

# REPORT FOR FIRST QUARTER 2018



# ABOUT KBN

Established by an act of Parliament in 1926 as a state administrative body, Kommunalbanken AS (KBN) gained its current organisational form by a conversion act in 1999. KBN's primary objective is to provide stable and low cost funding to Norwegian municipalities, counties, intermunicipal companies and other companies with a municipal guarantee for their primary municipal investments.

## FINANCIAL HIGHLIGHTS

(Amounts in NOK 1 000 000)	January-March 2018	January-March 2017	2017
<b>RESULTS</b>			
Net interest income	495	561	2 162
Core earnings <sup>1</sup>	309	377	1 517
Profit before tax	632	480	1 783
Profit for the period	474	360	1 429
Return on equity after tax <sup>2</sup>	14.82%	12.57%	12.72 %
Return on equity after tax (core earnings) <sup>2</sup>	9.90%	13.16%	13.51 %
Return on assets after tax <sup>2</sup>	0.46%	0.34%	0.34 %
Return on assets after tax (core earnings) <sup>2</sup>	0.30%	0.35%	0.36 %
<b>LENDING</b>			
New disbursements	9 126	17 131	55 021
Outstanding loans <sup>3</sup>	282 884	275 700	281 706
<b>LIQUIDITY PORTFOLIO<sup>3</sup></b>	<b>90 540</b>	<b>117 390</b>	<b>107 484</b>
<b>BORROWINGS</b>			
New long-term borrowings	53 859	47 038	118 509
Repurchase of own debt	50	654	837
Redemptions	41 506	34 391	112 555
Total borrowings <sup>3</sup>	374 716	394 409	373 816
<b>TOTAL ASSETS</b>	<b>403 939</b>	<b>431 253</b>	<b>412 854</b>
<b>EQUITY</b>			
Total capital adequacy ratio	14 984	12 807	14 667
Tier 1 capital adequacy ratio	23.85%	21.01%	24.61%
Common equity Tier 1 capital adequacy ratio	21.01%	18.11%	21.65%
Leverage ratio	17.91%	16.67%	18.41%
	3.86%	2.95%	3.68%
<b>LIQUIDITY COVERAGE RATIO (LCR)<sup>4</sup></b>			
Total	596%	819%	570%
NOK	1 244%	2 999%	2 052%
EUR	239%	285%	233%
USD	597%	312%	308%
AUD	Infinite	60%	Infinite
JPY	1 654%	4 540%	185%

<sup>1</sup> Profit after tax adjusted for unrealised gain/(loss) on financial instruments after tax. This result measure is included to give relevant information about the company's underlying operations.

<sup>2</sup> Annualised return on equity after tax: Profit after tax/Core earnings as percentage of average equity and average assets.

<sup>3</sup> Principal amounts

<sup>4</sup> 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.

# SOLID OPERATIONS AND GOOD PROFIT FOR THE FIRST QUARTER

KBN's net interest income in the first quarter of 2018 was NOK 495 million as compared to NOK 561 million in the same period in 2017. One of the reasons for this decrease was a significant increase in Norwegian money market rates. The quarter's net interest income reflects KBN's good underlying operations, and profit for the first quarter of 2018 was higher than in the same period in 2017.

## RESULTS

Profit for the first quarter of 2018 was NOK 474 million as compared to NOK 360 million in the same period in 2017. The increase was principally due to unrealised gains on financial instruments, which contrasts with unrealised losses in the first quarter of 2017. The gains stem from changes in the value of KBN's debt as a result of higher interest rates and a change in the market conditions for KBN's currency swap agreements. Net interest income totalled NOK 495 million in the first quarter of 2018 as compared to NOK 561 million in the same period in 2017. The decrease is due to lower credit margins through the second half of 2017 and the first three months of 2018, as well as to higher money market rates and KBN's particularly strong earnings in the first quarter of 2017.

KBN only lends to local municipality customers and the probability of credit losses is accordingly extremely low. Section 55 of the Local Government Act stipulates that municipalities and county authorities cannot go bankrupt. In its entire history going back over 90 years, KBN has never experienced an actual loss on its lending and consequently has not previously made provisions for lending losses. However, it is not possible for KBN to continue this practice under the new IFRS 9 accounting standard which is introduced from 2018.

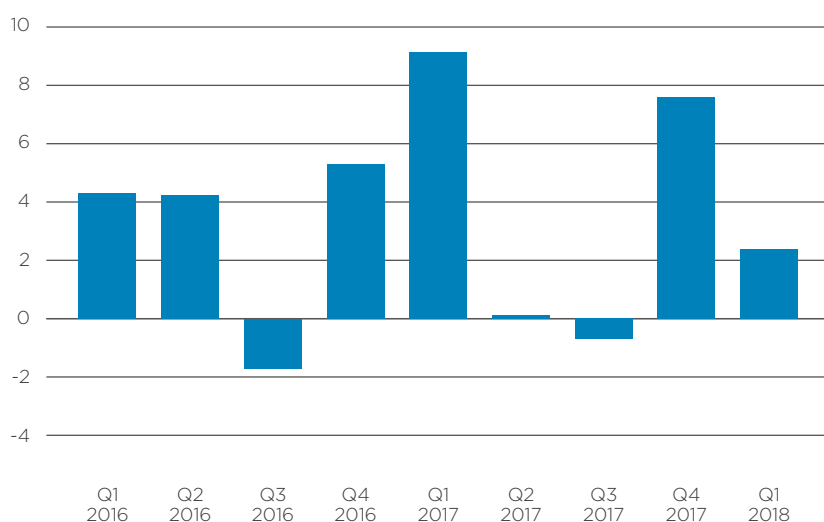
A consequence of the new standard is that KBN has introduced a theoretical model for credit losses. The new accounting standard requires KBN to make provisions for theoretical losses on its lending, despite its extremely low credit risk. KBN consequently

