REPORT FOR THIRD QUARTER 2018

KBN Kommunalbanken Norway

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.

Kongsvinger lower secondary school is financed by green lending rate from Kommunalbanken.
Photo: Jo Straube

FINANCIAL HIGHLIGHTS

(Amounts in NOK 1 000 000)	**January-September 2018**	**January-September 2017**	**2017**
RESULTS			
Net interest income	1 378	1 611	2 162
Core earnings[1]	864	1 066	1 517
Profit before tax	1 317	962	1 783
Profit for the period	988	721	1 429
Return on equity after tax[2]	10.33%	8.52%	12.72%
Return on equity after tax (core earnings)[2]	9.38%	12.60%	13.51%
Return on assets after tax[2]	0.32%	0.23%	0.34%
Return on assets after tax (core earnings)[2]	0.28%	0.33%	0.36%
LENDING			
New disbursements	31 343	35 874	55 021
Outstanding loans[3]	288 102	274 064	281 706
LIQUIDITY PORTFOLIO[3]	84 600	108 175	107 484
BORROWINGS			
New long-term borrowings	85 223	111 190	118 509
Repurchase of own debt	98	739	837
Redemptions	71 064	89 502	112 555
Total borrowings[3]	378 773	378 853	373 816
TOTAL ASSETS	414 033	415 005	412 854
EQUITY	14 925	13 964	14 667
Total capital adequacy ratio	22.9%	23.7%	24.6%
Tier 1 capital adequacy ratio	20.2%	20.8%	21.7%
Common equity Tier 1 capital adequacy ratio	17.2%	17.6%	18.4%
Leverage ratio	3.9%	3.6%	3.7%
LIQUIDITY COVERAGE RATIO (LCR)[4]			
Total	504%	1 292%	570%
NOK	918%	807%	2 052%
EUR	778%	992%	233%
USD	176%	333%	308%
AUD	333%	Infinite	Infinite
JPY	269%	854%	185%

[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 and return on assets as percentage of average equity and average assets

[3] Principal amounts

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

SATISFYING UNDERLYING OPERATIONS AND MARGINS

KBN's margins have decreased in 2018 in line with developments in the market and our target of providing financing on favourable terms. Profit for the third quarter was NOK 125 million, down from NOK 272 million in the same period in 2017.

RESULTS

Net interest income totalled NOK 419 million in the third quarter of 2018 compared to NOK 513 million in the same period in 2017. Net interest income in the third quarter was affected by less favourable prices for converting borrowings in foreign currencies into Norwegian kroner, as well as by a reduction in the volume of bonds held for liquidity purposes. KBN's result for the third quarter was a profit of NOK 125 million compared to a profit of NOK 272 million in the same period in 2017. The decrease was due to higher unrealised losses on financial instruments in the third quarter of 2018 than in the third quarter of 2017. These unrealised losses totalled NOK 198 million in the third quarter of 2018 compared to NOK 94 million in the same period in 2017. The unrealised losses in 2018 were due to changes in the price of converting US dollars into Norwegian kroner and affected derivatives contracts related to its borrowings. KBN's liquidity portfolio also saw unrealised losses in the third quarter of 2018.

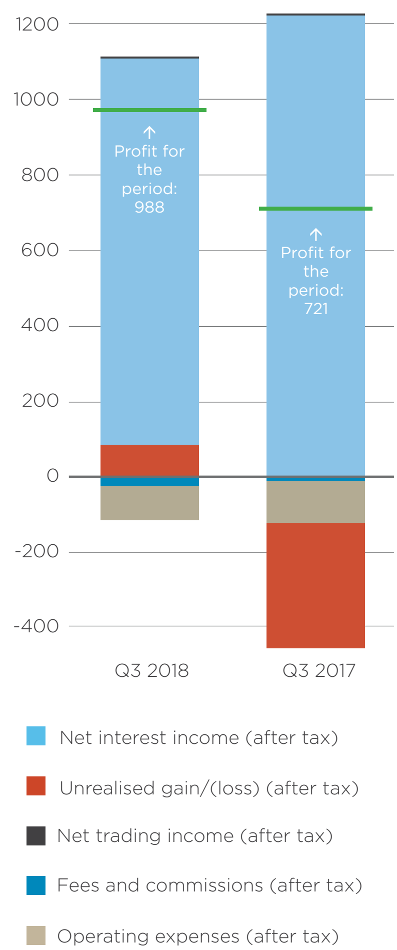
Net interest income totalled NOK 1,378 million in the first nine months of 2018 compared to NOK 1,611 million in the same period in 2017. The decrease was due to lower margins in 2018 than in 2017 and KBN's particularly strong earnings in 2017. KBN's result for the first nine months of 2018 was a profit of NOK 988 million compared to a profit of NOK 721 million in the first nine months of 2017. The increase was due to unrealised gains on KBN's financial instruments included in ordinary profit in 2018 in contrast to unrealised losses on its financial instruments in 2017.

