Disclosure Report
According to § 26a of the German Banking Act (KWG) and the German Solvency Regulation (SolvV)

as at 31 December 2009

Finanzgruppe

NORD/LB

Die norddeutsche Art.

1 Preamble

The German Solvency Regulation (SolvV) entered into force on 1 January 2007. This regulation spells out the regulations governing the capital adequacy of institutes, groups of institutions and financial holding groups demanded by § 10 of the German Banking Act (KWG) and supersedes the previous Principle I.

The Solvency Regulation transposes the European standards prescribed in the Banking Directive and the Capital Adequacy Directive into national law. The European standards in turn are based on the international Basel II set of regulations issued by the Basel Committee on Banking Supervision.

Requirements relating to the regular disclosure of qualitative and quantitative information to enhance market discipline are defined in Pillar III of Basel II. The aim is to create transparency as to the risks entered into by the institutes. Pillar III thus supplements the minimum capital requirements of Pillar I and the supervisory review process of Pillar II. In Germany the disclosure requirements were generally implemented in § 26a of the German Banking Act. These requirements were spelled out in Part 5 of the Solvency Regulation in §§ 319 to 337.

This report as at 31 December 2009 constitutes the disclosure of qualitative and quantitative information in accordance with the Solvency Regulation by Norddeutsche Landesbank Girozentrale, Hanover, (NORD/LB) as the superordinate institute in the NORD/LB Group for the regulatory group. Disclosure in accordance with the Solvency Regulation is generally aligned towards a group approach. This means that member companies in the Group are not obliged to disclose such information separately.

The disclosure principles and the disclosure process of the NORD/LB Group are set out in the “Disclosure Guidelines for the Norddeutsche Landesbank Group on Regulatory Disclosure according to § 26a of the German Banking Act (KWG) and the German Solvency Regulation (SolvV)”. An important principle in this respect is the regular review of the disclosure report with regard to the need for optimisation. As a result of the last review several optimisations have been carried out to further improve transparency.

The disclosure report is an auxiliary document supplementing the Annual Report of the NORD/LB Group prepared on the basis of International Financial Reporting Standards (IFRSs) and the individual annual reports of Group member institutes prepared on the basis of the German Commercial Code (HGB). Norddeutsche Landesbank Luxembourg S.A., Luxembourg, and NORD/LB Covered Finance Bank S.A., Luxembourg are exceptions in this case since the bank prepares its annual financial statements in accordance with IFRSs.

Information on equity is disclosed on the one hand, while on the other hand significant risks and the corresponding system of risk management as well as methods of risk control are described. The NORD/LB Group currently considers the risk of counterparty default (credit risk and investment risk), market price risk, liquidity risk and operational risk to be significant.

Quantitative information contained in this report is based on the German Commercial Code which currently constitutes the basis for preparing regulatory reports in accordance with the Solvency Regulation in the NORD/LB Group. Norddeutsche Landesbank Luxembourg S.A., is an exception in this case too, since its quantitative information is based on Lux GAAP (information on equity) or on IFRSs.

For further information about risk beyond regulatory Solvency Regulation requirements, this report contains a few references to the risk report which is part of the NORD/LB Group’s management report. Here a detailed account is given on risk developments for each significant type of risk in the period under review and an outlook for developments anticipated in future.

In accordance with § 320 Paragraph 1 of the Solvency Regulation, this disclosure report is published in the Investor Relations/Reports section of the NORD/LB website. Publication of the report is announced in the electronic German Federal Register (www.ebundesanzeiger.de) in accordance with § 320 Paragraph 2 of the Solvency Regulation.

2 Application

Solvency Regulation requirements for disclosure refer to regulatory groups of institutes in accordance with § 10 a of the German Banking Act. However, in terms of risk aspects, only significant entities in the group of institutes are included in disclosure. The institutes are selected on the basis of a concept of materiality which is regularly reviewed so that changes in the regulatory group are taken into account for disclosure purposes.

Based on this concept, NORD/LB, Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –, Bremen (Bremer Landesbank), Norddeutsche Landesbank Luxembourg S.A., Luxembourg (NORD/LB Luxembourg), Deutsche Hypothekenbank (Actien-Gesellschaft), Hanover (Deutsche Hypo) and for the first time NORD/LB Covered Finance Bank S.A., Luxembourg (NORD/LB CFB), are included in this report as significant Group institutes. All qualitative and quantitative information therefore refers to this regulatory basis of consolidation. Particularities of the individual Group institutes are explicitly stated.

From the point of view of the entire Group, the other institutes account in quantitative terms for an insignificant level of individual risk. Risks concerning these companies are treated as investment risk. The group of significant Group institutes in the regulatory group is at present identical with the group of significant institutes in the IFRS basis of consolidation. "Group" is hence the term used below to refer to both the regulatory group and the group according to IFRSs.

In accordance with § 323 Paragraph 1 No. 2 of the Solvency Regulation, Table 1 contains an overview of the regulatory group of significant institutes included in the NORD/LB Group and information on how they are treated in the IFRS basis of consolidation.

Table 1: Consolidation matrix for the NORD/LB Group

Type of institute	Name	Regulatory treatment				IFRS consolidation	
		Consolidation		Deduction method	Risk-weighted investments		
		Full	Proportionate			Full	Measured using equity method
Bank	Norddeutsche Landesbank Girozentrale	•				•	
Bank	Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –	•				•	
Bank	Norddeutsche Landesbank Luxembourg S.A.	•				•	
Bank	Deutsche Hypothekenbank (Actien-Gesellschaft)	•				•	
Bank	NORD/LB Covered Finance Bank S.A.	•				•	

The independent market image of the five significant Group institutes highlights the focus on their own products and regions while, at the same time, the close ties within the Group constitute a significant success factor. Below is a description of each institute.

NORD/LB is a registered public institute (AöR) in Germany, with registered offices in Hanover, Braunschweig and Magdeburg. Its head office is in Hanover. NORD/LB is the state bank for the federal states of Lower Saxony and Saxony-Anhalt. In these two federal states and in Mecklenburg-Western Pomerania the bank performs the functions of a central and clearing bank for the savings banks (Girozentrale). NORD/LB operates in the business segments of the savings bank network, private and commercial customers, corporate customers, structured finance (comprising ship and aircraft finance, commercial real estate finance and structured finance) and financial markets (comprising markets, corporate sales, portfolio management & solutions, portfolio investments und treasury).

Bremer Landesbank is the largest regional bank between the Ems and Elbe rivers. It assumes the roles of state bank, central bank for savings banks and commercial bank. The guarantors of Bremer Landesbank are NORD/LB, which holds 92.5 per cent of the share capital, and the federal state of Bremen with a 7.5 per cent shareholding.

NORD/LB Luxembourg was founded in 1972 as an independent public limited enterprise under Luxembourg law. Since 1975 the bank has been a full subsidiary of NORD/LB. NORD/LB Luxembourg's activities lie in the business segments of private banking, loans, credit investments & solutions and treasury.

Deutsche Hypo, which was established in 1872, is a well-positioned mortgage bank with a rising volume of commercial real estate business. The bank has more than 300 employees at five locations in Germany and branches in Amsterdam, London, Madrid and Paris. NORD/LB holds all the share capital and the voting rights of Deutsche Hypo.

NORD/LB CFB was established as a full subsidiary of NORD/LB Luxembourg. It is a specialised bank with a licence to issue lettres de gage (mortgage bonds under Luxembourg law). NORD/LB CFB acts as a centre of competence for the NORD/LB Group's OECD-wide international public finance business. NORD/LB CFB's issues concentrate on medium and long-term-covered issues outside the euro.

