**	**Amounts that are offset in the statement of financial position**	**Carrying amount**	**Offsetting effect for counterparties with both asset and liabilities items**	**Amount after offsetting**	**Cash collateral**	**Amounts after offsetting and collateral**
Assets							
Financial derivatives	11 476	0	11 476	8 588	2 888	4 714	0
Liabilities							
Financial derivatives	21 082	0	21 082	8 588	12 495	9 085	3 409

NOTE 23

SUBORDINATED DEBT

(Amounts in NOK 1 000 000)	Currency	Nominal amount in CCY	Redemption right	Coupon	Nominal amount in NOK 2018	2017
Ordinary subordinated loan capital	NOK	2 000	2028	3.02 %	2 000	2 000
Total subordinated debt					**2 000**	**2 000**

NOTE 24

SHARE CAPITAL

	2018 Number of shares	2018 Share in %	2017 Number of shares	2017 Share in %
The Kingdom of Norway	3 144 625	100	3 144 625	100

NOTE 25

ADDITIONAL TIER 1 CAPITAL

(Amounts in NOK 1 000 000)	Currency	Nominal amount in CCY	Redemption right	Coupon	Carrying amount 2018	2017
Additional Tier 1 capital	NOK	1 000	2020	3 month NIBOR +1.5%	994	994
Additional Tier 1 capital	NOK	1 200	2027	3.26%	1 195	1 195
Total additional Tier 1 capital					**2 189**	**2 189**

KBN issued additional Tier 1 capital in the form of a subordinated bond in June 2015 and one in June 2017. The bonds form part of KBN's Tier 1 capital, see Note 31. 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 2018 interest in the amount of NOK 48.4 million (after tax) has been paid (NOK 17.9 million in 2017). In addition, NOK 16.3 million (after tax) had accrued at year end 2018 (NOK 16.0 million in 2017). In total NOK 48.7 million of profit after tax is attributed to the additional Tier 1 capital holders in 2018 (NOK 33.9 million in 2017).

NOTE 26

RISK MANAGEMENT

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

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

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

ORGANISATION OF RISK MANAGEMENT

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

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

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

Three lines of defence. KBN's first line of defence within risk management and internal control comprises the Lending department, the Financial Markets department that performs funding and liquidity management, and the post trade operation functions. The second line of defence comprises financial control, as well as the risk management and the compliance functions. The second line of defence monitors, guides and contributes to improving the first line controls, and performs comprehensive risk measurement. This responsibility includes also risk management and monitoring of compliance to external and internal regulations. The third line of defence is carried out by the internal auditor Deloitte, reporting directly to the Board.

RISK TYPES

The risk management and risk exposure in KBN are subject to strict internal guidelines to ensure the bank's credit rating and access to the interbank markets. Credit and liquidity risk are generally low. Interest rate and currency risk is hedged on transaction level for all currencies except for NOK, USD and

EUR. Interest rate risk for these currencies is hedged with interest rate swaps, such that the bank is only exposed to changes in three-month interest rates.

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

Credit risk and counterparty risk

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

Market risk

- Interest rate and currency risk

Capital level
Liquidity risk
Operational risk

CREDIT RISK

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

Credit risk arising from lending customers is limited to payment deferrals as the payment obligation cannot be waived. The Local Government Act states that municipalities and similar cannot be declared bankrupt. In the Local Government Act, provisions have also been made on the procedures to be followed if payment deferral must be implemented. According to these provisions, the Ministry takes over the control of a municipality if the municipal council adopts payment deferrals. KBN does, however, perform credit assessment of all lending customers, based on a model for economic analysis of municipalities and similar. The model considers the municipalities' financial situation with both qualitative and quantitative key indicators for economic development and prospects of the customer.

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.

Financial counterparties are subject to regular credit assessment. Credit limits are determined through an internal assessment of the counterparty's rating, the bank's risk capital, the type of financial instrument and its maturity.

For investments in Notes, bonds and other interest-bearing securities, as well as for hedging instruments (financial derivatives), the minimum rating requirement is A2/A from Moody's and Standard and Poor's.

