REPORT FOR FIRST QUARTER 2019

KBN Kommunalbanken Norway

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.

Lenangen school is financed with KBNs green lending rate. Photo: John Trygve Tollefsen

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.

FINANCIAL HIGHLIGHTS

(Amounts in NOK 1 000 000)	**January-March 2019**	**January-March 2018**	**2018**
RESULTS			
Net interest income	458	495	1 885
Core earnings[1]	273	309	1 194
Profit before tax	217	632	1 996
Profit for the period	164	474	1 496
Return on equity after tax[2]	4.5 %	14.8%	11.9%
Return on equity after tax (core earnings)[2]	8.2 %	9.9%	9.8%
Return on assets after tax[2]	0.1 %	0.5%	0.4%
Return on assets after tax (core earnings)[2]	0.2 %	0.3%	0.3%
LENDING			
New disbursements	13 129	9 126	55 749
Outstanding loans[3]	305 740	282 884	302 229
LIQUIDITY PORTFOLIO[3]	111 446	90 540	113 557
BORROWINGS			
New long-term borrowings	34 787	53 859	104 844
Repurchase of own debt	8	50	206
Redemptions	26 137	41 506	79 937
Total borrowings[3]	421 647	374 716	414 603
TOTAL ASSETS	461 830	403 939	457 701
EQUITY	15 801	14 984	15 421
Total capital adequacy ratio	22.4 %	23.9%	22.9%
Tier 1 capital adequacy ratio	19.8 %	21.0%	20.3%
Common equity Tier 1 capital adequacy ratio	17.0 %	17.9%	17.4%
Leverage ratio	3.5 %	3.9%	3.6%
LIQUIDITY COVERAGE RATIO (LCR)[4]			
Total	310%	359%	349%
NOK	73%	9%	56%
EUR	135%	592%	625%
USD	346%	607%	248%
AUD	586%	Infinite	489%
JPY	3 922%	5 286%	Infinite
OTHER KEY FIGURES			
Green loans[5]	19 463	12 346	18 800

[1] *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.*

[2] *Annualised return on equity after tax: Profit after tax/Core earnings 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 2018 have been changed accordingly.*

[5] *Outstanding green loans according to KBN's set of criteria for green loans. 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.*

GOOD LEVEL OF LENDING ACTIVITY

KBN's net interest income in the first quarter of 2019 was NOK 458 million as compared to NOK 495 million in the same period in 2018. Its lending portfolio grew by 1.2% in the first three months of the year, compared to growth of 0.4% in the same period in 2018. NOK 663 million was disbursed in new, green loans.

RESULTS

Profit for the first quarter of 2019 was NOK 164 million as compared to NOK 474 million in the same period in 2018. Unrealised losses of NOK 164 million related to changes in the value of financial hedging instruments reduced KBN's profit for the first quarter. In the first quarter of 2018, unrealised gains of NOK 205 million were recognised.

Net interest income totalled NOK 458 million in the first quarter of 2019 as compared to NOK 495 million in the same period in 2018. The decrease was in line with KBN's expectations and should be viewed in the context of KBN's strong earnings at the start of 2018 and increased borrowing costs in Norwegian kroner in the first quarter of 2019. KBN's margins were lower than in the first quarter of 2018 due to less favourable prices for converting borrowings denominated in foreign currencies into Norwegian kroner as well as to lower credit spreads in the local government bond market.

TABLE 1
Profit for the period

	Q1 2019	Q1 2018	2018
Profit for the period	**164**	**474**	**1 496**
Net interest income	458	495	1 885
Fees and commission expenses	21	14	34
Net unrealised gain/(loss) on financial instruments	(164)	205	338
Expected credit loss	0	0	(1)
Net trading income	3	1	17
Total operating expenses	60	54	209
Income tax	52	158	499

Amounts in NOK 1 000 000

KBN's core earnings totalled NOK 273 million in the first quarter of 2019 as compared to NOK 309 million in the same period in 2018. The line item "Fees and commission expenses" includes a provision of NOK 15 million for KBN's accrued contribution to a resolution fund. The provision is based on the Norwegian Ministry of Finance's assessment in Proposition to the Storting (Prop.) 159 L (2016-17) according to which KBN's activities are especially low risk in relation to the resolution fund.