In addition to the five significant institutes in the NORD/LB Group stated above, the basis of consolidation under regulatory law and IFRSs comprises another 106 insignificant entities from a risk point of view in which NORD/LB holds direct and indirect participating interests. These include ten banks, two financial services institutions, 53 financial enterprises, two insurance companies and 39 other entities.

Of these institutes, 23 are fully consolidated under regulatory law, 36 are subject to the deduction method and 20 are exempted from inclusion in the Group report in accordance with § 31 Paragraph 3 of the German Banking Act. 27 entities included in the IFRS basis of consolidation are not consolidated under regulatory provisions. 34 companies are fully consolidated according to IFRS and 15 are measured using the equity method. 57 entities included in the regulatory basis of consolidation are not consolidated according to IFRS.

A complete list of equity holdings in accordance with § 313 Paragraph 2 of the German Commercial Code is published in the electronic German Federal Register (www.ebundesanzeiger.de).

Insignificant Group institutes from a risk aspect result in differences between the figures in the disclosure report and those in the Annual Report of the NORD/LB Group. Differences may also occur because German Commercial Code figures are used in the disclosure report and IFRS figures in the consolidated financial statements and because other effects of consolidation are not included.

Changes to the figures disclosed as at the reporting date 31 December 2008 are the result of the first-time inclusion of NORD/LB CFB and methodological changes made in the meantime.

In the NORD/LB Group there are currently no limitations or other significant restrictions on the transfer of funds or liable equity in accordance with § 323 Paragraph 1 No. 3 of the Solvency Regulation.

There are no exceptions in the NORD/LB Group relating to compliance with specific Banking Act provisions for subsidiary Group member institutes defined in the waiver regulation in § 2a of the Banking Act, for example instructions concerning equity, large-scale loans and internal control systems according to § 25a Paragraph 1 of the Banking Act.

There were no subsidiaries in the NORD/LB Group which are subject to the deduction method and report insufficient capital in accordance with § 323 Paragraph 2 of the Solvency Regulation.

3 Risk Management

3.1 Risk Management Strategies and Processes

The business activities of a bank inevitably involve the undertaking of risks. From a business point of view, the NORD/LB Group defines risk as being potential direct or indirect financial losses due to unexpected negative differences between the actual and projected results of business activity. Identifying, analysing, measuring, monitoring and the management and reporting of these risks are basic requirements for the sustained success of an enterprise.

The framework for structuring this risk management process is specified for banks and groups of banks in the Minimum Requirements for Risk Management (MaRisk) on the basis of § 25a of the German Banking Act. In accordance with these requirements, proper business organisation includes the specification of strategies on the basis of procedures for ascertaining and securing risk-bearing capacity, which comprises both risks and the capital available for covering these risks.

The risk policy of the NORD/LB Group is characterised by a responsible handling of risks. The Group risk strategy, drafted with this in mind, overrides the risks strategies of the principal companies in the NORD/LB Group and is, taking into account the respective business models, substantiated by the risk strategies of the principal companies in the NORD/LB Group.

The core element of the risk strategy is the risk-bearing capacity model (RBC model), on the basis of which risk willingness is specified and the allocation of risk capital to the material risk types is undertaken. Most of this is associated with credit risk, reflecting the focus of the NORD/LB Group on customer-oriented lending business.

The risk strategies of the principal companies in the Group are in each case defined in accordance with the business model, the business strategy and the Group risk strategy policy and are reviewed at least once a year. They contain information on the principles of risk strategy, the organisation of the risk control process and on sub-strategies for risks relating to the significant bank-related types of risk. Furthermore specifications with regard to the allocation of risk capital to the material risk types are made in the risk strategies.

The Group risk strategy and the risk strategy of the principal companies were revised in 2009 and discussed with the Supervisory Board after being passed by the Managing Board. The revision focused on the implementation of the requirements of the MaRisk amendment. Among other things the group-wide sub-strategies for risks and the group-wide allocation of risk capital were detailed.

The risk strategies aim at achieving an optimal method of controlling and monitoring all of the relevant types of risk and at achieving a transparent presentation of these risks to the management, the supervisory bodies and other third parties with a justified interest. They constitute the basis of risk control and include an overview of the measures and instruments described in more detail in the risk manual.

On the basis of a standard RBC model for the entire Group, the NORD/LB risk strategy, based on the current situation and taking into account scheduled business operations, focuses on securing a forward-looking risk-bearing capacity for the individual companies and the Group.

Based on this, the principal group companies in the Group have a range of instruments at operational level which provide the necessary transparency, limitation and portfolio diversification in a way which can be controlled and monitored. These instruments are described in detail in the risk manual or appropriate documents.

The NORD/LB Group has implemented a risk organisation system that complies with the risk policies of the Group's risk strategy. The risk organisation comprises structures to guarantee the regulated interaction of all the divisions involved in the process of risk control. Furthermore, efficient risk management and controlling processes with clearly defined tasks and authorities ensure smooth procedures – backed up by an adequate IT infrastructure and qualified employees. An effective internal control and monitoring system ensures compliance. The aim is to consistently optimise the risk organisation and to adapt it to current requirements.

The risk strategies of the significant institutes in the NORD/LB Group comprise standard principles concerning structures and processes in risk management and control which have been laid down for the entire Group.

The NORD/LB Group has implemented cross-division risk control processes. The sub-processes apply to all types of risk:

- Risk identification: identification and classification of risks taken
- Risk analysis: quantitative and qualitative risk assessment
- Risk measurement: regular measurement of risk in uniform procedures
- Risk monitoring: regular monitoring of risk limits; review of the general risk profile and non-quantifiable risks
- Risk management: handling risk, e.g. avoiding, mitigating or assuming risk
- Reporting: regular reports and ad-hoc reports on the risk situation

Activities for the ongoing optimisation of the risk organisation include improvement to the internal control system geared to establishing uniform process and risk-oriented structures and procedures. Detailed descriptions of the processes relating to risk management and risk control are laid down in the risk manual and the relevant working instructions.

Reference is made to Section 5 on the individual types of risk for more detailed information on risk management strategies and processes in accordance with §322 of the Solvency Regulation.

3.2 Risk Management Structure and Organisation

Responsibility for the risk control of the NORD/LB Group lies with the Managing Board of NORD/LB. The Managing Board initially coordinates the extended Group risk strategy and its amendments in the Erweiterter Konzernvorstand (extended Group Managing Board); the Erweiterter Konzernvorstand also includes the Chairmen of the Bremer Landesbank, NORD/LB Luxembourg and Deutsche Hypo and its resolutions are referred to the responsible bodies in the Group institutes concerned for formal decision. NORD/LB CFB, as a subsidiary of NORD/LB Luxembourg, is represented by NORD/LB Luxembourg in the Erweiterter Konzernvorstand. After agreement it is then passed by the Managing Board of NORD/LB and discussed in the Supervisory Board.

The responsible Chief Risk Officer (CRO) in the Managing Board bears, in concert with the heads of the market departments, responsibility for drawing up and monitoring the Group risk strategy. This includes the monitoring of quantifiable risks including the risk reporting at group level. At individual institute level responsibility lies with the respective Managing Board or the risk officer.