KBN enters into derivative transactions in order to control interest rate and currency risk. Counterparties in derivative transactions are financial institutions or central counterparties. In addition to strict rating requirements, the risk inherent in derivative transactions is mitigated through the use of ISDA agreements (offsetting). Such agreements, that include the exchange of cash collateral, have been made with all derivative counterparties.

KBN uses clearing services at a central counterparty (London Clearing House—LCH) for hedging instruments related to interest rate risk. Central counterparties that are established in the EU/EEA area are subject to capital and risk management through an own EU regulation (EMIR) and are considered to have lower counterparty risk than ordinary financial institutions.

KBN does not have a direct membership at LCH and two clearing brokers act on behalf of KBN towards LCH. KBN has chosen to segregate its derivative positions and funds (collateral) in relation to any possible default of the clearing broker. Thus, the bank's exposure is directly against LCH. KBN achieves a high degree of protection through such a solution.

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 70 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 years as of 31 December 2016. The price risk in the portfolio is managed at issuer level and is limited due to the portfolio's short duration.

MARKET RISK

Market risk consists mainly of interest rate and currency risk. KBN's risk policy allows minimal exposure to changes in interest rates and FX-rates. Interest rate and currency risk are managed through matching of assets and liabilities as well as through economic hedges with derivative instruments.

CAPITAL MANAGEMENT

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

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

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

KBN's Common equity Tier 1 capital adequacy ratio is 17.4 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 very low appetite for operational risk. Assessment of operational risk is performed at least on a yearly basis and otherwise when circumstances warrant it. Management reports to the Board on the operational risk and incidents. 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.

NOTE 27

CREDIT RISK

(Amounts in NOK 1 000 000)

KBN has credit exposures against the municipal sector in Norway, as well as against sovereigns, local authorities, multilateral development banks, financial institutions and issuers of covered bonds within the OECD. For the Norwegian municipal sector, the maximum maturity is determined by the Municipality Act and the credit framework is governed by regulations on large commitment. Credit exposures to financial institutions shall have a rating of A or above.

KBN has no actual loan losses in 2018, and neither is there any evidence of actual default as at 31 December 2018. 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. Exposures on line Regional authorities includes loans to companies guaranteed by municipalities and regional authorities.

Amounts in the table below represent actual credit exposure

2018

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	23 233	1 168	0	0	13 596	2 936		**40 934**
Regional authorities [1]	0	21 426	33 382	0	0	4 891	1 670	287 547	**348 917**
Multilateral development banks	0	7 756	351	0	0	468	2 279		**10 854**
Financial institutions	0	3 162	0	0	0	0	87	0	**3 213**
Securitisation	0	0	0	0	0	0	8	0	**8**
Covered bonds	0	11 467	994	0	0	1 441	13 066		**26 967**
Total	**0**	**67 009**	**35 895**	**0**	**0**	**20 396**	**20 046**	**287 547**	**430 893**

[1] Including loans to the municipal sector of NOK 303.6 billion.

Undisbursed loan commitments amount to NOK 6.8 billion as at 31 December 2018.

Credit exposure by country

2018

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	0	0	0	0	0	0	0	
Belgium	0	1 172	0	0	0	1 008	0	0	**2 180**
Canada	0	62	0	0	0	1 036	0	0	**1 098**
Denmark	0	10 877	0	0	0	87	656	0	**11 620**
Finland	0	410	495	0	0	730	0	0	**1 635**
France	0	11 813	1 272	0	0	1 216	0	0	**14 301**
Japan	0	3 044		0	0	0	0	0	**3 044**
Netherlands	0	990	902	0	0	0	87	0	**1 979**
Norway	0	3 604	27 716	0	0	1 441	9 339	287 547	**329 647**
Austria	0	27	0	0	0	57	0	0	**84**
Spain	0	0	0	0	0	0	8	0	**8**
United Kingdom	0	360	0	0	0	0	3 818	0	**4 178**
Supranationals	0	7 756	351	0	0	468	2 279	0	**10 854**
Switzerland	0	3 953	0	0	0	0	0	0	**3 953**
Sweden	0	11 878	2 922	0	0	0	1 610	0	**16 410**
Germany	0	10 199	2 238	0	0	1 821	2 248	0	**16 506**
United States	0	865	0	0	0	12 532	0	0	**13 396**
Total	**0**	**67 009**	**35 895**	**0**	**0**	**20 396**	**20 046**	**287 547**	**430 893**