KBN recognised a loss of NOK 267 million in other comprehensive income in the first nine months of 2018 due to changes in the value of KBN's borrowings caused by changes to KBN's own credit risk. Following the introduction of IFRS 9 in 2018, such value changes are presented as part of other comprehensive income rather than being included in ordinary profit for the period. In accordance with the accounting standards, the comparative figures for 2017 have not been restated, meaning that such value changes are included in the figures reported for ordinary profit for the period for 2017 in this report. Total comprehensive income was NOK 721 million in the first nine months of 2018, equalling the total comprehensive income in the same period of 2017.

Total operating expenses for the first nine months of 2018 were NOK 153 million compared to NOK 143

PROFIT AFTER TAX

(amounts in NOK million)



million in the same period in 2017. The increase was primarily due to higher salary costs on the basis of KBN having strengthened its organisation in connection with development activities and some support functions, and the comparison is also affected by a number of job vacancies in the first six months of 2017. Other operating costs reflect cost increases related to IT security and activities associated with digitalisation and efficiency measures. Operating expenses (annualised) represent 0.05% of total assets.

KBN achieved a return on equity after tax of 10.33% (annualised) in the first nine months of 2018 compared to 8.52% in the same period in 2017. Adjusted for unrealised changes in the value of financial instruments, the return on equity after tax was 9.38% compared to 12.6% in 2017.

LENDING

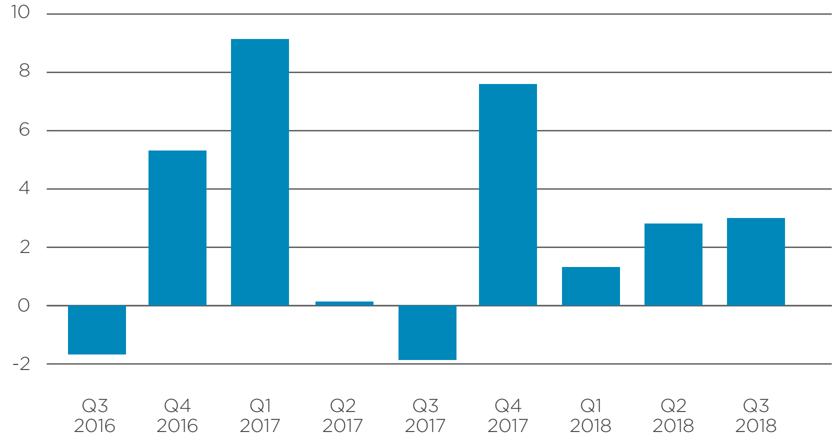
KBN's lending portfolio totalled NOK 288 billion at the end of the third quarter of 2018. KBN's lending portfolio grew by NOK 2.5 billion or 0.9% in the quarter, compared to a decrease of 0.7% in the same period in 2017. The third quarter is traditionally a weak quarter for new lending. A high level of demand for green loans contributed nearly NOK 1 billion to lending growth in the quarter.

KBN's lending portfolio grew by NOK 6.4 billion or 2.3% in the first nine months of 2018, compared to growth of 2.8% in the first nine months of 2017. Green loans, which are used to finance climate-friendly projects undertaken by the local government sector, grew strongly in the first nine months of 2018, with green lending up 14% over this period. KBN sees only a small increase in demand for loans with no repayment instalments prior to maturity, while demand for loans with maturities of twelve months or less is stable. KBN prioritises long-term loans but offers shorter maturity loans in the context of its liquidity and balance sheet management activities. KBN's liquidity situation was strong in the quarter and this led to a cautious increase in the outstanding amount of short-term lending.

New loan disbursements totalled NOK 11.4 billion in the third quarter of 2018, compared to NOK 7.8 billion in the same period in 2017. New loan disbursements in the first nine months of 2018 totalled NOK 31.3 billion, which is NOK 4.5 billion less than in the same period in 2017. These figures

LENDING GROWTH

(amounts in NOK billion)



include both loans disbursed as new financing and as refinancing for existing loans.

KBN registered demand for new financing in the first nine months of 2018 totalling NOK 30 billion. This is NOK 3 billion less than in the equivalent period in 2017. Loans totalling NOK 87 billion were refinanced in the first nine months of 2018. This is NOK 15 billion less than in 2017. One reason for the decrease is that 2017 showed a significant decrease in the use of short term financing, reducing the volume and number of loans that need to be refinanced this year.