Total comprehensive income in the first quarter amounted to NOK 387 million, compared to NOK 298 million in the same period in 2018. Unrealised gains on KBN-issued bonds recognised as part of total comprehensive income totalled NOK 296 million. The gains were due to the fact that the fair value of the bonds decreases when credit spreads rise. The equivalent changes in the first quarter of 2018 led to unrealised losses of NOK 235 million in the period, as the fair value of KBN's bonds increased.

TABLE 2

Comprehensive income for the period

	Q1 2019	Q1 2018	2018
Total comprehensive income for the period	**387**	**298**	**1 223**
Profit for the period	164	474	1 496
Unrealised change in fair value of liabilities (and related financial derivatives) after tax due to changes in own credit risk	296	(235)	(365)
Actuarial gain/(loss) on defined benefit plan	0	0	1
Tax effect on positions in Statement of comprehensive income	(74)	59	91

Amounts in NOK 1 000 000

KBN's total operating expenses for the first quarter of 2019 were NOK 60 million, as compared to NOK 54 million in the same period in 2018. The increase primarily relates to higher expenses associated with the development of new digital customer tools. Operating expenses (annualised) represented 0.05% of KBN's total assets.

Based on profit for the period, KBN achieved a return on equity after tax of 4.5% (annualised) in the first quarter of 2019, compared to 14.8% in the first quarter of 2018. Based on its core earnings, KBN achieved a return on equity after tax of 8.2%, compared to 9.9% in the first quarter of 2018.

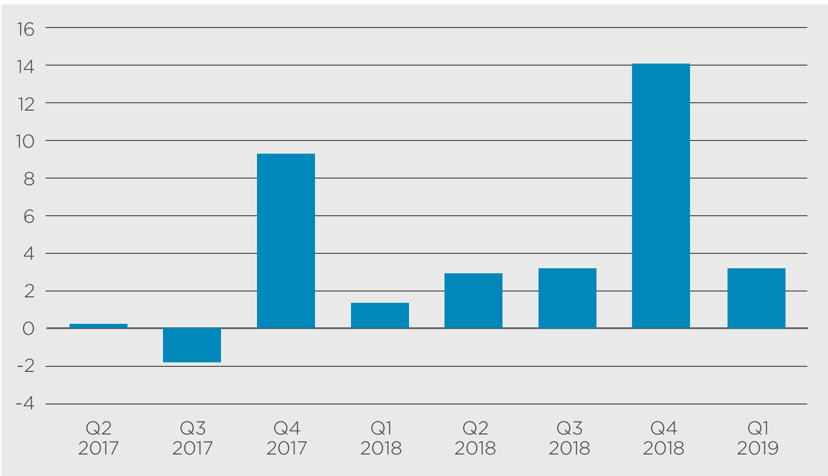
LENDING

KBN's lending portfolio totalled NOK 305.7 billion at the end of the first quarter of 2019. In the first quarter of 2019 KBN's lending portfolio grew by NOK 3.5 billion, equivalent to growth of 1.2%. KBN's lending portfolio grew by 0.4% in the same period in 2018.

New loan disbursements totalled NOK 13.1 billion in the first quarter of 2019 as compared to NOK 9.1 billion in the same period in 2018. These figures include loans disbursed both as new financing and as refinancing for existing loans.

LENDING GROWTH

Amounts in NOK 1 000 000 000



Eight green loans totalling NOK 663 million were disbursed in the first quarter as compared to NOK 846 million in the same period in 2018. The projects that were financed range from a shore-side power supply in Kristiansund and a recycling centre in Hedmarken to an upper secondary school in an energy-plus standard building in Tvedestrand.

The rate of debt growth in the local government sector according to Statistics Norway's credit indicator (C2) increased significantly toward the end of 2018, and at the end of February 2019 growth over the previous twelve months was 7.3%. KBN's own lending growth was in line with the C2 credit indicator over the same period. KBN's market share is approximately 48% at February 2019.