Amounts in the table below represent actual credit exposure

2017

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

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

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

Credit exposure by country

2017

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

NOTE 28

INTEREST RATE RISK

(Amounts in NOK 1 000 000)

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

KBN has bond debt and investments in several currencies, however, all interest rate risk is fully hedged for all currencies except for NOK, USD and EUR. The interest rate risk for these three currencies is hedged using interest rate swaps, such that KBN only has remaining exposure to changes in 3 month money market interest rates for these three currencies. This interest rate sensitivity is measured as a change in core earnings after an unfavourable one-percentage point change in the interest rate level. The NOK interest rate risk depends on the ability to regulate the floating rate on instalment loans.

The Board has adopted a limit for interest rate risk of NOK 12 million for each of the currencies NOK, USD and EUR and NOK 36 million all together. The interest rate sensitivity in the main currencies is presented in the table below:

Effect of 100 bp change in interest rate	Net interest rate risk	Gross interest rate risk
NOK	(6.5)	6.5
USD	6.0	6.0
EUR	10.3	10.3
Total	**9.9**	**22.8**

NOTE 29

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.

	2018		2017	
Currency	**Net position**	**10% change in FX rate**	**Net position**	**10% change in FX rate**
USD	80.6	8.1	12	1.2
EUR	4.3	0.4	5.3	0.5
Other currencies	4.4	0.4	3.3	0.3
Total	**89.3**	**8.9**	**20.6**	**2.0**

The table above shows an absolute effect in the income statement of a 10 percent change in FX rates relative to NOK. The amount is calculated based on all net positions in foreign currency as at 31 December 2018 and 2017. The sensitivity analysis assumes zero correlation between FX rates and other market risk factors.

NOTE 30

LIQUIDITY RISK

(Amounts in NOK 1 000 000)

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

The policy requires that the liquidity portfolio should generally cover 12 months' net redemptions, and at any time a minimum of 10 months' net redemptions. This implies that the bank has to be in the position to cover all its liabilities/payables, including that related to the lending activities, during the next 12 months without new borrowing.

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

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

The liquidity portfolio shall have low credit and market risk and is invested in notes and bonds issued by sovereigns, local authorities, multilateral development banks and highly rated financial institutions.

2018

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	**22 987**	22 987	0	0	0	0	0
Instalment loans	**360 490**	3 931	8 873	19 210	68 249	260 227	0
Notes, bonds and other interest-bearing securities	**119 015**	21 523	35 819	19 567	34 496	7 611	0
Total assets	**502 492**	**48 441**	**44 693**	**38 777**	**102 744**	**267 838**	**0**
Loans from credit institutions	**12 085**	12 085	0	0	0	0	0
Senior securities issued	**454 822**	3 553	22 498	72 547	260 482	95 742	0
Other liabilities	**1 244**	9	16	9	1 164	0	47
Subordinated debt	**2 604**	0	0	60	242	2 302	0
Additional Tier 1 capital	**2 578**	0	7	50	1 164	1 356	0
Total liabilities	**473 332**	**15 647**	**22 521**	**72 666**	**263 051**	**99 400**	**47**
Financial derivatives	**33 238**	**2 915**	**2 030**	**3 408**	**15 692**	**9 192**	**0**
Net liquidity exposure	**62 398**	**35 709**	**24 202**	**(30 482)**	**(144 615)**	**177 630**	**(47)**

The table shows the sum of net maturities in that period, including interest payments. Additional Tier 1 capital is included in the table although it is not classified as liability in the Statement of financial position, because it is included in the bank's liquidity management. Financial derivatives are net cash flows (principal and interest) per time period.