Operational risk management and the monitoring of risk are performed decentrally in the principal group companies. In order to ensure the greatest possible comparability with regard to the control, monitoring and reporting of all significant risks, it is essential that there is coordinated use of instruments used for this purpose. This is ensured by the higher-level institute establishing the methods.

In addition to the Erweiterter Konzernvorstand, the control of the NORD/LB Group is supported by a system of Konzernsteuerungskreise (Group Control Committees) implemented in the year under review. From a risk point of view in particular the Konzernsteuerungskreis Risk/Finance, which includes the risk officers of NORD/LB, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo as well as other divisional heads is relevant

With regard to the holistic consideration of risks in the NORD/LB Group, the respective Managing Board is supported by the Group Risk Committee (GRC). The GRC is a committee which is part of the group control division Risk/Finance and comprises the Chief Risk Officer, the heads of the market divisions and the heads of the divisions Generalia, Risk Controlling, Credit Risk Control, Research/Economy and the credit administrative divisions of NORD/LB and the risk officers at Bremer Landesbank, NORD/LB Luxembourg and Deutsche Hypo. Further participants are invited when required. The focus of the GRC lies in considering the overall portfolio of the NORD/LB Group taking into account all material types of risk and strengthening Group integration.

The structure and organisation of risk control in the NORD/LB Group complies with the requirements of MaRisk. The process of risk control is subject to constant review and improvement. Adjustments which may be made cover organisational measures, adjustments to procedures for quantifying risk and the continuous updating of relevant parameters.

NORD/LB's General Bank Risk Control Division is responsible for updating and developing the RBC model and regularly reviewing the risk strategies.

A risk-related examination of the effectiveness and adequacy of risk management is carried out independently of the processes by Internal Audit. As an instrument of the Managing Board it is part of the internal monitoring system. The aims of Internal Audit also include making a contribution towards securing the effectiveness, the efficiency and correctness of business activities. It also facilitates the optimisation of business processes and of controlling and monitoring procedures.

Within the framework of the Group-wide monitoring instruments, the internal audit departments of NORD/LB, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB work together closely using fundamentally uniform instruments (audit policy and assessment matrix for audit findings).

Due to the changes in regulatory requirements placed on the management of risk across the Group, the goals, tasks, function and instruments for Group audit have been revised and a new Group audit policy has been drawn up. The concept agreed in the extended Group Managing Board was passed by the Managing Board in December 2009 came into effect on 1 January 2010.

The treatment of new products, new markets, new sales channels, new services and their variations is regulated decentrally in the new product process (NPP) in the significant institutes of the NORD/LB Group taking into account the respective conditions; however there is also close coordination between the institutes in this respect.

The essential aim of the NPP is to identify, analyse and assess all potential risks for the institutes of the NORD/LB Group prior to starting the new business. This includes all of the essential audit areas, documentation of the new business activities, their treatment in the overall operational process, the decisions to start the business and where applicable the associated restrictions.

Reference is made to Section 5 on the individual types of risk for more detailed information on the structure and organisation of risk management in accordance with § 322 of the Solvency Regulation.

3.3 Hedging and Mitigating Risk

Various measures for hedging and mitigating risk are undertaken, depending on the type of risk in question. Reference is made to Section 5 on the individual types of risk for more detailed information on covering and mitigating risk in the system of risk management in accordance with § 322 of the Solvency Regulation.

3.4 Risk Reporting

The reports drawn up by the Risk Control Division on risk-bearing capacity (RBC reports) constitute the main instrument for risk reporting at group and individual institute level to the Managing Board and the supervisory bodies at full bank level.

In addition to receiving the report on risk-bearing capacity, the Managing Boards of the institutes subject to the Mortgage Bond Act (Pfandbriefgesetz) are also informed about risks relating to mortgage bond business on at least a quarterly basis. The reports prepared at individual institute level meet the requirements of § 27 of the Mortgage Bond Act.

In general the management approach is applied for risk reporting: internal and external risk reports are always based on the same terms, methods and data.

In addition to risk reporting for the entire bank, data relating to the individual types of risk is regularly reported to the Managing Board and to bodies, committees and specialised bank divisions. Reference is made to Section 5 on the individual types of risk for details on reporting within the system of risk management in accordance with § 322 of the Solvency Regulation.

3.5 Types of Risk

3.5.1 Credit Risk

Credit risk is an element of counterparty default risk. It defines the risk of loss involved when a borrower defaults or when the credit rating of such a borrower deteriorates.

Counterparty risk is included under the item of “credit risks” and constitutes the risk which results when the default of a party to a contract means that an unrealised profit from a pending trade transaction can no longer be earned (replacement risk) or if the default of a counterparty within the framework of a step-by-step transaction means that the return service for an advance payment already made will not be received (fulfilment risk).

In addition to borrower-related credit risks, a national risk will occur when cross-border capital transfer services involve the risk that, despite the ability and the willingness of individual borrowers to make repayment, a loss will occur as a result of overriding government hindrances (transfer risk).

3.5.2 Investment Risk

Investment risk is another component of counterparty default risk and defines the risk of incurring losses when making equity available to third parties.

3.5.3 Market Price Risk

Market price risks are potential losses which may be incurred as a result of changes in market parameters. With market price risk the NORD/LB Group makes a distinction between interest-rate risk, credit-spread risk in the investment book, currency risk, share-price and fund-price risk, volatility risk and raw material risk.

Interest rate risk always occurs when the value of an item or a portfolio reacts to changes to one or several interest rates or to changes in full yield curves and when these changes may consequently impair the item. Prepayment risk and credit spread risk constitute part of interest rate risk in the trading book. Prepayment risk occurs with products where the repayment structure is not specified in the contract (e. g. securitisation where discharge is related to the repayment of the underlying asset) and at the same time are not charged variable interest rates.

Credit spread risk arises in the event of changes to the additional interest rate for respective issuers, borrowers or reference entities which is added to the risk-free interest rate when a market value is determined for an item. Credit-spread risk in the trading book is a component of interest rate risk. A credit-spread risk for items in the investment book exists if this market value has an impact on the income statement or the revaluation reserve.

Currency risks (or exchange-rate risks) arise when the value of an item or portfolio reacts sensitively to changes in one or several currency exchange rates and if changes in the exchange rates could result in impairing an item.

Share-price risks always occur when the value of an item or a portfolio reacts to changes in one or several share prices or share indices and if these changes in share prices or share indices could impair the item. Fund-price risks occur when the value of an item or portfolio reacts sensitively to changes in one or several fund prices.

Volatility risks result from option items and refer to potential changes in the value of the derivative portfolios in question as a result of market fluctuations in the volatilities applied for valuing the options.

Risks relating to raw materials have no significant relevance in the NORD/LB Group.

3.5.4 Liquidity Risk

Liquidity risks are risks which may result from malfunctions in the liquidity of individual market segments, unexpected events in lending or investment business or deterioration in the bank's own refinancing conditions. Liquidity risks are defined as classical liquidity risk, refinancing risk and market liquidity risk.

Classical liquidity risk is the risk that the NORD/LB Group is not able to meet its payment obligations due to externally induced market disruptions or unexpected events in its lending or investment business. The focus of the NORD/LB Group consideration is on the respective coming twelve months.

Refinancing risk constitutes potential declines in earnings resulting for the NORD/LB Group from the worsening of the bank's own refinancing conditions on the money market or capital market. The most significant cause in this case is a change in the estimation of the bank's credit rating by other market participants. The focus of consideration here is on the entire range of terms to maturity.