FINANCIAL MARKETS

FUNDING

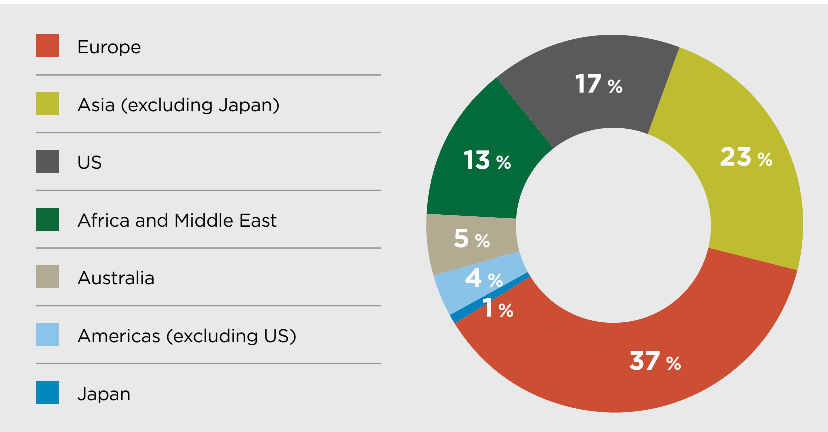
KBN's funding activities were less extensive in the first quarter of 2019 than in the same period in 2018 due to a reduced need for financing. There was a positive underlying tone in the capital markets, with KBN enjoying good market access throughout the quarter despite the political turmoil associated with the UK's withdrawal from the EU.

New borrowings totalled approximately NOK 35 billion through 16 bond issues in six currencies in the first quarter of 2019, compared to NOK 54 billion in the same period in 2018. The largest single bond issued by KBN in the first quarter of 2019 was a five-year USD 1.25 billion benchmark bond issued in January, which was well received by the market and significantly oversubscribed at launch. KBN also issued a significant volume of debt in US dollars in the form of variable rate bonds with maturities of between 18 and 24 months, with the total amount raised amounting to USD 1.45 billion.

In the first quarter KBN also saw a high level of activity from institutional investors that operate in Australian dollars, British pounds and Swedish kronor. The volume KBN borrowed in the Uridashi market was significantly lower than in the first quarter of 2018 in line with KBN's funding strategy. KBN enjoys low borrowing costs and good market access thanks to its AAA/Aaa rating.

FUNDING

Investor geography first quarter 2019.



LIQUIDITY MANAGEMENT

KBN's liquidity portfolio totalled NOK 111.4 billion at 31 March 2019 as compared to NOK 90.5 billion at the end of the first quarter of 2018. The liquidity portfolio should, over time, equal 12 months capital requirements allowing for growth in lending, and managed according to a low risk investment strategy.

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.

The credit margins for European countries, state-guaranteed financial institutions and covered bonds fell over the course of the first quarter. Falling credit margins reduce the return generated by the liquidity portfolio over time.

As expected, Norges Bank raised its key policy rate by one quarter of a percentage point to 1.0% in March 2019. This increase was expected, but the central bank indicated at the same time that it would be raising rates more quickly than it had previously indicated. However, Norges Bank does not expect its key policy rate to return to as high a level as before. According to its updated interest rate path, the key policy rate will reach 1.75% before levelling off in 2020.

CAPITAL

At the end of the first quarter of 2019, KBN's total common equity Tier 1 capital was NOK 13.3 billion, its total Tier 1 capital was NOK 15.5 billion and its total primary capital was NOK 17.5 billion. KBN's capital structure did not change in the quarter. KBN's total assets have increased by NOK 4.1 billion since 31 December 2018, principally due to lending growth and higher borrowing.