2018

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	**22 987**	22 987	0	0	0	0	0
Instalment loans	**360 490**	111 072	110 586	26 524	53 643	58 666	0
Notes, bonds and other interest-bearing securities	**119 015**	27 658	46 769	15 056	22 474	7 057	0
Total assets	**502 492**	**161 717**	**157 355**	**41 580**	**76 117**	**65 723**	**0**
Loans from credit institutions	**12 085**	12 085	0	0	0	0	0
Senior securities issued	**454 822**	8 747	77 821	65 546	202 653	100 055	0
Other liabilities	**1 244**	9	16	9	1 164	0	47
Subordinated debt	**2 604**	0	0	60	242	2 302	0
Additional Tier 1 capital	**2 578**	0	1 007	50	164	1 356	0
Total liabilities	**473 332**	**20 840**	**78 844**	**65 665**	**204 222**	**103 713**	**47**
Financial derivatives	**33 238**	**5 673**	**3 872**	**3 359**	**12 448**	**7 886**	**0**
Net liquidity exposure	**62 398**	**146 550**	**82 383**	**(20 727)**	**(115 657)**	**(30 104)**	**(47)**

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

2017

Exposure by time to maturity	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	**10 400**	10 400	0	0	0	0	0
Instalment loans	**330 118**	3 518	48 628	11 423	42 729	223 820	0
Notes, bonds and other interest-bearing securities	**108 661**	11 238	22 555	35 948	33 691	5 229	0
Total assets	**449 179**	**25 157**	**71 183**	**47 371**	**76 420**	**229 050**	**0**
Loans from credit institutions	**4 714**	4 714	0	0	0	0	0
Senior securities issued	**409 821**	4 970	40 517	41 162	235 854	87 319	0
Other liabilities	**899**	17	274	8	551	0	50
Subordinated debt	**2 664**	0	0	60	242	2 362	0
Additional Tier 1 capital	**2 631**	0	6	50	1 179	1 396	0
Total liabilities	**420 729**	**9 700**	**40 797**	**41 281**	**237 825**	**91 077**	**50**
Financial derivatives	**21 331**	**1 260**	**(2 004)**	**1 220**	**9 637**	**11 218**	**0**
Net liquidity exposure	**49 781**	**16 716**	**28 382**	**7 310**	**(151 768)**	**149 191**	**(50)**

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

2017

Exposure by time to interest rate reset	Total	< 1 month	1-3 months	3-12 months	1-5 years	>5 years	Without maturity
Deposits with credit institutions	**10 400**	10 400	0	0	0	0	0
Instalment loans	**330 118**	114 599	137 317	16 831	37 824	23 546	0
Notes, bonds and other interest-bearing securities	**108 661**	15 266	36 532	25 917	25 726	5 220	0
Total assets	**449 179**	**140 265**	**173 849**	**42 749**	**63 551**	**28 765**	**0**
Loans from credit institutions	**4 714**	4 714	0	0	0	0	0
Senior securities issued	**409 821**	6 006	81 387	39 996	191 988	90 443	0
Other liabilities	**899**	17	274	8	551	0	50
Subordinated debt	**2 664**	0	0	60	242	2 362	0
Additional Tier 1 capital	**2 631**	0	1 006	50	179	1 396	0
Total liabilities	**420 729**	**10 737**	**82 667**	**40 115**	**192 960**	**94 201**	**50**
Financial derivatives	**21 331**	**2 099**	**(1 847)**	**1 366**	**9 563**	**10 149**	**0**
Net liquidity exposure	**49 781**	**131 628**	**89 335**	**4 000**	**(119 846)**	**(55 287)**	**(50)**

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

NOTE 31

CAPITAL ADEQUACY AND CAPITAL MANAGEMENT

(Amounts in NOK 1 000 000)

KBN's capital consists of share capital, retained earnings, additional Tier 1 capital and supplementary capital/subordinated debt. A satisfactory level of capital is seen as necessary for maintaining the AAA-rating and to ensure efficient market competition. The Board assesses the capital level on an ongoing basis and approves KBN's principles for capital management.