KBN's overall market share increased slightly in the first nine months of 2018 to approximately 47%. The rate of debt growth in the local government sector is slowing. At the end of August, growth in debt over the past twelve months according to Statistics Norway's credit indicator (C2) stood at 4.7%, compared to a growth in the same period in 2017 of 6.4%. KBN expects the sector's borrowing requirements to increase in the fourth quarter and for its borrowing requirements to ultimately be approximately in line with 2017. Taking into account somewhat higher instalment payments in 2018, this may indicate a somewhat lower rate of debt growth in 2018 than in 2017.

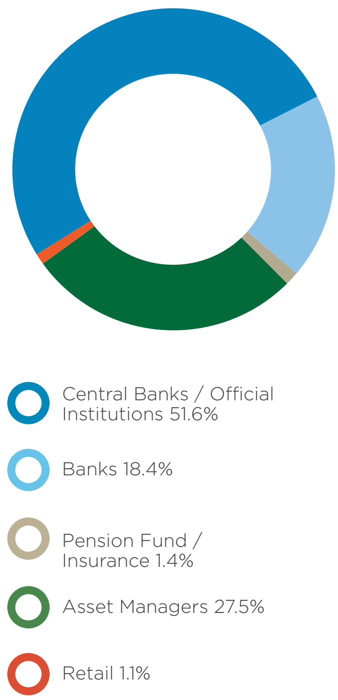
FINANCIAL MARKETS

Funding

KBN's funding activities were on a moderate scale in the third quarter of 2018, reflecting both KBN's strong liquidity and the market being quiet because of the summer break during part of the quarter. New borrowings totalled NOK 19 billion through 19

FUNDING MARKET

July-September 2018



bond issues compared to approximately NOK 26 billion through 58 bond issues in the same period in 2017.

KBN's funding activities have been generally good across all markets. The quarter also saw a range of transactions with institutional investors in US dollars, British pounds, Australian dollars and New Zealand dollars, many of which were on floating-rate terms. The largest single bond KBN issued in the third quarter was a five-year green transaction in Australian dollars, which was KBN's first green bond issued in that currency. This bond was very well received and was significantly oversubscribed at launch, allowing the amount raised to be increased to AUD 450 million. It was the largest single bond KBN has ever issued in this market. No transactions were carried out in the Japanese uridashi market in the third quarter.

In the first nine months of 2018, KBN issued bonds totalling approximately NOK 87 billion compared to NOK 109 billion in the same period in 2017. By the end of the third quarter, nearly 80% of KBN's estimated borrowing requirements for 2018 had been met. KBN enjoys low borrowing costs and good market access thanks to its AAA/Aaa rating.

Liquidity management

KBN's liquidity portfolio totalled NOK 84.6 billion at 30 September 2018 compared to NOK 108.2 billion at the same point in 2017.

KBN seeks to ensure its liquidity portfolio matches its capital requirements, including lending growth, for the subsequent twelve months at all times, and it is managed on the basis of 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. Furthermore, the majority of the portfolio is invested in assets with short maturities in order to meet the need to repay borrowings that mature and to ensure that KBN has sufficient liquidity for lending growth, as well as to provide for fluctuations in the amount of cash exchanged as collateral.

With the escalating trade war in the news as well as turmoil in emerging economies and the impact this has on their currencies, the markets were at times volatile in the third quarter. The Norwegian krone was also volatile through the third quarter. US Federal Reserve raised interest rates for the eighth time this economic cycle, and Norges Bank raised its key policy rate for the first time in some years to 0.75%. It is likely that interest rates will continue to be increased in the coming years.

CAPITAL

At the end of the third quarter, KBN's total primary capital was NOK 17.0 billion, its total Tier 1 capital was NOK 15.0 billion, and its total common equity Tier 1 capital was NOK 12.9 billion. KBN's capital structure was unchanged through the quarter. KBN's total assets have increased by NOK 1.2 billion since 31 December 2017. This increase was due to lending growth and a significant level of cash collateral pledged being offset by a decrease in the size of the liquidity portfolio.

At the end of the third quarter, KBN had a common equity Tier 1 capital adequacy ratio of 17.2%, a Tier 1 capital adequacy ratio of 20.2%, and a total capital adequacy ratio of 22.9%. At 30 September 2018, the capital requirements imposed by the authorities, including the pillar 2 requirement, 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%. KBN is also subject to a requirement to have a leverage ratio in excess of 3.0%. KBN's leverage ratio at 30 September 2018 was 3.9%.

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 was reduced by 0.1%.