made very small provisions for losses in its accounts for the first quarter of 2018. Also with effect from 2018, changes in the value of debt measured at fair value that are due to changes in the issuer organisation's credit rating no longer form part of the issuer's earnings before tax, but will instead be included in other comprehensive income. The comparison figures are not affected by this and are therefore unchanged.

Total operating expenses for the first quarter of 2018 totalled NOK 54 million as compared to NOK 50 million in the same period in 2017. Operating expenses (annualised) represent 0.05% of total assets.

KBN achieved a return on equity after tax of 14.82% (annualised) in the first quarter of 2018. After adjusting for unrealised gains on financial instruments, the return on equity after tax was 9.90%.

LENDING GROWTH  
(amounts in NOK billion)



## LENDING

KBN's lending portfolio totalled NOK 283 billion at the end of the first quarter of 2018. KBN's lending portfolio grew NOK 1.2 billion or 0.42% in the first quarter of 2018. The overall rate of lending growth was lower than in the first quarter of 2017 due to both lower borrowing growth in the market and a lower level of demand for new loans. There was an even level of demand for the various maturities and types of lending product. KBN experienced increasing demand for green loans in the first quarter. Green loans, which are used to finance climate-friendly projects undertaken by the local government sector, showed an increase in new lending of almost 4% in the first quarter.

In the first quarter, new disbursements totalled NOK 9.1 billion as compared to NOK 17.1 billion in the first quarter of 2017. These figures include loans issued as new financing as well as refinancing of existing loans.

The rate of growth in local government sector debt is decreasing. At the end of February, local government sector debt growth stood at 4.5% on a rolling annualised basis, down from 5.3% at the end of 2017. KBN has reviewed the 2018 investment budgets of local authorities that together represent over half the outstanding interest-bearing debt held by the sector. This review has revealed an expected level of investment in 2018 in line with 2017.

## FINANCIAL MARKETS

### Funding

KBN's funding activities were somewhat more extensive in the first quarter of 2018 than in the same period in 2017 due to a significant need for refinancing and favourable underlying market conditions. New borrowings totalled approximately NOK 54 billion through 64 bond issues in 10 different currencies, as compared to NOK 47 billion in the same period in 2017. The largest single bond issued by KBN in the first quarter was a five-year USD 1.5 billion benchmark bond issued in January. This was followed by a two-year USD 1.25 billion bond issued in March. Both bonds were well received and were significantly oversubscribed at launch.

In addition to these benchmark bonds, KBN saw a good level of activity from AUD and GBP-based institutional investors. After a strong January in which KBN borrowed USD 800 million in the Japanese Uridashi market, KBN's funding activities in this market decreased in volume in line with its funding strategy. At the same time, KBN was in greater dialogue with NOK-based investors and new NOK-denominated borrowings totalled NOK 600 million in the first quarter.

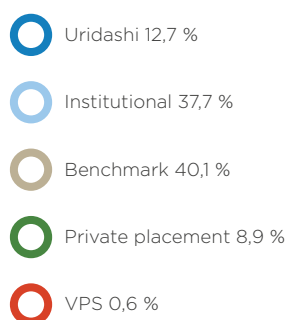
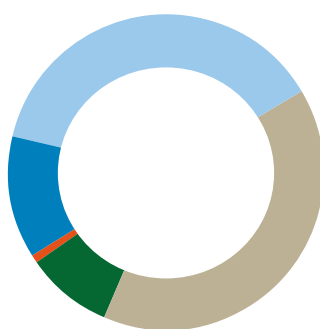
KBN's AAA/Aaa credit ratings ensure it has stable access to funding and low borrowing costs.

### Liquidity management

KBN's liquidity portfolio totalled NOK 90.5 billion at 31 March 2018 as compared to NOK 117.4 billion at the same point in 2017. The liquidity portfolio is principally held in zero-risk-weighted assets and primarily in foreign currencies. Fluctuations in the value of the Norwegian krone will therefore cause KBN's liquidity reserve to fluctuate in value.

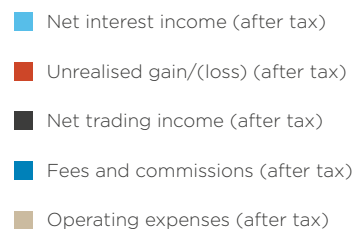
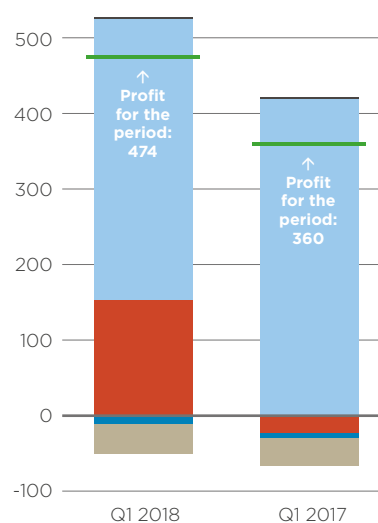
## KBN FUNDING MARKET

January-March 2018



## PROFIT AFTER TAX

(amounts in NOK million)



In the first quarter of 2018 the Norwegian krone strengthened against the US dollar by just over 4% in total. Exchange rate changes do not lead to currency risk as all KBN's investments are currency-hedged. However, a strong Norwegian krone does reduce the value of KBN's liquidity portfolio.