KBN is subject to the capital adequacy regulations and shall have a sufficient capital level based on its risk profile and the market conditions. The capital management target is operationalised through the common equity Tier 1 capital adequacy ratio, the Tier 1 capital adequacy ratio and total capital adequacy ratio. KBN's capital status is assessed against risk in a normal market situation and using long-term stress tests. The minimum requirement for total capital requirements including buffers is set at 17.5 per cent as at 31 December 2018. Minimum requirement for common equity Tier 1 capital adequacy has been set at 14.0 percent including buffer requirements from the same date on.

KBN's pillar 2 requirement has been set at 1.4 percent by the Financial Supervisory Authority of Norway, in total a 15.4 percent requirement on common equity Tier 1 capital. In addition a leverage ratio requirement of 3 percent came into force 30 June 2017. KBN is compliant with all statutory capital requirements as at 31 December 2018.

In order to maintain a sufficient capital level, KBN can, depending on market conditions, reduce or increase its total assets or enter into a dialogue with the owner regarding changing its capital structure by changes in dividend policy or issue of share capital.

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

Capital adequacy		2018			2017	
	Carrying amount	Risk-weighted assets	Minimum capital requirements and capital adequacy	Carrying amount	Risk-weighted assets	Minimum capital requirements and capital adequacy
Credit risk						
Sovereigns and central banks	40 934	0	0	25 181	0	0
Regional governments and local authorities	328 043	61 154	4 892	335 158	57 344	4 587
Of which are Norwegian municipalities	*303 538*	*61 154*	*4 892*	*283 358*	*57 344*	*4 587*
Public sector entities	10 038	0	0	8 467	0	0
Multilateral development banks	10 854	0	0	11 249	0	0
Financial institutions	40 467	6 520	522	19 366	3 672	294
Of which counterparty exposure on derivatives	*14 690*	*1 365*	*109*	*8 528*	*1 504*	*120*
Claims secured by residential property	33	33	3	38	38	3
Covered bonds	26 967	2 697	216	9 920	992	79
Other assets	10	10	1	12	12	1
Securitisation	8	8	1	9	9	1
Credit Valuation Adjustment	180	2 255	180	184	2 302	184
Total credit risk	**457 535**	**72 677**	**5 814**	**409 585**	**64 369**	**5 150**
Market risk	**0**	**0**	**0**	**0**	**0**	**0**
Operational risk - Basic Indicator Approach		**3 299**	**264**		**3 178**	**254**
Minimum capital requirements		**75 976**	**6 078**		**67 547**	**5 404**
Total capital ratio			**22.9 %**			**24.6 %**
Tier 1 capital adequacy ratio			**20.3 %**			**21.7 %**
Common equity Tier 1 capital adequacy ratio			**17.4 %**			**18.4 %**
Leverage ratio			**3.6 %**			**3.7 %**

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)	**2018**	**2017**
Common equity Tier 1 capital		
Share capital	3 145	3 145
Retained earnings previous years	8 591	7 904
Profit for the year included in Tier 1 capital	1 496	1 429
Pension funds above pension commitments	0	0
Deferred tax asset*	0	0
Intangible assets	(116)	(125)
Dividends payable	(481)	(443)
Other additions/deductions in common equity Tier 1 capital	609	525
Share of nulled unamortised estimate differences	0	0
Total common equity Tier 1 capital	**13 244**	**12 436**
Other approved Tier 1 capital	2 189	2 189
Total Tier 1 capital	**15 433**	**14 625**
Supplementary capital		
Ordinary subordinated debt	2 000	2 000
Total supplementary capital	**2 000**	**2 000**
Total primary capital	**17 433**	**16 625**

*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 2018 have been examined by the Supervisory Board.

The Supervisory Board recommends that the Board of Directors' proposals for the income statement and the statement of financial position as well as the application of profit, NOK 1,496,473,210 of which NOK 1,015,473,210 transferred to other equity, is adopted by the Annual Shareholders' Meeting.

Oslo, 3 April 2019
Supervisory Board for Kommunalbanken AS

Alfred Bjørlo
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 financial statements of Kommunalbanken AS, which comprise the statement of financial position as at 31 December 2018, income statement, statements of comprehensive income, changes in equity and cash flows for the year then ended and notes to the financial statements, including a summary of significant accounting policies.