Oslo, 31 October 2018
The Board of Directors of Kommunalbanken AS

INTERIM CONDENSED FINANCIAL INFORMATION

INCOME STATEMENT

(Amounts in NOK 1 000 000)	Note	July-September 2018	January-September 2018	July-September 2017	January-September 2017	2017
Interest income from assets measured at amortised cost		*963*	*2 706*	*425*	*1 340*	*1 754*
Interest income from assets measured at fair value		*711*	*2 131*	*975*	*3 080*	*4 089*
Total interest income		1 675	4 837	1 400	4 420	5 843
Interest expense		1 256	3 458	888	2 809	3 681
Net interest income	**1**	**419**	**1 378**	**513**	**1 611**	**2 162**
Fees and commission expenses		5	28	8	24	32
Net unrealised gain/(loss) on financial instruments	**2**	(198)	116	(94)	(490)	(163)
Expected credit loss	**6**	1	0	-	-	-
Net trading income		0	4	(2)	8	9
Total other operating income		**(204)**	**92**	**(105)**	**(507)**	**(186)**
Salaries and administrative expenses		34	107	33	102	132
Depreciation on fixed assets		6	16	5	16	21
Other expenses		9	30	6	25	40
Total operating expenses		**48**	**153**	**45**	**143**	**193**
Profit before tax		**167**	**1 317**	**363**	**962**	**1 783**
Income tax		42	329	91	241	354
Profit for the period		**125**	**988**	**272**	**721**	**1 429**
Portion allocated to shareholder		113	951	260	698	1 395
Portion allocated to owners of additional Tier 1 capital		12	36	12	22	34

STATEMENT OF COMPREHENSIVE INCOME

(Amounts in NOK 1 000 000)	Note	July-September 2018	January-September 2018	July-September 2017	January-September 2017	2017
Profit for the period		125	988	272	721	1 429
Other comprehensive income						
Items which will not be reclassified to profit or loss						
Change in fair value of liabilities due to changes in own credit risk	9	(115)	(356)	-	-	-
Actuarial gain/(loss) on defined benefit plan		0	0	0	0	(1)
Tax effect		29	89	0	0	0
Total other comprehensive income		**(86)**	**(267)**	**0**	**0**	**(1)**
Total comprehensive income for the period		**38**	**721**	**272**	**721**	**1 428**

STATEMENT OF FINANCIAL POSITION

(Amounts in NOK 1 000 000)	Note	30 September 2018	30 September 2017	31 December 2017
Assets				
Deposits with credit institutions	**3,4**	33 329	19 383	10 400
Instalment loans	**3,4,5,6**	289 129	275 843	283 396
Notes, bonds and other interest-bearing securities	**3,4,6,7,8**	85 333	108 198	107 445
Financial derivatives	**3,4**	6 114	10 900	11 476
Other assets		128	681	137
Total assets		**414 033**	**415 005**	**412 854**
Liabilities and equity				
Loans from credit institutions	**3,4**	921	2 393	4 714
Senior securities issued	**3,4,9**	363 438	376 878	369 482
Financial derivatives	**3,4**	31 723	19 687	21 082
Other liabilities		36	37	86
Current tax liabilities		529	0	214
Deferred tax liabilities		469	12	551
Pension liabilities		50	52	50
Subordinated debt	**3,4**	1 942	1 981	2 008
Total liabilities		**399 108**	**401 041**	**398 187**
Share capital		3 145	3 145	3 145
Additional Tier 1 capital		2 189	2 189	2 189
Retained earnings		8 604	7 909	9 333
Profit for the period		988	721	
Total equity	**10**	**14 925**	**13 964**	**14 667**
Total liabilities and equity		**414 033**	**415 005**	**412 854**

STATEMENT OF CHANGES IN EQUITY

(Amounts in NOK 1 000 000)	1 January - 30 September 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	988	988
Other comprehensive income—value change on liabilities due to changes in own credit risk	0	0	(267)	0	(267)
Other comprehensive income—actuarial gain/loss	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(43)	(43)
Dividends for 2017	0	0	0	(443)	(443)
Equity as of 30 September 2018	**3 145**	**2 189**	**(627)**	**10 217**	**14 925**

	1 January - 30 September 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	721	721
Total other comprehensive income	0	0	0	0	0
Interest paid on Tier 1 capital	0	0	0	(14)	(14)
Issued additional Tier 1 capital	0	1 195	0	0	1 195
Dividends for 2016	0	0	0	(390)	(390)
Equity as of 30 September 2017	**3 145**	**2 189**	**0**	**8 630**	**13 964**

	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)
Equity as of 31 December 2017	**3 145**	**2 189**	**0**	**9 333**	**14 667**

*See further information and specification of the transition effects in equity on 1 January 2018 relating to the implementation of IFRS 9 in the Accounting Policies of both the Annual Report 2017 and the quarterly report for the first quarter of 2018.