At the end of the first quarter, KBN had a common equity Tier 1 capital adequacy ratio of 17.0%, a Tier 1 capital adequacy ratio of 19.8%, and a total capital adequacy ratio of 22.4%. The capital requirements imposed by the authorities at the end of the first quarter required KBN to have a common equity Tier 1 capital adequacy ratio of 15.4%, a Tier 1 capital adequacy ratio of 16.9%, and a total capital adequacy ratio of 18.9%. With effect from 31 December 2019, the requirements to which KBN is subject will increase to 15.9% for the common equity Tier 1 capital adequacy ratio, 17.4% for the Tier 1 capital adequacy ratio, and 19.4% for the total capital adequacy ratio. KBN's leverage ratio at the end of the first quarter was 3.5%, which compares with the official requirement of 3.0%.

INTERIM CONDENSED FINANCIAL INFORMATION

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	January-March 2019	January-March 2018	2018
Interest income from assets measured at amortised cost		*1 123*	*807*	*3 738*
Interest income from assets measured at fair value		*944*	*648*	*3 017*
Total interest income		2 067	1 456	6 755
Total interest expense		1 609	961	4 871
Net interest income	**1**	**458**	**495**	1 885
Fees and commission expenses		21	14	34
Net unrealised gain/(loss) on financial instruments	**2**	(164)	205	338
Expected credit loss	**6**	0	0	1
Net trading income		3	1	17
Total other operating income		**(182)**	**191**	320
Salaries and administrative expenses		41	40	142
Depreciation on fixed assets		6	5	22
Other expenses		14	9	46
Total operating expenses		**60**	**54**	209
Profit before tax		**217**	**632**	1 996
Income tax		52	158	499
Profit for the period		**164**	**474**	1 496
Portion allocated to shareholder		152	462	1 448
Portion allocated to owners of additional Tier 1 capital		13	12	48

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	January-March 2019	January-March 2018	2018
Profit for the period		164	474	1 496
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		296	(235)	(365)
Actuarial gain/(loss) on defined benefit plan		0	0	1
Tax effect		*(74)*	*59*	*91*
Total other comprehensive income		**222**	**(176)**	**(273)**
Total comprehensive income for the period		**387**	**298**	**1 223**

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	31 March 2019	31 March 2018	31 December 2018
Assets				
Deposits with credit institutions	**3,4**	29 659	22 600	22 987
Instalment loans	**3,4,5,6**	307 317	283 800	303 571
Notes, bonds and other interest-bearing securities	**3,4,6,7,8**	114 418	88 792	116 519
Financial derivatives	**3,4**	10 267	8 613	14 497
Other assets		169	135	127
Total assets		**461 830**	**403 939**	**457 701**
Liabilities and equity				
Loans from credit institutions	**3,4**	4 370	1 409	12 085
Senior securities issued	**3,4,9**	414 280	365 377	402 916
Financial derivatives	**3,4**	23 917	19 227	24 051
Other liabilities		108	46	34
Current tax liabilities		52	371	0
Deferred tax liabilities		1 238	500	1 164
Pension liabilities		47	50	47
Subordinated debt	**3,4**	2 016	1 977	1 982
Total liabilities		**446 029**	**388 955**	**442 279**
Share capital		3 145	3 145	3 145
Additional Tier 1 capital		2 189	2 189	2 189
Retained earnings		10 303	9 177	10 088
Profit for the period		164	474	
Total equity	**10**	**15 801**	**14 984**	**15 421**
Total liabilities and equity		**461 830**	**403 939**	**457 701**

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)	1 January - 31 March 2019				
	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 2018	**3 145**	**2 189**	**(634)**	**10 720**	**15 421**
Profit for the period	0	0	0	164	164
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	222	0	222
Other comprehensive income—actuarial gain/ loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(7)	(7)
Dividends for 2018	0	0	0	0	0
Equity as of 31 March 2019	**3 145**	**2 189**	**(412)**	**10 878**	**15 801**

	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
Equity as of 31 March 2018	**3 145**	**2 189**	**(536)**	**10 185**	**14 984**

	1 January - 31 December 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	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	0	0	0	(48)	(48)
Dividends for 2017	0	0	0	(443)	(443)
Equity as of 31 December 2018	**3 145**	**2 189**	**(634)**	**10 720**	**15 421**

*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 in the report for first quarter 2018.