Market liquidity risk defines potential losses to be borne by the Group if transactions need to be concluded at conditions which are not in line with the fair market value due to a lack of liquidity in individual market segments. Market liquidity risks may primarily result from security items in the trading and investment books.

3.5.5 Operational Risk

Operational risk is defined as the risk of incurring losses as a result of the inadequacy or failure of internal procedures, employees and technology or losses which occur as a result of external influences. Besides covering legal risks, this definition implicitly covers reputation risks as consequential or secondary risks. Strategic risks and business risks have not been included.

4 Capital Structure and Adequacy

4.1 Capital Structure

The components of capital of the NORD/LB Group included in the summary according to § 10a Paragraph 6 of the German Banking Act comprise the core capital and the supplementary capital allocated to the Group entities as well as certain deductions.

Aggregated core capital as at 31 December 2009 amounts to € 8,051 million and primarily comprises share capital paid in, other eligible reserves, contributions from silent partners, a special item for general banking risks according to § 340g of the German Commercial Code and asset-side differences of which 50 per cent may be recognised.

Share capital paid in comprises the capital stock of NORD/LB as the superordinate entity (approx. € 1,085 million), shares in the share capital or capital stock of subordinate entities (approx. € 54 million) and an indefinite contribution to capital in accordance with § 15 Paragraph 1 of the NORD/LB state treaty (approx. € 51 million). This investment is subject to variable interest rates to the amount of the respective capital market yield plus a risk premium fixed for a period of five years in each case.

Other eligible reserves comprise capital reserves and retained earnings. Compared to the end of 2008 these reserves have increased by approximately € 158 million due primarily to the retention of earnings from the profit in 2008.

Contributions from silent partners are eligible as core capital in accordance with § 10 Paragraph 4 of the German Banking Act. The contracts are worded differently as follows:

- Indefinite contributions without any cancellation privilege on the part of the subscribers (altogether € 2,054 million), issued in 2005, 2007 and 2009. In 2009 the volume of these contributions increased by approximately € 454 million due to the conversion of former participatory capital liabilities and the issue of hybrid capital by a special purpose entity. The interest for all of these contributions is either fixed at the capital market yield on the date of issue plus a standard market risk premium or it is only fixed for the first few years of the term as already described, after which it varies on an annual basis and amounts to the respective capital market yield plus a standard market risk premium which is fixed on the date of issue. Interest payments are excluded under certain conditions and in some cases such payments are at the discretion of the issuer.
- Indefinite contributions with a cancellation privilege for the subscribers (a total of around € 784 million) issued in 1994, 1996, 1998, 1999 and 2001. Contributions are mainly redeemable by the subscribers and by the issuer at the earliest at the end of the tenth calendar year after issue on observance of a two-year period of notice. The amount of interest is either fixed in line at the capital market yield on the date of issue plus a risk premium for the term until the earliest possible cancellation date or it is fixed for the first few years of the term after which it varies on an annual basis and amounts to the respective capital market yield plus a standard market risk premium which is fixed on the date of issue. Interest payments are excluded under certain conditions.
- A temporary contribution to mature at the end of 2011 (€ 44 million).

The special item for general banking risks in accordance with § 340g of the German Commercial Code serves to reinforce the capital of the NORD/LB Group.

Asset-side differences result for all the regulatory participating interests which are fully or proportionately consolidated and whose carrying amount in the superordinate entity exceeds the total of that participating interest's share capital and reserves. Half of these asset-side differences (altogether approx. € 30 million) are included as core capital.

Furthermore, for solvency purposes, half of the deductions shown below are deducted from the core capital (a total of € 1,120 million). The resulting core capital for solvency purposes amounted to a total of € 6,931 million as at 31 December 2009.

Aggregated supplementary capital as at 31 December 2009 amounts to € 3,165 million and primarily comprises the following components:

- Provision reserves according to § 340f of the German Commercial Code (approx. € 136 million).
- Participatory capital liabilities (altogether approx. € 297 million), which have an original term to maturity of at least ten years or which are partly indefinite. The amount of interest is calculated as the capital market yield on the date of issue or prolongation plus a standard market risk premium. The requirements for inclusion in supplementary capital according to § 10 Section 5 of the German Banking Act have been fulfilled. Compared to the end of 2008 these participatory capital liabilities have been reduced by approximately € 525 million. This reduction is primarily the result of the above-mentioned conversion of participatory capital liabilities into indefinite contributions from silent partners and banking regulatory eligibility no longer applying due to a residual term of less than two years.
- Subordinated liabilities (amounting to approx. € 2,762 million) with original terms to maturity of ten years or more. The amount of interest is calculated as the capital market yield on the date of issue or prolongation plus a standard market risk premium. The requirements for inclusion in supplementary capital according to § 10 Section 5a of the German Banking Act have been fulfilled. In 2009 longer-term subordinated liabilities with a total volume of approximately € 376 million were taken on.
- The half of asset-side differences to be deducted (altogether approximately € 30 million). The asset-side differences indicated above, half of which are recognised as core capital, are in turn deducted from supplementary capital.

Furthermore, for solvency purposes, half of the deductions shown below is deducted from supplementary capital (a total of € 1,120 million). The resulting core capital for solvency purposes amounts to € 2,054 million as at 31 December 2009.

The deductions from core capital and supplementary capital amounted to € 2,240 million of 31 December 2009 and comprise

- the carrying amounts of participating interests in accordance with § 10 Paragraph 6 Clause 1 Nos. 1 and 5 of the German Banking Act
- receivables from subordinated liabilities under § 10 Paragraph 6 Clause 1 No. 2 of the German Banking Act
- deficits in bad debt allowances under § 10 Paragraph 6a No.1 of the German Banking Act.

Compared to the end of 2008 these deductions have been increased due primarily to the considerable increase in deficits in bad debt allowances by in total approximately € 678 million. This increase in deficits is however also to a large extent the result of bad allowances for loans and advances made in 2009 not being eligible under banking regulations as at 31 December 2009 because at this time no certified annual financial statements for the Group entities were available. After the bad debt allowances from 2009 are allowed under banking regulations during the course of 2010, the deficits in bad debt allowances and therefore total deductions are likely to fall again.

For solvency purposes, half of the total of these deductions is deducted from core capital and half is deducted from supplementary capital.

Table 2 shows the components of capital in the regulatory capital structure in accordance with § 324 Paragraph 2 of the Solvency Regulation.

Table 2: Capital structure

Components of capital	(in € million)
Share capital paid in	1,191
Other eligible reserves	2,869
Contributions from silent partners	2,882
Special item for general banking risks in accordance with § 340g of the German Commercial Code	1,094
Other capital components less other deductions according to § 10 Paragraph 2a Clause 2 of the German Banking Act	15
Aggregated core capital according to § 10 Paragraph 2a of the German Banking Act	**8,051**
Aggregated supplementary capital according to § 10 Paragraph 2b of the German Banking Act and tier three funds according to § 10 Paragraph 2c of the German Banking Act	**3,165**
Total capital deductions according to § 10 Paragraph 6 and 6a of the German Banking Act	**– 2,240**
of which deficits in bad debt allowances and anticipated loss amounts according to § 10 Paragraph 6a No. 1 and 2 of the German Banking Act	– 1,090
Aggregated amount of modified available equity according to § 10 Paragraph 1d of the German Banking Act and eligible tier three funds according to § 10 Paragraph 2c of the German Banking Act	**8,976**

4.2 Capital Adequacy

4.2.1 Approaches for Ascertaining Capital Requirements

4.2.1.1 Credit Risks

In order to calculate equity capital required for credit risks, the NORD/LB Group basically uses the Internal Ratings Based Approach (IRBA).