Credit margins for European states and state-guaranteed financial institutions fell slightly in the first quarter. Falling credit margins reduce the return on the liquidity portfolio over time. The cost of converting borrowings in foreign currencies into Norwegian krone has increased, and will in isolation lead to higher costs for funding in NOK terms over time.

There was a marked increase in money market interest rates in the quarter in both Norway and the USA.

## CAPITAL

At the end of the first quarter, KBN's total primary capital was NOK 16.8 billion, its total Tier 1 capital was NOK 14.8 billion, and its total common equity Tier 1 capital was NOK 12.6 billion. KBN's capital structure was unchanged in the quarter. At the end of the first quarter, KBN's total assets were NOK 9.0 billion lower than at 31

December 2017, principally due to the stronger Norwegian krone.

At the end of the first quarter, KBN had a common equity Tier 1 capital adequacy ratio of 17.91% (the capital requirements imposed by the authorities required KBN to have a common equity Tier 1 capital adequacy ratio of 15.4% at this point), a Tier 1 capital adequacy ratio of 21.01% (requirement of 16.9%), and a total capital adequacy ratio of 23.85% (requirement of 18.9%). KBN is also subject to a requirement to have a leverage ratio of 3%. KBN's leverage ratio at 31 March 2018 was 3.86%.

KBN manages its operations to ensure it complies with the regulatory requirements in force at any time. With effect from 31 December 2017, the requirements to which KBN is subject increased by 0.4% for the common equity Tier 1 capital adequacy ratio through a 0.5% increase in the countercyclical capital buffer, while KBN's Pillar 2 capital requirement reduced by 0.1%.

Oslo, 30 April 2018  
The Board of Directors  
of Kommunalbanken AS

# INTERIM CONDENSED FINANCIAL INFORMATION

## INCOME STATEMENT

<i>(Amounts in NOK 1 000 000)</i>	Note	January-March 2018	January-March 2017	2017
<i>Interest income from assets measured at amortised cost</i>		807	460	1 754
<i>Interest income from assets measured at fair value</i>		648	1 076	4 089
Total interest income		1 456	1 536	5 843
Interest expense		961	975	3 681
<b>Net interest income</b>	<b>1</b>	<b>495</b>	<b>561</b>	<b>2 162</b>
Fees and commission expenses		14	9	32
Net unrealised gain/(loss) on financial instruments	<b>2</b>	205	(29)	(163)
Expected credit loss	<b>6</b>	0	-	-
Net trading income		1	7	9
<b>Total other operating income</b>		<b>191</b>	<b>(31)</b>	<b>(186)</b>
Salaries and administrative expenses		40	36	132
Depreciation on fixed assets		5	5	21
Other expenses		9	9	40
<b>Total operating expenses</b>		<b>54</b>	<b>50</b>	<b>193</b>
<b>Profit before tax</b>		<b>632</b>	<b>480</b>	<b>1 783</b>
Income tax		158	120	354
<b>Profit for the period</b>		<b>474</b>	<b>360</b>	<b>1 429</b>
Portion allocated to shareholder		462	355	1 395
Portion allocated to owners of additional Tier 1 capital		12	5	34

## STATEMENT OF COMPREHENSIVE INCOME

<i>(Amounts in NOK 1 000 000)</i>	Note	January-March 2018	January-March 2017	2017
Profit for the period		474	360	1 429
<b>Other comprehensive income</b>				
<i>Items which will not be reclassified to profit or loss</i>				
Change in fair value of liabilities due to changes in own credit risk		(235)	-	-
Actuarial gain/(loss) on defined benefit plan		0	0	(1)
Tax effect		59	0	0
<b>Total other comprehensive income</b>		<b>(176)</b>	<b>0</b>	<b>(1)</b>
<b>Total comprehensive income for the period</b>		<b>298</b>	<b>360</b>	<b>1 428</b>