STATEMENT OF CASH FLOWS

(Amounts in NOK 1 000 000)	**January-September 2018**	**January-September 2017**	**2017**
Cash flows from operating activities			
Interest received	4 712	4 401	5 830
Interest paid	(2 771)	(2 557)	(3 310)
Fees and commissions paid	(28)	(24)	(32)
Receipts from repurchase of issued securities	4	8	9
Cash payments to employees and suppliers	(153)	(127)	(172)
Income taxes paid	0	(726)	404
Net disbursement of loans to customers	(6 399)	(7 506)	(15 148)
Net (increase)/decrease in deposits with credit institutions	(26 617)	(8 011)	3 527
Net (increase)/decrease in notes, bonds and other interest-bearing securities	18 354	10 260	14 406
Net (increase)/decrease in other assets	7	(530)	13
Net increase/(decrease) in other liabilities	(50)	481	36
Net (increase)/decrease in financial derivatives	(1 816)	0	(12 094)
Net cash flows from operating activities	**(14 757)**	**(4 330)**	**(6 531)**
Cash flows from investing activities			
Net (purchase)/sales of property and equipment	2	(13)	(18)
Net cash flows from investing activities	**2**	**(13)**	**(18)**
Cash flows from financing activities			
Proceeds from issuance of debt securities	85 224	111 191	118 509
Repayment of debt securities	(69 906)	(89 983)	(112 676)
Proceeds from issuance of additional Tier 1 capital	0	1 195	1 195
Interest paid on Tier 1 capital	(58)	(19)	(25)
Proceeds from issuance of subordinated debt	0	0	0
Repayment of subordinated debt	0	0	0
Dividends paid	(443)	(390)	(390)
Net cash flows from financing activities	**14 817**	**21 994**	**6 614**
Net cash flows	**61**	**17 651**	**65**
Effects of foreign exchange differences	(28)	(17 769)	(54)
Net cash flows after foreign exchange differences	**33**	**(118)**	**11**
Cash and cash equivalents at 1 January	87	76	76
Net change in cash and cash equivalents	33	(118)	11
Cash and cash equivalents at end of period	**120**	**(42)**	**87**
Whereof			
Deposits with credit institutions without agreed time to maturity	*120*	*0*	*87*
Loans from credit institutions without agreed time to maturity	*0*	*(42)*	*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 30 September 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 except for new accounting policies for financial instruments under IFRS 9 as presented in the financial statements for the first quarter of 2018.

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)

		At fair value				
July-September 2018 (IFRS 9)	**Total**	**Fair value option**	**Mandatory at fair value**	**Fair value hedge**	**Total at fair value**	**Amortised cost**
Deposits with credit institutions	**13**	0	0	0	0	13
Instalment loans	**1 260**	405	0	0	405	855
Notes, bonds and other interest-bearing securities	**198**	102	0	0	102	95
Financial derivatives	**204**	0	204	0	204	0
Total interest income	**1 675**	**507**	**204**	**0**	**711**	**963**
Loans from credit institutions	**0**	0	0	0	0	0
Senior securities issued	**2 856**	1 790	0	0	1 790	1 067
Financial derivatives	**(1 616)**	0	(1 685)	69	(1 616)	0
Subordinated debt	**15**	15	0	0	15	0
Total interest expenses	**1 256**	**1 805**	**(1 685)**	**69**	**189**	**1 067**
Net interest income	**419**	**(1 298)**	**1 889**	**(69)**	**522**	**(103)**

		At fair value				
January-September 2018 (IFRS 9)	**Total**	**Fair value option**	**Mandatory at fair value**	**Fair value hedge**	**Total at fair value**	**Amortised cost**
Deposits with credit institutions	**27**	0	0	0	0	27
Instalment loans	**3 658**	1 198	0	0	1 198	2 461
Notes, bonds and other interest-bearing securities	**520**	301	0	0	301	218
Financial derivatives	**632**	0	632	0	632	0
Total interest income	**4 837**	1 499	632	0	**2 131**	2 706
Loans from credit institutions	**3**	1	0	0	1	1
Senior securities issued	**8 246**	4 917	0	0	4 917	3 330
Financial derivatives	**(4 836)**	0	(4 874)	38	(4 836)	0
Subordinated debt	**46**	46	0	0	46	0
Total interest expenses	**3 458**	4 964	(4 874)	38	127	3 331
Net interest income	**1 378**	**(3 465)**	**5 506**	**(38)**	**2 003**	**(625)**