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	**January-March 2019**	**January-March 2018**	**2018**
Cash flows from operating activities			
Interest received	1 974	1 429	6 529
Interest paid	(1 734)	(626)	(3 899)
Fees and commissions paid	(21)	(14)	(34)
Receipts from repurchase of issued securities	3	1	17
Cash payments to employees and suppliers	(53)	(52)	(209)
Income taxes paid	0	0	0
Net disbursement of loans to customers	(3 510)	(1 179)	(20 525)
Net (increase)/decrease in deposits with credit institutions	(14 275)	(15 553)	(4 492)
Net (increase)/decrease in notes, bonds and other interest-bearing securities	768	15 245	(6 370)
Net (increase)/decrease in other assets	0	1	8
Net increase/(decrease) in other liabilities	31	(39)	(55)
Net (increase)/decrease in financial derivatives	7 366	(11 648)	3 489
Net cash flows from operating activities	**(9 450)**	**(12 434)**	**(25 542)**
Cash flows from investing activities			
Net (purchase)/sales of property and equipment	(6)	(1)	2
Net cash flows from investing activities	**(6)**	**(1)**	2
Cash flows from financing activities			
Down payment on leasing obligation	(2)	0	0
Proceeds from issuance of debt securities	34 787	53 860	104 845
Repayment of debt securities	(25 343)	(41 556)	(79 004)
Proceeds from issuance of additional Tier 1 capital	0	0	0
Interest paid on Tier 1 capital	(7)	(6)	(65)
Proceeds from issuance of subordinated debt	0	0	0
Repayment of subordinated debt	0	0	0
Dividends paid	0	0	(443)
Net cash flows from financing activities	**9 435**	**12 297**	25 333
Net cash flows	**(21)**	**(138)**	(208)
Effects of foreign exchange differences	139	(6)	396
Net cash flows after foreign exchange differences	**119**	**(144)**	189
Cash and cash equivalents at 1 January	276	87	87
Net change in cash and cash equivalents	119	(144)	189
Cash and cash equivalents at end of period	**395**	**(57)**	276
Whereof			
Deposits with credit institutions without agreed time to maturity	*395*	*0*	*276*
Loans from credit institutions without agreed time to maturity	*0*	*(57)*	*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 2019 are prepared in accordance with IAS 34 *Interim Financial Reporting*, and follow the same accounting policies as presented in the annual financial statements for 2018, except for the following:

The EU's Bank Recovery and Resolution Directive (BRRD) has been implemented in Norwegian law with effect from 1 January 2019. The transition is regulated by the provisions in the Financial Undertakings Act implementing BRRD in Norway, amongst others. KBN falls under the Directive and expects to be charged an annual recovery fee of about NOK 60 million in accordance with the Bill to Parliament concerning legislation to implement BRRD in Norway (Prop 159L (2016-2017)). In the first quarter, NOK 15 million was recognised as an expense on the line Fees and commission expenses.

IFRS 16 *Leases* came into force on 1 January 2019. As a result of the new standard, an asset relating to the bank's lease agreements, that convey the right to control the use, of NOK 43 million has been recognised on the line Other assets. A corresponding lease liability amounting to NOK 43 million has been recognised on the line Other liabilities. When implemented, the modified retrospective method has been chosen, and therefore comparative figures for 2018 have not been restated. The implementation had no effect on equity.

IAS 12 *Income Taxes* has been amended with effect from 1 January 2019. The change means that tax deductions on interest expenses from Additional Tier 1 capital, that is classified as equity, are presented as a reduction of the Income tax in the Income statement. Prior to the change, that tax deduction was recognized directly in equity. The change entails a reduced Income tax in the Income statement of NOK 1.8 million compared to the previous accounting principle. Comparative figures have not been restated.

The preparation of financial statements in accordance with IFRS requires that management uses estimates and judgments that may affect the carrying amounts of assets and liabilities, and revenues and costs. Estimates and judgments 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 judgments and assumptions related to credit and liquidity risk related to the financial instruments. Even though the judgments 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.