## STATEMENT OF FINANCIAL POSITION

<i>(Amounts in NOK 1 000 000)</i>	Note	31 March 2018	31 March 2017	31 December 2017
<b>Assets</b>				
Deposits with credit institutions	3,4	22 600	19 002	10 400
Instalment loans	3,4,5,6	283 800	276 984	283 396
Notes, bonds and other interest-bearing securities	3,4,6,7,8	88 792	117 278	107 445
Financial derivatives	3,4	8 613	17 174	11 476
Deferred tax asset		0	0	0
Other assets		135	815	137
<b>Total assets</b>		<b>403 939</b>	<b>431 253</b>	<b>412 854</b>
<b>Liabilities and equity</b>				
Loans from credit institutions	3,4	1 409	4 010	4 714
Senior securities issued	3,4,9	365 377	388 345	369 482
Financial derivatives	3,4	19 227	23 608	21 082
Other liabilities		46	426	86
Current tax liabilities		371	0	214
Deferred tax liabilities		500	12	551
Pension liabilities		50	52	50
Subordinated debt	3,4	1 977	1 992	2 008
<b>Total liabilities</b>		<b>388 955</b>	<b>418 445</b>	<b>398 187</b>
Share capital		3 145	3 145	3 145
Additional Tier 1 capital		2 189	994	2 189
Retained earnings		9 177	8 309	9 333
Total comprehensive income for the period		474	360	
<b>Total equity</b>	<b>10</b>	<b>14 984</b>	<b>12 807</b>	<b>14 667</b>
<b>Total liabilities and equity</b>		<b>403 939</b>	<b>431 253</b>	<b>412 854</b>

## STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)

### 1 January - 31 March 2018

	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 January 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 period	0	0	0	474	474
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	(176)	0	(176)
Other comprehensive income—actuarial gain/loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(5)	(5)
Dividends for 2017	0	0	0	0	0
<b>Equity as of 31 March 2018</b>	<b>3 145</b>	<b>2 189</b>	<b>(536)</b>	<b>10 185</b>	<b>14 984</b>

### 1 January - 31 March 2017

	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 period	0	0	0	360	360
Total other comprehensive income	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(5)	(5)
Dividends for 2016	0	0	0	0	0
<b>Equity as of 31 March 2017</b>	<b>3 145</b>	<b>994</b>	<b>0</b>	<b>8 669</b>	<b>12 807</b>

### 1 January - 31 December 2017

	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 period	0	0	0	1 429	1 429
Total other comprehensive income	0	0	0	(1)	(1)
Interest paid on Tier 1 capital	0	0	0	(18)	(18)
Issued additional Tier 1 capital	0	1 195	0	0	1 195
Dividends for 2016	0	0	0	(390)	(390)
<b>Equity as of 31 December 2017</b>	<b>3 145</b>	<b>2 189</b>	<b>0</b>	<b>9 333</b>	<b>14 667</b>

\*See further information and specification of the transition effects in equity on 1 January 2018 relating to the implementation of IFRS 9 under Accounting Policies below.

## STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)

	January-March 2018	January-March 2017	2017
<b>Cash flows from operating activities</b>			
Interest received	1 429	1 486	5 830
Interest paid	(626)	(806)	(3 310)
Fees and commissions paid	(14)	(9)	(32)
Receipts from repurchase of issued securities	1	7	9
Cash payments to employees and suppliers	(52)	(45)	(172)
Income taxes paid	0	(338)	404
Net disbursement of loans to customers	(1 179)	(9 142)	(15 148)
Net (increase)/decrease in deposits with credit institutions	(15 553)	(5 985)	3 527
Net (increase)/decrease in notes, bonds and other interest-bearing securities	15 245	2 726	14 406
Net (increase)/decrease in other assets	1	(663)	13
Net increase/(decrease) in other liabilities	(39)	600	36
Net (increase)/decrease in financial derivatives	(11 648)	0	(12 094)
<b>Net cash flows from operating activities</b>	<b>(12 434)</b>	<b>(12 168)</b>	<b>(6 531)</b>
<b>Cash flows from investing activities</b>			
Net (purchase)/sales of property and equipment	(1)	(4)	(18)
<b>Net cash flows from investing activities</b>	<b>(1)</b>	<b>(4)</b>	<b>(18)</b>
<b>Cash flows from financing activities</b>			
Proceeds from issuance of debt securities	53 860	47 038	118 509
Repayment of debt securities	(41 556)	(35 058)	(112 676)
Proceeds from issuance of additional Tier 1 capital	0	0	1 195
Interest paid on Tier 1 capital	(6)	(6)	(25)
Proceeds from issuance of subordinated debt	0	0	0
Repayment of subordinated debt	0	0	0
Dividends paid	0	0	(390)
<b>Net cash flows from financing activities</b>	<b>12 297</b>	<b>11 974</b>	<b>6 614</b>
<b>Net cash flows</b>	<b>(138)</b>	<b>(199)</b>	<b>65</b>
Effects of foreign exchange differences	(6)	226	(54)
<b>Net cash flows after foreign exchange differences</b>	<b>(144)</b>	<b>27</b>	<b>11</b>
Cash and cash equivalents at 1 January	87	76	76
Net change in cash and cash equivalents	(144)	27	11
<b>Cash and cash equivalents at end of period</b>	<b>(57)</b>	<b>103</b>	<b>87</b>
Whereof			
<i>Deposits with credit institutions without agreed time to maturity</i>	0	103	87
<i>Loans from credit institutions without agreed time to maturity</i>	(57)	0	0



## ACCOUNTING POLICIES

KBN prepares its financial statements in accordance with International Financial Reporting Standards (IFRS) as adopted by the EU. The interim financial statements as of 31 March 2018 are prepared in accordance with IAS 34 Interim Financial Reporting, and follow the same accounting policies as presented in the annual financial statements for 2017.

The preparation of financial statements in accordance with IFRS requires that management uses estimates and judgements that may affect the carrying amounts of assets and liabilities, and revenues and costs. Estimates and judgements are based on historical experience and expectations regarding future developments and actual outcomes may deviate from the estimates.