July-September 2017 (IAS 39)	**Total**	**At fair value**	**Amortised cost**
Total interest income	**1 400**	975	425
Total interest expense	**888**	293	594
Net interest income	**513**	**681**	**(169)**

January-September 2017 (IAS 39)	Total	At fair value	Amortised cost
Total interest income	**4 420**	3 080	1 340
Total interest expense	**2 809**	967	1 842
Net interest income	**1 611**	**2 113**	**(502)**

2017 (IAS 39)	Total	At fair value	Amortised cost
Total interest income	**5 843**	4 089	1 754
Total interest expense	**3 681**	1 188	2 492
Net interest income	**2 162**	**2 901**	**(738)**

NOTE 2

Net unrealised gain/(loss) on financial instruments

(Amounts in NOK 1 000 000)	July-September 2018	January-September 2018	July-September 2017	January-September 2017	2017
Instalment loans	(266)	(821)	78	688	760
Notes, bonds and other interest-bearing securities	(70)	(289)	58	229	71
Financial derivatives	(1 545)	(10 440)	2 853	4 701	2 271
Loans from credit institutions	0	0	0	0	0
Senior securities issued	1 661	11 614	(3 083)	(6 086)	(3 231)
Subordinated debt	21	52	0	(22)	(34)
Net unrealised gain/(loss) on financial instruments	**(198)**	**116**	**(94)**	**(490)**	**(163)**

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 or exchange 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 losses in the third quarter of 2018 amounting to NOK 198 million come from Notes, bonds and other interest-bearing securities, as well as Senior securities issued and related derivatives contracts due to a widening of credit spreads for bond holdings and a widening of USD-NOK basis swap spreads.

NOTE 3

Classification of financial instruments

(Amounts in NOK 1 000 000)

At 30 September 2018 (IFRS 9)		At fair value			
	Total	Fair value option	Mandatory at fair value	Fair value hedge	Amortised cost
Deposits with credit institutions	**33 329**	0	0	0	33 329
Instalment loans	**289 129**	81 162	0	0	207 967
Notes, bonds and other interest-bearing securities	**85 333**	61 258	0	0	24 075
Financial derivatives	**6 114**	0	6 114	0	0
Total financial assets	**413 905**	**142 420**	**6 114**	**0**	**265 371**
Loans from credit institutions	**921**	0	0	0	921
Senior securities issued	**363 438**	156 350	0	0	207 088
Financial derivatives	**31 723**	0	28 852	2 871	0
Subordinated debt	**1 942**	1 942	0	0	0
Total financial liabilities	**398 024**	**158 292**	**28 852**	**2 871**	**208 009**

At 30 September 2017 (IAS 39)		At fair value through profit or loss					
	Total	Fair value option	Held for trading	Fair value hedge	Held to maturity	Loans and receivables	Other liabilities
Deposits with credit institutions	**19 383**	9 300	0	0	0	10 083	0
Instalment loans	**275 843**	165 461	0	0	0	110 382	0
Notes, bonds and other interest-bearing securities	**108 198**	107 939	0	0	10	248	0
Financial derivatives	**10 900**	0	10 139	761	0	0	0
Total financial assets	**414 325**	**282 701**	**10 139**	**761**	**10**	**120 713**	**0**
Loans from credit institutions	**2 393**	0	0	0	0	0	2 393
Senior securities issued	**376 878**	224 387	0	0	0	0	152 492
Financial derivatives	**19 687**	0	18 398	1 288	0	0	0
Subordinated debt	**1 981**	1 981	0	0	0	0	0
Total financial liabilities	**400 939**	**226 368**	**18 398**	**1 288**	**0**	**0**	**154 885**

At 31 December 2017 (IAS 39)		At fair value through profit or loss					
	Total	Fair value option	Held for trading	Fair value hedge	Held to maturity	Loans and receivables	Other liabili-ties
Deposits with credit institutions	**10 400**	1 228	0	0	0	9 172	0
Instalment loans	**283 396**	168 777	0	0	0	114 619	0
Notes, bonds and other interest-bearing securities	**107 445**	107 435	0	0	10	0	0
Financial derivatives	**11 476**	0	10 805	671	0	0	0
Total financial assets	**412 717**	**277 440**	**10 805**	**671**	**10**	**123 791**	**0**
Loans from credit institutions	**4 714**	0	0	0	0	0	4 714
Senior securities issued	**369 482**	**211 390**	**0**	**0**	**0**	**0**	**158 092**
Financial derivatives	**21 082**	**0**	**19 720**	**1 362**	**0**	**0**	**0**
Subordinated debt	**2 008**	**2 008**	**0**	**0**	**0**	**0**	**0**
Total financial liabilities	**397 286**	**213 398**	**19 720**	**1 362**	**0**	**0**	**162 806**