NOTE 1

NET INTEREST INCOME

(Amounts in NOK 1 000 000)

January-March 2019	Total	At fair value				Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
Deposits with credit institutions	**4**	0	0	0	0	4
Instalment loans	**1 441**	452	0	0	452	989
Notes, bonds and other interest-bearing securities	**267**	137	0	0	137	130
Financial derivatives	**355**	0	355	0	355	0
Total interest income	**2 067**	**588**	**355**	**0**	**944**	**1 123**
Loans from credit institutions	**0**	0	0	0	0	0
Senior securities issued	**2 948**	1 642	0	0	1 642	1 306
Financial derivatives	**(1 355)**	0	(1 517)	162	(1 355)	0
Subordinated debt	**15**	15	0	0	15	0
Total interest expenses	**1 609**	**1 657**	**(1 517)**	**162**	**302**	**1 306**
Net interest income	**458**	**(1 069)**	**1 873**	**(162)**	**641**	**(183)**

January-March 2018	Total	At fair value				Amortised cost
		Fair value option	Mandatory at fair value	Fair value hedge	Total at fair value	
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
Total interest income	**1 456**	**456**	**192**	**0**	**648**	**807**
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
Total interest expenses	**961**	**1 711**	**(1 591)**	**(55)**	**65**	**896**
Net interest income	**495**	**(1 255)**	**1 784**	**55**	**583**	**(88)**

2018	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)**

NOTE 2

Net unrealised gain/(loss) on financial instruments

(Amounts in NOK 1 000 000)	**January-March 2019**	**January-March 2018**	**2018**
Instalment loans	124	(742)	(420)
Notes, bonds and other interest-bearing securities	333	(140)	44
Financial derivatives	4 570	(4 030)	(8 084)
Loans from credit institutions	0	0	0
Senior securities issued	(5 172)	5 071	8 771
Subordinated debt	(19)	46	27
Net unrealised gain/(loss) on financial instruments	**(164)**	**205**	338

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 table above. Such fair value changes are recognised in Other comprehensive income in the Statement of comprehensive income. 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 or volatility.

Changes in fair value are the result of changes in market prices, mainly prices on bonds, 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, fixed rate instalment loans and issued bonds may on the other hand lead to significant income statement effects, as may changes in basis swap spreads.

KBN is in the process of updating its methods and models to measure interest rate sensitivity. The bank's sensitivity to net interest income (NII method) based on a change in the market interest rate of 1 percentage point over a horizon of 3 months is estimated at NOK 38 million (gross sensitivity) as of 31 March 2019. These calculations do not affect the Income statement and Statement of financial position for the period, but illustrate an estimate of the effect given that the market interest rate changes had occured. The model has been corrected and updated with some adjusted assumptions compared to the corresponding calculations as of 31 December 2018. The bank plans further to expand its interest rate sensitivity notes to include future time intervals based on the EVE method (Economic Value of Equity). This method provides a sensitivity-estimate for a change in market value related to a change in market interest rates of 1 percentage point.

The NII method will estimate possible changes to the period's result, while the EVE method will estimate the possible effect on market value on all of the bank's balance sheet items. Models that are based on the EVE method indicate that the bank will have a higher gross interest rate sensitivity than previously stated.

Net unrealised losses in the first quarter of 2019 amounting to NOK 164 million come from Senior securities issued and related derivatives contracts due to a widening of USD-NOK basis swap spreads, which results in a reduction in market value for existing hedging contracts.

NOTE 3

Classification of financial instruments

(Amounts in NOK 1 000 000)

At 31 March 2019		At fair value			
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Amortised cost
Deposits with credit institutions	**29 659**	0	0	0	29 659
Instalment loans	**307 317**	88 270	0	0	219 047
Notes, bonds and other interest-bearing securities	**114 418**	80 989	0	0	33 429
Financial derivatives	**10 267**	0	8 651	1 616	0
Total financial assets	**461 661**	**169 259**	**8 651**	**1 616**	**282 135**
Loans from credit institutions	**4 370**	0	0	0	4 370
Senior securities issued	**414 280**	170 270	0	0	244 010
Financial derivatives	**23 917**	0	22 882	1 035	0
Subordinated debt	**2 016**	2 016	0	0	0
Total financial liabilities	**444 583**	**172 286**	**22 882**	**1 035**	**248 380**