Fair value of financial instruments that are not traded in an active market or where quoted prices are not readily available on the reporting date is determined using valuation techniques. The measurement of fair value requires management to make judgements and assumptions related to credit and liquidity risk related to the financial instruments. Even though the judgements and assumptions are based to the largest extent possible on actual market conditions on the reporting date, they may increase the uncertainty related to carrying amounts.

IFRS 9 *Financial Instruments* replaces IAS 39 *Financial Instruments – Recognition and Measurement* and KBN reports under IFRS 9 *Financial Instruments*, that became effective 1 January 2018, for the first time. New accounting policies for financial instruments under IFRS 9 *Financial Instruments* are as follows, and replace the corresponding policies for financial instruments as presented in the Annual Report 2017.

### FINANCIAL INSTRUMENTS

#### Recognition and derecognition

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

Financial assets are derecognized when the contractual rights to the cash flows expire or are transferred. Financial liabilities are derecognized when the contractual obligation has been discharged, cancelled or has expired. When issued debt securities are repurchased, the liability is derecognized. Any difference between the settlement amount and the carrying amount is recognized 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 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. Lending subject to fair value hedging is 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, 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 for 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 are designated as hedged items and hedge accounting is applied. This implies that value changes that are attributable to the hedged risk are recognized 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 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 normalised 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 ongoing basis using Dollar-offset method. Any ineffective part of the hedge is recognized in the Income statement.

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

## 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. 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 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 9, 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, cash flow hedging for parts of the liquidity portfolio is considered, but only for bonds purchased after the system solution for cash flow hedging is in place. Furthermore, it has been decided to introduce portfolio hedging of interest rate risk for parts of the lending portfolio (Instalment loans with fixed interest rate), for Instalment loans granted after the system solution for portfolio hedge is in place. 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.

Implementation of IFRS 9 leads to KBN recognising and presenting provisions for credit losses for the first time in its history. However, the recognised provisions are very small due to the quality of the portfolio. Loss provisions reduce equity and will increase the volatility of profit or loss going forward, especially if a significant increase in credit risk is seen to occur. All relevant exposures were considered to be in stage 1 as of 31 December 2017 and are still in stage 1 as of 31 March 2018. See the table below for measurement categories for relevant balance sheet items under IAS 39 and IFRS 9 as at 1 January 2018, and related carrying amounts.

(Amounts in NOK 1 000 000)

1 January 2018	Measurement category IAS 39	Measurement category IFRS 9	Carrying amount IAS 39	Carrying amount IFRS 9
Deposits with credit institutions	At fair value through profit or loss (FVO)	Amortised cost	1 228	1 228
Deposits with credit institutions	Loans and receivables	Amortised cost	9 172	9 172
<b>Deposits with credit institutions</b>			<b>10 400</b>	<b>10 400</b>
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
<b>Instalment loans</b>			<b>283 396</b>	<b>283 367</b>
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
<b>Notes, bonds and other interest-bearing securities</b>			<b>107 445</b>	<b>107 421</b>
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
<b>Financial derivatives</b>			<b>11 476</b>	<b>11 476</b>
<b>Total financial assets</b>			<b>412 717</b>	<b>412 664</b>
<b>Loans from credit institutions</b>	Other liabilities	Amortised cost	<b>4 714</b>	<b>4 714</b>
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
<b>Senior securities issued</b>			<b>369 482</b>	<b>369 399</b>
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
<b>Financial derivatives</b>			<b>21 082</b>	<b>21 082</b>
<b>Subordinated debt</b>	At fair value through profit or loss (FVO)	At fair value through profit or loss (FVO) and OCI (own credit)	<b>2 008</b>	<b>2 008</b>
<b>Total financial liabilities</b>			<b>397 286</b>	<b>397 203</b>

The following table shows transition effects:

(Amounts in NOK 1 000 000)

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

\*Amounts before tax. In the Statement of changes in equity the effects are shown after tax.

\*\*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 the column Retained earnings to Value changes on liabilities due to changes in own credit risk in the Statement of changes in equity on the transition date.

## NOTE 1

### Net interest income

(Amounts in NOK 1 000 000)

#### January-March 2018 (IFRS 9)

	Total	At fair value through profit or loss			Total at fair value	Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge		
Deposits with credit institutions	9	0	0	0	0	9
Instalment loans	1 140	393	0	0	393	747
Notes, bonds and other interest-bearing securities	115	63	0	0	63	52
Financial derivatives	192	0	192	0	192	0
<b>Total interest income</b>	<b>1 456</b>	<b>456</b>	<b>192</b>	<b>0</b>	<b>648</b>	<b>807</b>
Loans from credit institutions	1	0	0	0	0	1
Senior securities issued	2 591	1 696	0	0	1 696	895
Financial derivatives	(1 646)	0	(1 591)	(55)	(1 646)	0
Subordinated debt	15	15	0	0	15	0
<b>Interest expense</b>	<b>961</b>	<b>1 711</b>	<b>(1 591)</b>	<b>(55)</b>	<b>65</b>	<b>896</b>
<b>Net interest income</b>	<b>495</b>	<b>(1 255)</b>	<b>1 784</b>	<b>55</b>	<b>583</b>	<b>(88)</b>