Promotional institutes, the subsidiary Skandifinanz Bank AG, insurers, the Bremer Landesbank's commercial foreign real estate finance and Deutsche Hypo's retail banking are excluded for an indefinite period from the IRBA Exposures excluded from the IRBA for an indefinite period are shown in the Credit Risk Standardised Approach (CRSA).

The exposure class of retail is currently still treated as partial use and is gradually being transferred to the IRBA (NORD/LB probably in 2010 and Bremer Landesbank by 2012). For the segment of minor customers without a current account partial use is still applied.

Exposures for which no internal rating procedure is available due to a gap in methodology are also treated as partial use. A regular system of rating controls will ensure that the target level of rating cover of 92 per cent is achieved by 2012.

The CRSA is used for individual business segments at NORD/LB Luxembourg and NORD/LB CFB, i.e. for savings bank guaranteed lending business, current account overdrafts, Lombard loans and business transacted with Südwestbank. Permanent partial use was authorised by the Luxembourg Financial Supervisory Authority CSSF (Commission de Surveillance du Secteur Financier).

Deutsche Hypo currently uses the CRSA for receivables from central governments, local authorities and corporates that are not included in the system for rating real estate customers (temporary partial use). The extension of IRBA authorisation to cover the named exposure classes is planned for 2010.

NORD/LB currently employs simple risk weights for special financing in the case of aircraft financing with comparatively short lease terms and with limited remaining value risks (operating leases). These aircraft loans are given a risk weight in accordance with Appendix 1 Table 14 of the Solvency Regulation, depending on the remaining term and the risk weight category. At Bremer Landesbank the elementary approach for special financing is not used. Aircraft loans are being phased out at Bremer Landesbank. Simple risk weights for special financing are not relevant at NORD/LB Luxembourg, Deutsche Hypo or NORD/LB CFB.

In the case of securitisation transactions, the choice of a method for calculating capital requirements – CRSA or IRBA – is made on the basis of pool receivables at NORD/LB, Bremer Landesbank and Deutsche Hypo. Relevant details can be seen in Section 5.1.8.2 on procedures for determining risk-weighted exposure values as well as on rating agencies named for securitisations. Securitisation transactions have so far not been relevant for NORD/LB Luxembourg and NORD/LB CFB.

4.2.1.2 Investment Risk and Investment Funds

NORD/LB always handles participating interests in the IRBA system, apart from the transition rules and exceptions defined in the Solvency Regulation.

Participating interests that were held in the portfolio prior to 1 January 2008 are treated according to § 338 Paragraph 4 of the Solvency Regulation in accordance with the CRSA grandfathering rule. Participating interests that are not covered by grandfathering are for the time being indefinitely exempted from the IRBA in accordance with § 70 No. 2 and No. 9 of the Solvency Regulation and are also backed by equity in accordance with CRSA regulations. Compliance with the materiality threshold is monitored constantly. Participating interests are not relevant for NORD/LB CFB.

Investment funds in the investment book are always handled in accordance with the transparency method. If transparency is not possible, investment shares are allocated to the participating interests exposure class. These exposures are then included in the calculation of capital at the simple risk weight for participating interests in accordance with § 98 of the Solvency Regulation. Investment funds are not relevant for NORD/LB CFB.

4.2.1.3 Market Price Risk

In terms of market price risk, NORD/LB has employed an internal risk model for general interest rate risk and for general and special share price risks to ascertain the regulatory capital requirements since this method was authorised by the Federal Financial Supervisory Authority (BaFin) in 2005. The standard approach is used for special interest rate risks and for currency risks. Bremer Landesbank generally uses the standard approach, in particular the duration method, for general interest rate risk. The same applies for NORD/LB Luxembourg, although in this case, share price risk is irrelevant. For Deutsche Hypo and NORD/LB CFB only currency risk plays a role and this is treated according to the standard approach. As risks relating to raw materials have no significant relevance in the NORD/LB Group, no method was implemented here.

4.2.1.4 Operational Risk

The standard approach is used in the NORD/LB Group to calculate the equity capital required for operational risk.

4.2.2 Capital Requirements per Risk Type

Table 3 shows the regulatory capital requirements in accordance with § 325 Paragraph 2 Nos.1– 4 and § 330 Paragraph 1 of the Solvency Regulation for the NORD/LB Group, broken down by significant types of risk and the methods employed. Due to the economic crisis and the associated rating migrations, the capital requirements have increased compared to the previous reporting date (31 December 2008: € 7,186 million). In particular ship finance and securitisation transactions have been affected.

Table 3: Capital requirements

Capital requirements	(in € million)
1. Credit risk	**6,934**
CRSA credit risks	**961**
Central governments	4
Regional governments and local authorities	33
Other public-sector entities	6
Multilateral development banks	–
International organisations	–
Banks	58
Covered bonds issued by banks	1
Corporates	530
Retail	246
Exposures secured by real estate	58
Investment certificates	–
Other exposures	7
Past due exposures	18
IRBA credit risks	**5,471**
Central governments and central banks	61
Banks	919
Retail	–
Corporates	4,410
Other non-credit-obligation assets	81
Securitisation transactions	**385**
CRSA securitisation transactions	71
IRBA securitisation transactions	314
Investments	**117**
CRSA shares	104
IRBA shares	13
2. Market price risk	**227**
Market price risk in the standard approach	122
of which: interest rate risk	101
of which: share price risk	–
of which: currency risk	21
of which: raw materials risk	–
of which: other	–
Market price risk is in the internal model approach	105
3. Operational risk	**245**
Operational risk in the basic indicator approach	–
Operational risk in the standard approach	245
Operational risk in the advanced measurement approach	–
Total	**7,406**

4.2.3 Capital Ratios

As shown in Table 4 in accordance with § 325 Paragraph 2 No. 5 of the Solvency Regulation, the total capital ratio and the core capital ratio of the significant NORD/LB Group institutes exceed the regulatory minimum capital ratios of eight per cent for total capital and four per cent for core capital as at the balance sheet date. Regulatory capital adequacy was given throughout the entire reporting period.

Compared to the previous reporting date the NORD/LB Group's total capital ratio has fallen slightly (31 December 2008: 10.0 per cent), while the core capital ratio has risen significantly (31 December 2008: 8.1 per cent).

Tabelle 4: Capital ratios

(in %)	Total capital ratio	Core capital ratio
Consolidation bank group		
NORD/LB Group	9.7	8.7
Parent company (as a single institute)		
Norddeutsche Landesbank Girozentrale	11.8	9.9
Subsidiaries		
Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –	11.9	10.0
Norddeutsche Landesbank Luxembourg S.A.	16.3	16.3
Deutsche Hypothekenbank (Actien-Gesellschaft)	9.1	8.3
NORD/LB Covered Finance Bank S.A.	13.1	7.8

4.2.4 Risk-Bearing Capacity

The risk-bearing capacity model constitutes the methodical basis for monitoring compliance with the risk strategies in the NORD/LB Group. This monitoring is carried out at group level by NORD/LB's Risk Control Division and by the respective risk control divisions at individual institute level.

The aim of the model is to aggregate and duly present the bank's risk-bearing capacity (RBC) at both institute and group level. The monitoring and reporting process is conducted regularly and guarantees that the responsible bodies are promptly informed about the risk-bearing capacity situation. The continuous development of the model also improves risk-related corporate control.