At 31 March 2018		At fair value			
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Amortised cost
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
Total financial assets	**403 805**	**144 831**	**8 613**	**0**	**250 361**
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
Total financial liabilities	**387 989**	**162 132**	**17 185**	**2 042**	**206 631**

At 31 December 2018		At fair value			
	Total	Fair value option	Mandatory 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**

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 2018 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 2019 are distributed in the following way in the fair value hierarchy:

(Amounts in NOK 1 000 000)	**Level 1**	**Level 2**	**Level 3**	**Total**
Deposits with credit institutions	0	0	0	**0**
Instalment loans	0	16 558	71 713	**88 270**
Notes, bonds and other interest-bearing securities	61 114	12 954	6 921	**80 989**
Financial derivatives	0	8 903	1 364	**10 267**
Total financial assets measured at fair value	**61 114**	**38 415**	**79 998**	**179 526**
Loans from credit institutions	0	0	0	**0**
Senior securities issued	11 270	84 659	74 341	**170 270**
Financial derivatives	0	6 430	17 487	**23 917**
Subordinated debt	0	0	2 016	**2 016**
Total financial liabilities measured at fair value	**11 270**	**91 089**	**93 844**	**196 203**

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 2018	**71 496**	**3 616**	**75 822**	**1 982**	**(17 106)**
Purchase	0	4 593	0	0	(1)
Sale	0	0	(8)	0	0
Issue	8 150	0	2 049	0	0
Settlement	(6 665)	(204)	(4 355)	0	13
Transfer into Level 3	474	35	0	0	0
Transfer out of Level 3	(437)	(1 821)	0	0	0
Gain/(loss) recognised in the period	(1 305)	701	833	34	971
Carrying amount at 31 March 2019	**71 713**	**6 921**	**74 341**	**2 016**	**(16 123)**

Holdings amounting to approximately NOK 13 million have been transferred from Level 1 to Level 2 in the first quarter of 2019. There are net transfers of NOK 1 750 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 2019:

	31 March 2019
Instalment loans	(243)
Notes, bonds and other interest-bearing securities	(33)
Financial derivatives	(434)
Senior securities issued	483
Subordinated debt	16
Total	**(211)**

NOTE 5

Instalment loans

(Amounts in NOK 1 000 000)	31 March 2019	31 March 2018	31 December 2018
Principal amount	305 741	282 884	302 232
Accrued interest	1 234	1 018	1 121
Fair value adjustment	353	(93)	229
Expected credit loss	(11)	(11)	(11)
Total instalment loans	**307 317**	**283 800**	**303 571**

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.

	31 March 2019		31. December 2018	January—March 2019
(Amounts in NOK 1 000 000)	Carrying amount	Expected credit loss	Expected credit loss	Expected credit loss—change in period
Instalment loans	219 047	(11)	(11)	(0.1)
Notes, bonds and other interest-bearing securities	33 429	(1)	(1)	(0.1)
Total	**252 477**	**(12)**	**(12)**	**(0.2)**

The following table shows an allocation of KBN's expected credit losses as at 31 March 2019 to stage 1, 2 and 3. According to the impairment principles described in IFRS 9 *Financial Instruments*, 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 in the Q1 2018 report 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 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 2019	31 March 2018	31 December 2018
Domestic			
Issued by other borrowers	17 706	4 802	15 274
Foreign			
Issued by public bodies[1]	94 040	79 931	98 567
Issued by other borrowers	2 672	4 060	2 679
Total notes, bonds and other interest-bearing securities	**114 418**	**88 792**	**116 519**

[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	31 March 2019	31 March 2018	31 December 2018
Under 1 year	61 722	60 143	76 078
1-5 years	42 279	23 626	33 224
Over 5 years	10 417	5 024	7 217
Total notes, bonds and other interest-bearing securities	**114 418**	**88 792**	**116 519**