#### January– March 2017 (IAS 39)

	Total	At fair value	Amortised cost
Interest income	1 536	1 076	460
Interest expense	975	354	621
<b>Net interest income</b>	<b>561</b>	<b>722</b>	<b>(161)</b>

#### 2017 (IAS 39)

	Total	At fair value	Amortised cost
Interest income	5 843	4 089	1 754
Interest expense	3 681	1 188	2 492
<b>Net interest income</b>	<b>2 162</b>	<b>2 901</b>	<b>(738)</b>

## NOTE 2

### Net unrealised gain/(loss) on financial instruments

(Amounts in NOK 1 000 000)

	January-March 2018	January-March 2017	2017
Instalment loans	(742)	277	760
Notes, bonds and other interest-bearing securities	(140)	113	71
Financial derivatives	(4 030)	1 531	2 271
Loans from credit institutions	0	0	0
Senior securities issued	5 071	(1 948)	(3 231)
Subordinated debt	46	(3)	(34)
<b>Net unrealised gain/(loss) on financial instruments</b>	<b>205</b>	<b>(29)</b>	<b>(163)</b>

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 9 Senior securities issued for information on calculating 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 fixed rate instalment loans may on the other hand lead to significant Income statement effects, as may changes in basis swap spreads.

Net unrealised gains in the first quarter of 2018 amounting to NOK 205 million come from Senior securities issued due to a tightening of USD-NOK basis swap spreads and increase in 3m USD Libor.

## NOTE 3

### Classification of financial instruments

(Amounts in NOK 1 000 000)

At 31 March 2018 (IFRS 9)

	Total	At fair value through profit or loss			Amortised cost
		Fair value option	Mandato-ry at fair value	Fair value hedge	
Deposits with credit institutions	22 600	0	0	0	22 600
Instalment loans	283 800	76 346	0	0	207 454
Notes, bonds and other interest-bearing securities	88 792	68 485	0	0	20 307
Financial derivatives	8 613	0	8 613	0	0
<b>Total financial assets</b>	<b>403 805</b>	<b>144 831</b>	<b>8 613</b>	<b>0</b>	<b>250 361</b>
Loans from credit institutions	1 409	0	0	0	1 409
Senior securities issued	365 377	160 155	0	0	205 222
Financial derivatives	19 227	0	17 185	2 042	0
Subordinated debt	1 977	1 977	0	0	0
<b>Total financial liabilities</b>	<b>387 989</b>	<b>162 132</b>	<b>17 185</b>	<b>2 042</b>	<b>206 631</b>

At 31 March 2017 (IAS 39)

	Total	At fair value through profit or loss				Held to maturity	Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge				
Deposits with credit institutions	19 002	8 635	0	0	0	10 264	103	
Instalment loans	276 984	168 748	0	0	0	108 234	0	
Notes, bonds and other interest-bearing securities	117 278	116 429	0	0	20	829	0	
Financial derivatives	17 174	0	16 043	1 130	0	0	0	
<b>Total financial assets</b>	<b>430 436</b>	<b>293 813</b>	<b>16 043</b>	<b>1 130</b>	<b>20</b>	<b>119 328</b>	<b>103</b>	
Loans from credit institutions	4 010	0	0	0	0	0	4 010	
Senior securities issued	388 345	229 505	0	0	0	0	158 839	
Financial derivatives	23 608	0	22 383	1 225	0	0	0	
Subordinated debt	1 992	1 992	0	0	0	0	0	
<b>Total financial liabilities</b>	<b>417 953</b>	<b>231 497</b>	<b>22 383</b>	<b>1 225</b>	<b>0</b>	<b>0</b>	<b>162 850</b>	

At 31 December 2017 (IAS 39)

	Total	At fair value through profit or loss				Held to maturity	Loans and receivables	Other liabilities
		Fair value option	Held for trading	Fair value hedge				
Deposits with credit institutions	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	
<b>Total financial assets</b>	<b>412 717</b>	<b>277 440</b>	<b>10 805</b>	<b>671</b>	<b>10</b>	<b>123 791</b>	<b>0</b>	
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	
<b>Total financial liabilities</b>	<b>397 286</b>	<b>213 398</b>	<b>19 720</b>	<b>1 362</b>	<b>0</b>	<b>0</b>	<b>162 806</b>	

## NOTE 4

### Financial instruments measured at 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

See Note 11 in the Annual Report 2017 for further information about valuation techniques, inputs, value change analysis and sensitivities. Financial instruments measured at fair value in KBN's Statement of financial position as of 31 March 2018 are distributed in the following way in the fair value hierarchy:

<i>(Amounts in NOK 1 000 000)</i>	Level 1	Level 2	Level 3	Total
Deposits with credit institutions	0	0	0	0
Instalment loans	0	9 260	67 085	76 346
Notes, bonds and other interest-bearing securities	68 209	197	79	68 485
Financial derivatives	0	6 040	2 573	8 613
<b>Total financial assets measured at fair value</b>	<b>68 209</b>	<b>15 497</b>	<b>69 737</b>	<b>153 444</b>
Loans from credit institutions	0	0	0	0
Senior securities issued	7 540	73 093	79 522	160 155
Financial derivatives	0	8 012	11 215	19 227
Subordinated debt	0	0	1 977	1 977
<b>Total financial liabilities measured at fair value</b>	<b>7 540</b>	<b>81 105</b>	<b>92 714</b>	<b>181 359</b>