In our opinion, the financial statements have been prepared in accordance with laws and regulations and present fairly, in all material respects, the financial position of the Company as at 31 December 2018 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the EU.

Basis for opinion

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

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements for 2018. 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 has a higher risk of errors. Such instruments comprise assets of NOK 76,391 million and liabilities of NOK 96,190 million measured at fair value in the statement of financial position and classified as level 3 instruments within the fair value hierarchy. Due to the materiality of the unlisted or illiquid instruments, we considered the valuation of these instruments a key audit matter.

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

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

IT systems supporting financial reporting

Kommunalbanken uses complex IT systems in an automated IT environment and is highly dependent on its IT systems in supporting the reporting of financial information. To ensure complete and accurate presentation of financial information, it is important that controls over transaction processing and measurement are designed and operate effectively. Likewise IT-general controls need to be designed and operate effectively to ensure appropriate access rights and system changes. The IT systems supporting financial reporting are considered a Key Audit Matter as these systems are critical to ensure accurate, complete and reliable financial reporting.

We obtained an understanding of Kommunalbanken's IT systems and the IT-environment relevant for financial reporting. We assessed and tested the automated controls within the financial system related to amongst others, effective interest rate and discounting. Furthermore, we involved IT specialists in assessing and testing the operating effectiveness of the IT general controls exercised by management throughout the reporting period.

Other information

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

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

Responsibilities of management for the financial statements

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

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

Auditor's responsibilities for the audit of the financial statements

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

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control;
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control;
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management;
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern;
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

Report on other legal and regulatory requirements

Opinion on the Board of Directors' report and on the statement on corporate social responsibility

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

Opinion on registration and documentation

Based on our audit of the financial statements as described above, and control procedures we have considered necessary in accordance with the International Standard on Assurance Engagements (ISAE) 3000, *Assurance Engagements Other than* Audits *or Reviews of Historical Financial Information*, it is our opinion that management has fulfilled its duty to ensure that the Company's accounting information is properly recorded and documented as required by law and bookkeeping standards and practices accepted in Norway.

Building a better working world

Oslo, 28 February 2019

ERNST & YOUNG AS

Einar Hersvik
State Authorised Public Accountant (Norway)

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

ARTICLES OF ASSOCIATION

The Articles of Association were last changed by the Annual General Meeting 29 June 2016.

The bylaws are issued in Norwegian and translated into English. In case of discrepancy between the two versions, the Norwegian version prevails.

CHAPTER I
Company, objectives, registered office

§ 1 The Company's name is Kommunalbanken AS.

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

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

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

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

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

CHAPTER II
Equity and subordinated loan capital - shares

§ 5 The Company's share capital is NOK 3,144,625,000 (three billion, one hundred and forty-four million, six hundred and twenty five thousand Norwegian kroner) divided into 3,144,625 shares of NOK 1,000 (one thousand Norwegian kroner) each.

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

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

CHAPTER III
Board of Directors

§ 8 The Company's Board of Directors shall collectively exhibit diversity and breadth of qualifications, experience and background and consist of between five (5) and nine (9) members. If a majority of the employees should so decide, it can 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 Directorsand 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

- Brit Kristin Rugland, Chair
- Martin Skancke, Vice Chair
- Nanna Egidius
- Rune Midtgaard
- Martha Takvam
- Petter Steen jr.
- Ida Espolin Johnson
- Marit Urmo Harstad, employee representative
- Jarle Byre, employee representative

ALTERNATES TO THE EMPLOYEE REPRESENTATIVES

- Anne Jenny Dvergsdal
- Harald Jacobsen

SUPERVISORY BOARD

- Alfred Bjørlo, Chair, Mayor, Eid municipality
- Berit Flåmo, Vice Chair, Mayor, Frøya municipality
- Hans Olav Syversen, former Member of parliament
- Arne Johansen, former CEO, Harstad municipality
- Rigmor Brøste, County Governor, Møre og Romsdal county
- Bjørn Ropstad, Mayor, Evje og Hornnes municipality
- Ane Marie Braut Nese, Mayor, Klepp municipality
- Ida Stuberg, Mayor, Inderøy municipality
- Leif Harald Walle, CEO, Stor-Elvdal municipality
- Tron Bamrud, CEO, Akershus county
- Anne Kathrine Slungård, CEO, Stjørdal municipality
- Terje Dalby, Senior Relationship Manager, employee representative