NOTE 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 30 September 2018 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	14 465	66 697	**81 162**
Notes, bonds and other interest-bearing securities	59 254	2 005	0	**61 258**
Financial derivatives	0	5 302	811	**6114**
Total financial assets measured at fair value	**59 254**	**21 772**	**67 508**	**148 533**
Loans from credit institutions	0	0	0	**0**
Senior securities issued	7 796	79 894	68 659	**156 350**
Financial derivatives	0	10 889	20 834	**31 723**
Subordinated debt	0	0	1 942	**1 942**
Total financial liabilities measured at fair value	**7 796**	**90 783**	**91 436**	**190 015**

Reconciliation of movements in Level 3

	Instalment loans	**Notes, bonds and other interest-bearing securities**	**Senior securities issued**	**Subordinated debt**	**Financial derivatives**
Carrying amount at 31 December 2017	**69 313**	**574**	**80 159**	**2 008**	**(10 183)**
Purchase	0	0	0	0	(827)
Sale	0	0	(33)	0	0
Issue	11 394	0	12 909	0	0
Settlement	(8 151)	(187)	(13 597)	0	4 044
Transfer into Level 3	934	79	0	0	0
Transfer out of Level 3	(2 031)	(287)	0	0	0
Gain/(loss) recognised in the period	(4 762)	(179)	(10 779)	(66)	(13 057)
Carrying amount at 30 September 2018	**66 697**	**0**	**68 659**	**1 942**	**(20 023)**

Out of assets still in the portfolio on 30 September 2018 there have been net transfers of NOK 5.2 billion from Level 2 to Level 1 during the course of 2018. In the third quarter of 2018 in isolation NOK 1.2 billion have been transferred from Level 1 to Level 2. There are net transfers of NOK 1 305 million out of Level 3 during the course of 2018. 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" , "Net trading income" or in Other comprehensive income (for value changes on liabilities due to changes in own credit risk).

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 30 September 2018:

	30 September 2018
Instalment loans	(203)
Notes, bonds and other interest-bearing securities	0
Financial derivatives	87
Senior securities issued	391
Subordinated debt	19
Total	**294**

NOTE 5

Instalment loans

(Amounts in NOK 1 000 000)	30 September 2018 (IFRS 9)	30 September 2017 (IAS 39)	31 December 2017 (IAS 39)
Principal amount	288 102	274 064	281 706
Accrued interest	1 208	1 184	1 023
Fair value adjustment	(171)	594	667
Expected credit loss	(11)	-	-
Total instalment loans	**289 129**	**275 843**	**283 396**
Transition effect Expected credit loss on 1 January 2018			(10)
Transition effect reclassification on 1 January 2018			(18)
Carrying amount on 1 January 2018 (IFRS 9)			**283 367**

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.

	30 September 2018		1 January 2018	July-September 2018	January-September 2018
(Amounts in NOK 1 000 000)	Carrying amount	Expected credit loss	Expected credit loss	Expected credit loss	Expected credit loss
Instalment loans	207 967	(11)	(10)	(0.2)	(0.3)
Notes, bonds and other interest-bearing securities	24 075	0	(1)	(0.4)	0.0
Total	**232 042**	**(11)**	**(11)**	**(0.5)**	(0.3)

The following table shows an allocation of KBN's expected credit losses as at 30 September 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
Total expected credit loss	**(11)**	**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	30 September 2018 (IFRS 9)	30 September 2017 (IAS 39)	31 December 2017 (IAS 39)
Domestic			
Issued by public bodies[1]	0	0	0
Issued by other borrowers	8 960	5 558	5 938
Foreign			
Issued by public bodies[1]	73 052	93 423	96 696
Issued by other borrowers	3 322	9 188	4 809
Total notes, bonds and other interest-bearing securities	**85 333**	**108 198**	**107 445**
Transition effect Expected credit loss on 1 January 2018			(1)
Transition effect reclassification on 1 January 2018			(23)
Carrying amount on 1 January 2018 (IFRS 9)			**107 421**

[1]Issued by or guaranteed by sovereigns, central banks, regional authorities and multilateral development banks.