### Reconciliation of movements in Level 3

	Instalment loans	Notes, bonds and other interest-bearing securities	Senior securities issued	Subordinated debt	Financial derivatives
<b>Carrying amount at 31 December 2017</b>	<b>69 313</b>	<b>574</b>	<b>80 159</b>	<b>2 008</b>	<b>(10 183)</b>
Purchase	0	0	0	0	(477)
Sale	0	0	0	0	0
Issue	3 795	0	11 006	0	0
Settlement	(4 709)	(153)	(8 421)	0	2 798
Transfer into Level 3	362	79	0	0	0
Transfer out of Level 3	(1 051)	(248)	0	0	0
Gain/(loss) recognised in the period	(625)	(173)	(3 222)	(31)	(780)
<b>Carrying amount at 31 March 2018</b>	<b>67 085</b>	<b>79</b>	<b>79 522</b>	<b>1 977</b>	<b>(8 642)</b>

Holdings amounting to approximately NOK 12 billion have been transferred from Level 2 to Level 1 in the first quarter of 2018. There are net transfers of NOK 858 million out of Level 3 in the quarter. The transfers into and out of Level 3 are mainly due to changes in market conditions that affect the assessment of inputs to the valuation techniques during the reporting period, and refinancing/change of loan product for Instalment loans. All gains/(losses) on financial instruments in Level 3 are recognised in the Income statement under "Net interest income", "Net unrealised gain/(loss) on financial instruments" or "Net trading income", or in Other comprehensive income.

#### Information on valuation techniques:

The methods used for determining the fair value of financial instruments are defined based on the instruments' features and structure. Fair value of financial instruments without embedded derivatives or option elements is determined using the discounted cash flows method, where discount rates are derived from the relevant observable money market interest rates and other significant risk factors that may affect the fair value of the instruments. When such factors cannot be reliably observed at a reporting date, management may make assumptions and use estimates when determining fair value. Fair value of financial instruments with embedded derivatives or option elements is determined using a combination of a discounted cash flow method and option pricing models with observable market data and estimates as inputs. The most significant unobservable inputs used in the valuation in Level 3 are credit spreads for financial instruments not traded in an active market. The table below shows the impact of a 10 bp increase in the credit spread for financial assets and liabilities in Level 3 at 31 March 2018:

	31 March 2018
Instalment loans	(266)
Notes, bonds and other interest-bearing securities	0
Financial derivatives	36
Senior securities issued	374
Subordinated debt	20
<b>Total</b>	<b>164</b>



## NOTE 5

### Instalment loans

(Amounts in NOK 1 000 000)

	31 March 2018 (IFRS 9)	31 March 2017 (IAS 39)	31 December 2017 (IAS 39)
Principal amount	282 884	275 700	281 706
Accrued interest	1 018	1 099	1 023
Fair value adjustment	(93)	184	667
Expected credit loss	(11)	-	-
<b>Total instalment loans</b>	<b>283 800</b>	<b>276 984</b>	<b>283 396</b>
Transition effect Expected credit loss on 1 January 2018			(10)
Transition effect reclassification on 1 January 2018			(18)
<b>Carrying amount on 1 January 2018 (IFRS 9)</b>			<b>283 367</b>

## NOTE 6

### 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.

(Amounts in NOK 1 000 000)	31 March 2018		1 January 2018	January-March 2018
	Carrying amount	Expected credit loss	Expected credit loss	Expected credit loss
Instalment loans	207 454	(11)	(10)	(1)
Notes, bonds and other interest-bearing securities	20 307	0	(1)	1
<b>Total</b>		<b>(11)</b>	<b>(11)</b>	<b>0</b>

The following table shows an allocation of KBN's expected credit losses as at 31 March 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	0	0	0
<b>Total expected credit loss</b>	<b>(11)</b>	<b>0</b>	<b>0</b>

## NOTE 7

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

(Amounts in NOK 1 000 000)

Notes, bonds and other interest-bearing securities by type of issuer	31 March 2018 (IFRS 9)	31 March 2017 (IAS 39)	31 December 2017 (IAS 39)
Domestic			
Issued by other borrowers	4 802	2 135	5 938
Foreign			
Issued by public bodies <sup>1</sup>	79 931	106 450	96 696
Issued by other borrowers	4 060	8 693	4 809
<b>Total notes, bonds and other interest-bearing securities</b>	<b>88 792</b>	<b>117 278</b>	<b>107 445</b>

<sup>1</sup>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	31 March 2018 (IFRS 9)	31 March 2017 (IAS 39)	31 December 2017 (IAS 39)
Under 1 year	60 143	56 338	68 980
1-5 years	23 626	54 820	33 073
Over 5 years	5 024	6 120	5 391
<b>Total notes, bonds and other interest-bearing securities</b>	<b>88 792</b>	<b>117 278</b>	<b>107 445</b>

## NOTE 8

### Credit exposure in notes, bonds and other interest-bearing securities

Amounts in the table below represent actual credit exposure

(Amounts in NOK 1 000 000)