The NORD/LB Group employs a scenario-based risk-bearing capacity model which also fulfils the requirements of the Internal Capital Adequacy Assessment Process (ICAAP) in accordance with Basel II and MaRisk requirements. Besides providing the required evidence that an adequate amount of capital is available, the model also serves to verify consistency between risk strategies and specific business activities.

Assessment on the basis of the risk-bearing capacity model compares risks (potential for risk) and the defined risk capital of the individual institutes and the Group in an aggregated form on at least a quarterly basis. In the model, risk capital and risk potential are determined for four different risk scenarios with different, in each case declining probabilities of occurrence. In turn, risk capital and risk potential always grow step by step. The three internally defined scenarios serve as early warning indicators and were specified in compliance with the requirement of a going concern. The fourth step serves the external verification relating to the implementation of the supervisory requirements in accordance with MaRisk.

Risk capital is calculated based on the understanding of capital in accordance with supervisory regulations. When calculating risk potential, a distinction is made between the risk types of credit, investment, market price, liquidity and operational risk, with credit risk being by far the most significant of these risk types.

The RBC model was designed by NORD/LB in close cooperation with the other significant subsidiaries of the NORD/LB Group and is developed jointly with these partners. The identity of the basic methods and their presentation enables aggregation to achieve a Group value, in this case involving the conservative addition of risk potential, while risk capital is fully consolidated.

Quotients resulting from risk capital and risk potential, the levels of risk cover, serve as a yardstick for determining the risk-bearing capacity, which is given from a risk cover level of 100 per cent in the ICAAP. In line with a conservative approach, it was specified at Group level for the ICAAP model that the risk cover level was not to fall below 125 per cent, therefore defining an additional buffer.

At an individual institute level on the other hand, the requirement of a risk cover ratio of at least 125 per cent specified in the respective risk strategy applies not only for ICAAP model, but also for internally defined stages. This specification was intended to ensure that the regulatory requirement of an adequate supply of equity capital was met at all times and that capital distribution is optimised in future with a view to generating target yields.

Taking into account its risk-bearing capacity, the NORD/LB Group and the principal institutes allocate a maximum percentage of risk capital to the five significant types of risk.

The utilisation of risk capital with risk potential in the ICAAP for the NORD/LB Group may be seen in the following overview of risk-bearing capacity.

4.2.5 Security Mechanisms at Association Level

In addition to an adequate supply of available capital, other mechanisms at association level are in place to secure the institute.

NORD/LB is included in the security reserve of the Landesbanken and giro centres and is also covered by the protection system of the Savings Bank Financial Group. In addition to the security reserve of the Landesbanks and giro centres, this protection system comprises twelve other protection schemes which have been consolidated in accordance with their statutes under the umbrella of the Deutscher Sparkassen- und Giroverband (German Association of Savings Banks and Girobanks).

The aim of the protection scheme of the Savings Bank Financial Group is to recognise risks and jeopardising situations among the member institutes as early as possible and to initiate counter-measures. In this case the joint liability scheme operates a risk monitoring system with which the risk positions of participating institutes are monitored by the monitoring committees of their respective protection schemes. These committees in turn report to a central transparency committee which watches over the general risk situation of the joint liability scheme.

The joint liability scheme combines the individual protection schemes in a united protection system within the savings bank financial group. The savings bank financial group thus assumes responsibility for the portfolio of its institutes and completely covers customers' deposits from its own resources (§ 12 of the German Deposit Guarantee and Investor Compensation Act). This makes the joint liability scheme a symbol of cooperation and internal stability within the Group.

As a member of the security reserve for landesbanks and giro centres, Bremer Landesbank is also covered by the joint liability scheme of the savings bank financial group. NORD/LB Luxembourg and NORD/LB CFB are also secured as subsidiaries of NORD/LB. Deutsche Hypo has been a member of the security reserve as an affiliated institute since 1 January 2009.

5 Disclosures on Risk Types

5.1 Credit Risk

5.1.1 Credit Risk Management

5.1.1.1 Credit Risk Management Strategies and Processes

Credit business and the management of credit risks is a core competence for the NORD/LB Group that is to be permanently developed and extended. The NORD/LB Group sees itself as a reliable universal bank focusing on credit business and it positions itself with its customers accordingly.

In order to meet the specific requirements of each business segment, NORD/LB has established financing principles for the individual market segments. These represent binding guidelines for new business for the respective market divisions.

New lending business clearly focuses on concluding agreements with customers with a good to very good credit rating. The NORD/LB Group also concentrates on business with borrowers of good standing in the capital market business. The aim is to produce competitive profitability and ensure efficiency and flexibility in terms of the active management of credit risk positions in order to minimise unexpected losses.

The controlling of the NORD/LB Group's credit portfolio takes into account opportunities and risks. This includes the early identification of crisis situations. For this reason a number of processes, systems and instructions are in place, for portfolios and for individual borrowers, which combined form a system for the early recognition and effective management of risks and the initiation of measures to limit these risks.

The key risk indicators of expected loss and unexpected loss are applied in order to quantify counterparty default risk (credit risk and investment risk). Expected loss is determined on the basis of probability of default, taking into account recovery rates. The risk premium, which must be collected in order to cover expected loss, is calculated with Group-wide standard methods.

Unexpected loss for credit risk is quantified Group-wide with the help of a credit risk model for four different confidence levels and a time frame of one year. The NORD/LB Group has performed the calculation in the year under review for the first time on the basis of a new economic credit risk model which includes correlations and concentrations in the risk assessment more than before, therefore representing a significant improvement in the method used.

The credit risk model calculates the unexpected losses at the level of the overall portfolio. This is then apportioned over the individual borrowers. The model is based on CreditRisk+. Using correlated sector variables, systematic industry effects are represented in the loss distribution. The estimated probability of default (PD) is based on the internal rating method. The loss given default (LGD) is determined on a transaction-specific basis.

The model is supported by the use of limit models to limit concentrations of risk (large exposure management, country exposure management and industry limitation) in order to adequately manage concentrations of risk in the portfolio.

The methods and procedures for risk quantification are agreed on between the risk controlling units in the significant Group companies in order to ensure standardisation throughout the Group. Risk management and controlling are performed constantly and decentrally in the group companies.

5.1.1.2 Credit Risk Management Structure and Organisation

A risk-related organisational structure and the functions, responsibilities and authorisation of divisions involved in risk processes are clearly defined at employee level. In accordance with MaRisk, processes in credit business are characterised by a clear organisational separation of the market and risk management divisions, right through to management level.

NORD/LB market divisions conduct the operational financing business relating to customers, properties and projects on a national and international level within a framework of specified limits. They are primarily responsible for the core tasks of acquisition and sales and are relieved of administrative tasks. The market divisions are responsible for the initial vote, for structuring conditions and for earnings. In the case of minor-volume, low-risk exposures, the market divisions will in some cases also bear sole responsibility for the risk (unilateral authorisation) as well as responsibility for analysing and monitoring these risks.

Tasks relating to analysis and risk monitoring as well as the specification of collateral values are combined in the Credit Risk Management (CRM) back office division. Real estate and special appraisals are exceptions here; these are carried out in a separate department. The Credit Risk Management Division is also responsible for the second vote taken for decisions on individual loans. In a multi-stage reporting system, the division also prepares segment portfolio reports on selected sub-segments at regular intervals.