DEPUTIES

- Toril Eeg, CEO, Færder municipality
- Hans Seierstad,former Mayor, Østre Toten municipality
- Tommy Steinsvik, CEO, Vågan municipality
- Nina Bordi Øvergaard, CEO, Sør-Varanger municipality
- Terje Fronth-Pedersen, Senior Relationship Manager, alternate to the employee representative

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

Deloitte AS

- Eivind Skaug, State Authorised Public Accountant

BOARD PREPARATORY COMMITTEES

Audit Committee

- Martha Takvam, Chair
- Nanna Egidius
- Rune Midtgaard
- Ida Espolin Johnson

Risk Committee

- Martin Skancke, Chair
- Martha Takvam
- Brit Kristin Rugland

Remuneration Committee

- Brit Kristin Rugland, Chair
- Rune Midtgaard
- Petter Steen jr.
- Jarle Byre

GRI INDEX

GENERAL INFORMATION

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<tr><td>102-2</td><td>Activities, brands, products, and services</td><td>About KBN Norway (8)</td><td></td></tr>
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<tr><td>102-4</td><td>Location of operations</td><td></td><td>Kommunalbanken operates in Norway</td></tr>
<tr><td>102-5</td><td>Ownership and legal form</td><td>About KBN Norway (8)</td><td></td></tr>
<tr><td>102-6</td><td>Markets served</td><td>About KBN Norway (8)</td><td>Kommunalbanken borrows from around the world in order to offer low-cost financing to Norwegian municipalities and county authorities</td></tr>
<tr><td>102-7</td><td>Scale of organisation</td><td>About KBN Norway (8)
The Board of Directors' Annual Report - Annual Accounts (20, 21)
The Board of Directors' Annual Report - Organisation and employees (28)</td><td></td></tr>
<tr><td>102-8</td><td>Information on employees and other workers</td><td>The Board of Directors' Annual Report - Organisation and employees (28)</td><td>
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<tr><th></th><th>Women</th><th>Men</th></tr>
<tr><td>Permanent employees</td><td>31</td><td>43</td></tr>
<tr><td>Temporary employees</td><td>5</td><td>3</td></tr>
</table>
<table>
<tr><th></th><th>Women</th><th>Men</th></tr>
<tr><td>Full-time</td><td>31</td><td>43</td></tr>
<tr><td>Part-time</td><td>5</td><td>3</td></tr>
</table>
No work in Kommunalbanken is performed by workers who are not employees.
No significant fluctuations in employee numbers
</td></tr>
</table>

GRI-indicator	Description	Location in the report	Information
102-9	Supply chain	Performance in 2018 – suppliers (41) 2019 Objectives - Supply chain (48)	
102-10	Significant changes to the organisation and its supply chain	The Board of Directors' Annual Report - KBN's Activities in 2018 (18)	No significant changes to KBN's structure, ownership or staffing.
102-11	Precautionary Principle or approach		Kommunalbanken seeks to reduce the adverse environmental impact of its normal activities by obtaining Eco-Lighthouse certification and through its green lending, but it has no material risk of causing unknown environmental consequences as a result of its activities or lending. Kommunalbanken is a member of the UN Global Compact and is therefore committed to complying with the precautionary principle.
102-12	External initiatives	2019 Objectives – Green finance (43, 44)	
102-13	Membership of associations	2019 Objectives – Green finance (43, 44)	
Strategy			
102-14	Statement from senior decision maker	CEO's foreword (6, 7)	
Ethics and integrity			
102-16	Values, standards, principles and norms	Code of Conduct: https://www.kommunalbanken.no/en/corporate-social-responsibility/code-of-conduct 2019 Objectives – Ethical conduct (48)	
Governance			
102-18	Governance structure	Our corporate social Responsibility work (34, 35, 36)	
Stakeholder analysis			
102-40	List of stakeholder groups	List of stakeholders (36, 37, 38)	
102-41	Collective bargaining agreements	The Board of Directors Annual Report - Organisation and employees (28, 29)	All employees covered by collective bargaining agreements
102-42	Identifying and selecting stakeholders	Our corporate social Responsibility work (34, 35, 36)	
102-43	Approach to stakeholder engagement	Our corporate social Responsibility work (34, 35, 36) List of stakeholders (36, 37, 38)	
102-44	Key topics and concerns raised	List of stakeholders (36, 37, 38)	