Exposure as at 31 March 2018

Time to maturity	< 1 year				> 1 year					Total
	A-1	A-2	A-3	Not rated	BBB	A	AA	AAA	Not rated	
Sovereigns and central banks	12 551	0	0	0	0	0	10 788	847	0	<b>24 187</b>
Multilateral development banks	8 058	0	0	0	0	0	916	3 024	0	<b>11 998</b>
Regional authorities	31 687	0	0	3 775	0	0	4 471	2 816	998	<b>43 746</b>
Financial institutions	0	0	0	0	0	0	0	0	0	<b>0</b>
Securitisation	9	0	0	0	0	0	0	0	0	<b>9</b>
Covered bonds	3 316	0	0	746	0	0	0	4 790	0	<b>8 853</b>
<b>Total</b>	<b>55 622</b>	<b>0</b>	<b>0</b>	<b>4 521</b>	<b>0</b>	<b>0</b>	<b>16 175</b>	<b>11 478</b>	<b>998</b>	<b>88 792</b>

## NOTE 9

### Senior securities issued

(Amounts in NOK 1 000 000)

31 March 2018  
(IFRS 9)

31 March 2017  
(IAS 39)

31 December 2017  
(IAS 39)

<b>Senior securities issued (nominal amounts) as at 1 January</b>	<b>373 816</b>	<b>376 785</b>	<b>376 785</b>
New issuance	53 859	47 038	118 509
Redemptions	(41 903)	(35 045)	(113 392)
Amortisation	347	(13)	716
Translation differences	(11 403)	5 644	(8 802)
<b>Senior securities issued (nominal amounts) as at end of period</b>	<b>374 716</b>	<b>394 409</b>	<b>373 816</b>
Accrued interest	3 252	2 887	3 336
Fair value adjustment	(12 589)	(8 952)	(7 670)
Of which value change that is due to change in own credit risk	(715)	-	-
Of which value change that is due to other reasons	(11 875)	-	-
<b>Total senior securities issued</b>	<b>365 377</b>	<b>388 345</b>	<b>369 482</b>
Transition effect on 1 January 2018 due to reclassification*			(84)
<b>Carrying amount on 1 January 2018 (IFRS 9)</b>			<b>369 399</b>

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

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 converted to 3M USD Libor, Euribor or Nibor interest rates, i.e. after adjustment for any conversion 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.

## NOTE 10

### Primary capital

(Amounts in NOK 1 000 000)

31 March 2018 31 March 2017 31 December 2017

<i>Common equity Tier 1 capital</i>			
Share capital	3 145	3 145	3 145
Retained earnings	8 734	7 919	7 904
Profit for the period included in Tier 1 capital	474	360	1 429
Pension funds above pension commitments	0	0	0
Deferred tax asset*	0	0	0
Intangible assets	(122)	(134)	(125)
Dividends payable	(120)	(112)	(443)
Other additions/deductions in common equity Tier 1 capital	512	329	525
Share of nulled unamortised estimate differences	0	0	0
<b>Total common equity Tier 1 capital</b>	<b>12 622</b>	<b>11 507</b>	<b>12 436</b>
Other approved Tier 1 capital	2 189	994	2 189
<b>Total Tier 1 capital</b>	<b>14 811</b>	<b>12 500</b>	<b>14 625</b>
<i>Supplementary capital</i>			
Ordinary subordinated debt	2 000	2 000	2 000
<b>Total supplementary capital</b>	<b>2 000</b>	<b>2 000</b>	<b>2 000</b>
<b>Total primary capital</b>	<b>16 811</b>	<b>14 500</b>	<b>16 625</b>

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

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

## NOTE 11

### Capital adequacy

(Amounts in NOK 1 000 000)

	31 March 2018		31 March 2017	31 December 2017
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Minimum capital requirements
<b>Credit risk</b>				
Sovereigns and central banks	24 187	0	0	0
Regional governments and local authorities	319 827	57 402	4 592	4 587
<i>Of which are Norwegian municipalities</i>	283 762	57 402	4 592	4 587
Public sector entities	7 680	0	0	0
Multilateral development banks	11 998	0	0	0
Financial institutions	27 709	5 916	473	496
<i>Of which counterparty exposure on derivatives</i>	5 467	1 468	117	183
Claims secured by residential property	38	38	3	3
Covered bonds	8 853	885	71	79
Other assets	13	13	1	2
Securitisation	9	8	1	1
Credit Valuation Adjustment	208	2 598	208	217
<b>Total credit risk</b>	<b>400 522</b>	<b>66 861</b>	<b>5 349</b>	<b>5 288</b>
<b>Market risk</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Operational risk—Basic Indicator Approach</b>	<b>3 629</b>	<b>290</b>	<b>233</b>	<b>254</b>
<b>Minimum capital requirements</b>	<b>70 490</b>	<b>5 639</b>	<b>5 521</b>	<b>5 404</b>
<b>Total capital ratio</b>		<b>23.85 %</b>	<b>21.01 %</b>	<b>24.61 %</b>
<b>Tier 1 capital adequacy ratio</b>		<b>21.01 %</b>	<b>18.11 %</b>	<b>21.65 %</b>
<b>Common equity Tier 1 capital adequacy ratio</b>		<b>17.91 %</b>	<b>16.67 %</b>	<b>18.41 %</b>
<b>Leverage ratio</b>		<b>3.86%</b>	<b>2.95%</b>	<b>3.68%</b>