The Credit and Securities Management division in the CRM is responsible for implementing the credit decisions including the contract documentation and for managing portfolios. With special finance the respective market division is responsible for these tasks.

The processing of non-performing exposures or exposures requiring debt readjustment is the responsibility of the Special Credit Management (SCM) Division at NORD/LB. Credits with a rating of 11 on the DSGV rating master scale (i.e. allocation to the "high risk" category in accordance with the "Initiative Finanzstandort Deutschland" (IFD, initiative for Germany as a financial location) or lower and exposures with a rating of 7 (allocation to the "good/satisfactory" category in accordance with IFD) or lower which exhibit other established risk indicators must all be reported to the SCM division where a decision can be taken on whether the processing of a loan is to be taken over or whether the loan is to remain with the credit risk management division. From a rating 16 (allocation to the IFD Default risk category), the SCM division is obliged to take over responsibility for an exposure.

Credit decision authorisation is classified in accordance with the total loan eligible and the rating of a borrower. Credit decisions are always taken by a person in authority in the market division and a person in authority in the risk-management division (bilateral authorisation). The second vote is prepared in units independent of the market divisions in accordance with specified criteria. In addition to fulfilling the regulatory requirement of functional separation for credit assessments, this ensures that first-class credit decisions are taken on the basis of unified standards.

The Managing Board is responsible for the general credit risk management of the NORD/LB portfolio. In performing its tasks, the Board consults among other things the Group Risk Committee (GRC), which ensures that a link between individual credit decisions and portfolio management as well as an approach covering all the types of risk is given. The GRC recommends to the Managing Board various instruments for this purpose such as the ordering of an acquisition stop, the limiting of national, industrial or borrower-related risks or making recommendations relating to the placement of exposures and sub-portfolios.

As at a certain volume, decisions are taken by the Managing Board or by the General Working and Credit Committee (AAKA), a sub-committee of the Supervisory Board of NORD/LB. The AAKA participates in the process of granting loans in accordance with an authorisation regulation passed by the Supervisory Board. The acquiring of participating interests is also subject to a Supervisory Board resolution as is approval for loans to executives.

The Credit Risk Control Division is responsible for the methods employed for measuring and controlling credit risk in the area of credit risk control, which comprises the Reporting System/Methods and the Credit Portfolio Management divisions.

The Reporting System/Methods department is responsible for the independent monitoring of credit and investment risk at portfolio level and for the corresponding report system as well as the regulatory reporting system. This is also where method-related responsibility for procedures relating to the economic quantification of counterparty default risk already agreed on with the Risk Control Division lies.

The main task of loan portfolio management is to supervise concentration risks in the loan portfolio. Concentrations in terms of the magnitude of a borrower entity as well as national and industrial concentrations are examined.

At Bremer Landesbank independent back office tasks are carried out by the back office department Financing Risk Management. In addition to casting a second vote, it verifies and stipulates rating levels, verifies collateral values, processes and supervises of debt restructuring and work-out exposures and loan loss provisions, and shapes the policies and procedures for the lending business. Exposures beyond the scope of rating categories 1 to 8 are supervised more intensively or are handed over for restructuring to the department bearing the same name. This department is principally responsible for deciding on how an exposure is to be monitored in future or whether it is to be cancelled and coercive measures implemented. The tasks relating to independently monitoring risks at portfolio level and to independent reporting are the responsibility of the risk control group in Overall Bank Management.

Risk management at NORD/LB Luxembourg and NORD/LB CFB is based on the concepts of NORD/LB and is regularly improved in accordance with commercial and regulatory criteria. Credit decisions are made in accordance with the back office vote of the authorised persons in the Credit Risk Management (CRM) division of NORD/LB Luxembourg. The independent monitoring of the portfolio is carried out by the Risk Control Division at NORD/LB Luxembourg. NORD/LB's SCM division and the CRM division are responsible for monitoring loans requiring comment or debt restructuring.

Risk management at Deutsche Hypo is also based on the concepts of NORD/LB and regularly improved. The second vote for credit transactions is performed by the back office division Credit Risk Management. The exposures requiring debt restructuring are looked after by the SCM division of Deutsche Hypo, either intensively with the goal of out-of-court restructuring or with defaulting counterparties with the goal of realising collateral. The local risk control division monitors the risks of Deutsche Hypo at portfolio level.

5.1.1.3 Credit Risk Cover and Mitigation

A specific limit is stipulated for each borrower at individual transaction level within the scope of operational limiting in order to control risks; this has the character of an upper limit. The significant parameters applied for deriving this limit are a borrower's creditworthiness, expressed as a rating, and the funds that are available at the borrower's free disposal for making principal payments when servicing a loan.

Risk concentrations and correlations are shown using the credit risk model. Risk concentrations are also limited by country and industry limits at portfolio level as well as by the Large Exposure Management model for individual counterparties. The latter defines an exposure limit for every rating on the basis of which a Group exposure for the categories corporates, financial institutes and special finance is classified as being normal, bearing risk concentration or bearing concentration risk concentration. The exposure limits are based on the risk-bearing capacity of the NORD/LB Group.

Methods of mitigating credit risk are described in Section 5.1.7.

5.1.1.4 Credit Risk Reporting

NORD/LB's Credit Risk Control Division draws up a quarterly report for the Managing Board which shows and analyses all the significant structural features and parameters required for controlling the loan portfolio. In 2009 the previously established Credit Risk Report was replaced by the Credit Portfolio Report. The Credit Portfolio Report also includes in-depth analyses and stress scenarios relating to the credit portfolio. It complements the Risk-Bearing Capacity Report and is further specified by Industry Portfolio Reports for individual sub-segments.

At Bremer Landesbank the Managing Board is informed of credit risks within the scope of monthly RBC reporting. The Managing Board also receives on a monthly basis a report on an individual borrower basis on intensive and problem exposures.

For NORD/LB Luxembourg and NORD/LB CFB the Controlling division prepares together with the Credit Risk Management division a credit risk report on a quarterly basis as part of the management information system for the Managing Board and the Credit Risk Committee in order to make existing risks and risk concentrations transparent and to initiate measures where necessary.

Deutsche Hypo prepares a risk report on a quarterly basis in accordance with the requirements of MaRisk. This report informs the Managing Board and the Supervisory Board in detail about the bank's risk situation.

5.1.2 Credit Portfolio Structure

Tables 5 to 7 show the volume of exposure values by credit exposure excluding investment exposures and securitisations in accordance with § 327 Paragraph 2 Nos. 1–4 of the Solvency Regulation. The positions are broken down by industry, region and residual contractual maturity. Exposure values were ascertained prior to the inclusion of credit risk mitigation methods and after inclusion of the credit conversion factor (CCF) in accordance with § 48 and § 99 of the Solvency Regulation. The credit equivalent amount was reported for derivative instruments.

Although there has been a significant fall in business with financing institutes/insurance companies compared to the previous reporting date, this industry still has the largest share in total value of exposures. It is followed in second place by service industries/other, which also includes public authorities. Here the exposures rose compared to the previous reporting date.

With regard to exposures by region, the euro countries still have by far the largest share, whereby the total value of exposures fell slightly compared to the previous reporting date.

Table 5: Credit exposures by industry

Industry (in € million)	Credits, commitments and other non-derivative off balance sheet assets	Securities *)	Derivative financial instruments *)
Financing institutes/insurance companies	64,795	45,436	7,479
Service industries/other	67,943	18,028	2,057
Transport/communications	29,144	543	517
Manufacturing	7,757	753	577
Energy, water and mining	8,199	1,001	420
Trade, maintenance and repairs	3,616	58	86
Agriculture, forestry and fishing	1,584	25	8
Construction	3,122	61	70
Total	**186,160**	**65,906**	**11,213**

*) Total differences are rounding differences.