GRI-indicator	Description	Location in the report	Information
Reporting practice			
102-45	Entities included in the consolidated financial statements		Kommunalbanken AS
102-46	Defining report content and topic Boundaries	Our corporate social Responsibility work (34, 35, 36) Materiality Analysis (38)	
102-47	List of material topics	Materiality Analysis (38)	
102-48	Restatements of information		None
102-49	Changes in reporting		None
102-50	Reporting period		2018
102-51	Date of previous Annual Report		28.02.2018
102-52	Reporting cycle		Annual
102-53	Contact point		TOR OLE STEINSLAND Chief Communications Officer (CCO) +47 98 24 70 16 tost@kommunalbanken.no
102-54	Claims of reporting in accordance with the GRI Standards		This report has been prepared in accordance with the GRI Standards: Core option.
102-55	GRI content index		Annual Report 2018, pages 101-105
102-56	External assurance		This report is not externally verified

SPECIFIC INFORMATION

GRI-indicator	Description	Location in the report	Information
Anti-corruption			
103-1	Explanation of the material topic and its boundary	2019 Objectives – Ethical conduct (48) 2019 Objectives – Expertise sharing and responsible lending (45, 46)	
103-2	The management approach and its components		
103-3	Evaluation of the management approach		
205-2	Communication and training about anti-corruption policies and procedures	2019 Objectives – Ethical conduct (48)	Partly reported. Kommunalbanken is working on complete reporting in 2019
205-3	Confirmed incidents of corruption and actions taken	Performance in 2018 – suppliers (41)	No confirmed incidents.
Diversity and equal opportunity			
103-1	Explanation of the material topic and its boundary	2019 Objectives – Diversity and equality (46, 47)	
103-2	The management approach and its components		
103-3	Evaluation of the management approach		
405-1	Diversity of governance bodies and employees	2019 Objectives – Diversity and equality (46, 47)	

	Women	Men
Top management	4	7
Other managers	4	4
Regular employees	28	36

	30 and below	30 - 50	50 +
Top management		6	4
Other managers		6	2
Regular employees	16	35	13

	Women	Men
Support	30	33
Core	6	13

	30 and below	30 - 50	50 +
Support	13	34	16
Core	3	13	3

GRI-indicator	Description	Location in the report	Information
405-2	Ratio of basic salary and remuneration of women to men	2019 Objectives – Diversity and equality (46, 47)	<table><tr><th></th><th>Ratio Women:Men</th></tr><tr><td>Support</td><td>0.96</td></tr><tr><td>Core</td><td>0.74</td></tr></table> Students are excluded from the calculations.
419-1	Non-compliance with laws and regulations in the social and economic area		Kommunalbanken has not identified any internal noncompliance with Norwegian or international regulations.
Product responsibility			
103-1	Explanation of the material topic and its boundary	The Board of Directors' Annual Report – Lending (22) Performance in 2018 – Green finance, Expertise sharing and responsible lending (39) 2019 Objectives – Green finance, Expertise sharing and responsible lending (43, 44, 45, 46)	
103-2	The management approach and its components		
103-3	Evaluation of the management approach		
FS8	Monetary value of products and services designed to deliver a specific environmental benefit for each business line broken down by purpose	The Board of Directors' Annual Report – Lending (22) 2019 Objectives - Green finance (43, 44)	

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