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 2019**

Time to maturity	< 1 year				> 1 year					
Risk class	**A-1**	**A-2**	**A-3**	**Not rated**	**BBB**	**A**	**AA**	**AAA**	**Not rated**	**Total**
Sovereigns and central banks	15 698	0	0	271	0	0	19 896	2 595	0	38 461
Multilateral development banks	5 176	0	0	0	0	0	465	2 981	0	8 622
Regional authorities	17 952	0	0	6 047	0	0	8 346	1 425	263	34 033
Financial institutions	3 583	0	0	0	0	0	0	175	0	3 757
Securitisation	0	0	0	0	0	0	0	7	0	7
Covered bonds	6 253	0	0	6 742	0	0	1 540	15 004	0	29 539
Total	**48 662**	**0**	**0**	**13 060**	**0**	**0**	**30 248**	**22 186**	**263**	**114 418**

NOTE 9

Senior securities issued

(Amounts in NOK 1 000 000)	31 March 2019	31 March 2018	31 December 2018
Senior securities issued (nominal amounts) as at 1 January	**414 603**	**373 816**	**373 816**
New issuance	34 787	53 859	104 844
Redemptions	(26 145)	(41 903)	(80 143)
Amortisation	802	347	1 138
Translation differences	(2 399)	(11 403)	14 947
Senior securities issued (nominal amounts) as at end of period	**421 647**	**374 716**	**414 603**
Accrued interest	3 917	3 252	4 474
Fair value adjustment	(11 284)	(12 589)	(16 160)
Of which value change that is due to change in own credit risk	*549*	*(715)*	*845*
Of which value change that is due to other reasons	*(11 833)*	*(11 875)*	*(17 005)*
Total senior securities issued	**414 280**	**365 377**	**402 916**

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 2019	31 March 2018	31 December 2018
Common equity Tier 1 capital			
Share capital	3 145	3 145	3 145
Retained earnings	9 822	8 734	8 591
Profit for the period included in Tier 1 capital	164	474	1 496
Pension funds above pension commitments	0	0	0
Deferred tax asset*	0	0	0
Intangible assets	(112)	(122)	(116)
Dividends payable	(128)	(120)	(481)
Other additions/deductions in common equity Tier 1 capital	386	512	609
Share of nulled unamortised estimate differences	0	0	0
Total common equity Tier 1 capital	**13 278**	**12 622**	**13 244**
Other approved Tier 1 capital	2 189	2 189	2 189
Total Tier 1 capital	**15 467**	**14 811**	**15 433**
Supplementary capital			
Ordinary subordinated debt	2 000	2 000	2 000
Total supplementary capital	**2 000**	**2 000**	**2 000**
Total primary capital	**17 467**	**16 811**	**17 433**

*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 2019			31 March 2018	31 December 2018
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Minimum capital requirements	Minimum capital requirements
Credit risk					
Sovereigns and central banks	38 461	0	0	0	0
Regional governments and local authorities	334 463	61 895	4 952	4 592	4 892
Of which are Norwegian municipalities	*307 287*	*61 895*	*4 952*	*4 592*	*4 892*
Public sector entities	6 857	0	0	0	0
Multilateral development banks	8 622	0	0	0	0
Financial institutions	40 044	7 557	605	473	522
Of which counterparty exposure on derivatives	*7 659*	*1 322*	*106*	*117*	*109*
Claims secured by residential property	30	30	2	3	3
Covered bonds	29 539	2 954	236	71	216
Other assets	15	15	1	1	1
Securitisation	7	7	1	1	1
Credit Valuation Adjustment	176	2 202	176	208	180
Total credit risk	**458 213**	**74 660**	**5 973**	**5 349**	**5 814**
Market risk	**0**	**0**	**0**	**0**	**0**
Operational risk—Basic Indicator Approach		**3 299**	**264**	**290**	**264**
Minimum capital requirements		**77 960**	**6 237**	**5 639**	**6 078**
Total capital ratio			**22.4 %**	**23.9%**	**22.9 %**
Tier 1 capital adequacy ratio			**19.8 %**	**21.0%**	**20.3 %**
Common equity Tier 1 capital adequacy ratio			**17.0 %**	**17.9%**	**17.4 %**
Leverage ratio			**3.5 %**	**3.9%**	**3.6 %**

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