Notes, bonds and other interest-bearing securities by time to maturity	30 September 2018 (IFRS 9)	30 September 2017 (IAS 39)	31 December 2017 (IAS 39)
Under 1 year	53 552	63 016	68 980
1-5 years	31 128	39 500	33 073
Over 5 years	654	5 682	5 391
Total notes, bonds and other interest-bearing securities	**85 333**	**108 198**	**107 445**

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 30 September 2018**

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	15 576	0	0	0	0	0	10 976	276	0	**26 828**
Multilateral development banks	7 082	0	0	0	0	0	719	618	0	**8 419**
Regional authorities	19 573	0	0	3 743	0	0	3 571	1 766	384	**29 037**
Financial institutions	3 487	0	0	0	0	0	0	82	0	**3 569**
Securitisation	0	0	0	0	0	0	8	0	0	**8**
Covered bonds	3 989	0	0	101	0	0	558	12 825	0	**17 473**
Total	**49 708**	**0**	**0**	**3 844**	**0**	**0**	**15 831**	**15 567**	**384**	**85 333**

NOTE 9

Senior securities issued

(Amounts in NOK 1 000 000)	30 September 2018 (IFRS 9)	30 September 2017 (IAS 39)	31 December 2017 (IAS 39)
Senior securities issued (nominal amounts) as at 1 January	**373 816**	**376 785**	**376 785**
New issuance	85 223	111 190	118 509
Redemptions	(71 162)	(90 241)	(113 392)
Amortisation	1 256	258	716
Translation differences	(10 360)	(19 140)	(8 802)
Senior securities issued (nominal amounts) as at end of period	**378 773**	**378 853**	**373 816**
Accrued interest	3 677	2 839	3 336
Fair value adjustment	(19 012)	(4 814)	(7 670)
Of which value change that is due to change in own credit risk	*(836)*	-	-
Of which value change that is due to other reasons	*(18 176)*	-	-
Total senior securities issued	**363 438**	**376 878**	**369 482**
Transition effect on 1 January 2018 due to reclassification*			(84)
Carrying amount on 1 January 2018 (IFRS 9)			**369 399**

**See further information on the transition effect in the Accounting Policies in the annual financial statemens for 2017 and the financial statements for the first quarter of 2018 .*

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

NOTE 10

Primary capital

(Amounts in NOK 1 000 000)	**30 September 2018**	**30 September 2017**	**31 December 2017**
Common equity Tier 1 capital			
Share capital	3 145	3 145	3 145
Retained earnings	8 604	7 909	7 904
Profit for the period included in Tier 1 capital	988	721	1 429
Pension funds above pension commitments	0	0	0
Deferred tax asset*	0	0	0
Intangible assets	(118)	(127)	(125)
Dividends payable	(361)	(335)	(443)
Other additions/deductions in common equity Tier 1 capital	601	761	525
Share of nulled unamortised estimate differences	0	0	0
Total common equity Tier 1 capital	**12 858**	**12 074**	**12 436**
Other approved Tier 1 capital	2 189	2 189	2 189
Total Tier 1 capital	**15 047**	**14 263**	**14 625**
Supplementary capital			
Ordinary subordinated debt	2 000	2 000	2 000
Total supplementary capital	**2 000**	**2 000**	**2 000**
Total primary capital	**17 047**	**16 263**	**16 625**

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

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

NOTE 11

Capital adequacy

(Amounts in NOK 1 000 000)	**30 September 2018**			**30 September 2017**	**31 December 2017**
	Carrying amount	Risk-weighted assets	Minimum capital requirements	Minimum capital requirements	Minimum capital requirements
Credit risk					
Sovereigns and central banks	26 828	0	0	0	0
Regional governments and local authorities	310 278	58 286	4 663	4 467	4 587
Of which are Norwegian municipalities	*289 096*	*58 275*	*4 662*	*4 467*	*4 587*
Public sector entities	7 855	0	0	0	0
Multilateral development banks	8 419	0	0	0	0
Financial institutions	40 735	8 563	685	504	294
Of which counterparty exposure on derivatives	*4 335*	*1 283*	*103*	*132*	*120*
Claims secured by residential property	33	33	3	3	3
Covered bonds	17 473	1 747	140	88	79
Other assets	9	9	1	1	1
Securitisation	8	8	1	1	1
Credit Valuation Adjustment	182	2 279	182	199	184
Total credit risk	**411 820**	**70 925**	**5 674**	**5 263**	**5 150**
Market risk	**0**	**0**	**0**	**0**	**0**
Operational risk—Basic Indicator Approach		**3 629**	**290**	**233**	**254**
Minimum capital requirements		**74 554**	**5 964**	**5 496**	**5 404**
Total capital ratio			**22.9 %**	**23.7%**	**24.6%**
Tier 1 capital adequacy ratio			**20.2 %**	**20.8%**	**21.7%**
Common equity Tier 1 capital adequacy ratio			**17.2 %**	**17.6%**	**18.4%**
Leverage ratio			**3.9 %**	**3.6%**	**3.7%**