Table 6: Credit exposures by region

Region (in € million)	Credits, commitments and other non-derivative off balance sheet assets *)	Securities*)	Derivative financial instruments
Euro countries	150,828	54,894	7,336
Other Western Europe	9,212	3,543	2,025
Eastern Europe	3,247	899	87
North America	10,938	3,225	1,387
Latin America	1,365	530	19
Middle East/Africa	1,031	238	–
Asia	3,732	1,875	335
Other countries	5,806	701	24
Total	**186,160**	**65,906**	**11,213**

*) Total differences are rounding differences.

Table 7: Residual contract maturities

Residual maturity (in € million)	Credits, commitments and other non-derivative off balance sheet assets	Securities	Derivative financial instruments *)
> 0 years to ≤ 1 year	41,795	13,391	1,056
> 1 year ≤ 5 years	40,699	26,561	5,464
> 5 years, no term	103,666	25,954	4,692
Total	**186,160**	**65,906**	**11,213**

*) Total differences are rounding differences.

5.1.3 Risk Provisions

Exposures are inspected at regular intervals, i.e. in a system of scheduled loan monitoring, in order to ascertain whether the claims of the NORD/LB Group are recoverable or whether interest and principal payments appear to be totally or partly at risk. The essential criteria for a bad debt allowance are for example the default on interest and capital payments or a delay in such payments of more than 90 days and considerable financial difficulties on the part of the debtor. An inspection is also carried out when negative information is received (early warning indicators) about a borrower, for example information relating to the borrower's financial situation, collateral and industry environment.

Since reports in accordance with the Solvency Regulation are currently made on the basis of the accounts prepared in accordance with the German Commercial Code in the NORD/LB Group, information is also provided on risk provisions in accordance with the German Commercial Code at this point.

For acute counterparty default risks relating to lending business reported in the balance sheet, the NORD/LB Group makes specific bad debt allowances and flat-rate specific bad debt allowances. A need for loan loss provisions is based on a present value consideration of anticipated interest and redemption payments which are still expected as well as on earnings from the realisation of collateral.

The NORD/LB Group takes account of latent borrower default risk relating to transactions with non-banks for which no specific bad debt allowances are established by establishing portfolio debt allowances.

Risks relating to off-balance sheet transactions (guarantees, endorsement liabilities and loan commitments) are accounted for by a loan loss provision.

Irrecoverable debts for which there is no specific bad debt allowance are written off immediately. Payments received for written-off loans and advances are recognised in profit or loss.

In accordance with § 327 Paragraph 2 Nos. 5 and 6 of the Solvency Regulation, Tables 8 to 10 show non-performing receivables in default, excluding investment exposures and securitisation transactions by industry and region respectively, and the development of risk provisions in the reporting period. In the classification by industry, retail business is also reported. The flat-rate specific bad debt allowances are included in the specific bad debt allowances. NORD/LB Luxembourg and NORD/LB CFB have been included with portfolio bad debt allowances according to IFRSs. General and portfolio bad debt allowances, direct write-offs and receipts for written-off loans are reported as a total amount and are not broken down by industry or region.

For rated CRSA and IRBA positions, all the non-performing exposures are equivalent to rating grades 17 and 18. All the remaining past-due receivables are included in rating grade 16. Unrated CRSA positions in the past due exposure class are allocated to the respective category on the basis of specific characteristics. In the case of past due receivables without a need to make allowances for impairments, a cautious assumption is made in that the receivables in rating categories 16 to 18 and corresponding CRSA positions for which no allowances were established are all considered to be past due. Exposure values are stated.

Compared to the figures presented in the disclosure report as at 31 December 2008, Table 9 now also includes for the regions the changes in specific bad debt allowances, general/portfolio bad debt allowances, provisions, direct write-offs and receipts for written-off loans. This reporting goes beyond the requirement of § 327 Paragraph 2 No. 5 of the Solvency Regulation, but was chosen for reasons of transparency and uniformity – consistent with Table 8 with the breakdown by industry.

The NORD/LB Group also felt the consequences of the financial and economic crisis in the period under review. As a result non-performing and defaulted loans and risk provisions have increased.

Table 8: Non-performing and defaulted loans by industry

Industry (in € million)	Non-performing and defaulted loans (requiring bad debt allowances)	Specific bad debt allowances*	General and portfolio bad debt allowances	Provisions	Changes in specific bad debt allowances	Changes in general and portfolio bad debt allowances	Changes in provisions	Direct write-offs	Receipts for written-off loans	Defaulted loans (not requiring bad debt allowances)*)
Financing institutes / insurance companies	181	104		65	25		65			45
Service industries / other	1,224	489		40	12		– 161			430
Transport / communications	739	219		5	195		5			291
Manufacturing	267	131		3	28		– 2			8
Energy, water and mining	127	30		–	11		– 3			2
Trade, maintenance and repairs	122	66		–	12		–			40
Agriculture, forestry and fishing	29	20		3	8		– 1			9
Construction	74	60		1	– 1		1			5
Retail	349	62		–	17		–			59
Total	**3,112**	**1,180**	**247**	**117**	**307**	**18**	**– 96**	**95**	**11**	**888**

*) Total differences are rounding differences.

Table 9: Non-performing and defaulted loans by region

Region (in € million)	Non-performing and defaulted loans (requiring bad debt allowances)	Specific bad debt allowances*	General and portfolio bad debt allowances	Provisions*)	Changes in specific bad debt allowances*)	Changes in general and portfolio bad debt allowances	Changes in provisions*)	Direct write-offs	Receipts for written-off loans	Defaulted loans (not requiring bad debt allowances)
Euro countries	2,162	919		20	173		– 15			521
Other Western Europe	291	129		3	49		3			199
Eastern Europe	14	3		–	–		–			2
North America	582	119		17	83		17			114
Latin America	2	1		44	–		44			20
Middle East/Africa	–	–		–	–		–			–
Asia	31	3		–	– 3		–			18
Other countries	30	6		32	6		– 146			14
Total	**3,112**	**1,180**	**247**	**117**	**307**	**18**	**– 96**	**95**	**11**	**888**

*) Total differences are rounding differences.

Table 10: Development of risk provisions

Type of risk provision (in € million)	Opening balance for the period	Adjustments/allocations in the period	Reversal	Utilisation	Exchange rate related and other changes	Closing balance for the period*)
Specific bad debt allowances	873	702	251	143	–	1,180
General/portfolio bad debt allowances	229	23	5	–	–	247
Provisions	213	98	30	164	–	117

*) Total differences are rounding differences.

5.1.4 Information on IRBA Exposures

5.1.4.1 Internal Rating Methods

In order to assess credit risks in the NORD/LB Group, each borrower is rated within the framework of an initial or annual credit rating process and a cause-related rating or credit rating category is also determined for each borrower. The rating modules employed were either developed in various cooperation projects conducted by the savings bank financial group or the Landesbanks or they were developed internally by NORD/LB.

The classification is based on the standard IFD rating scale which the banks, savings banks and associations in the "Initiative Finanzstandort Deutschland" (IFD, initiative for Germany as a financial location) have agreed on in order to improve comparability between the rating levels of the individual credit institutes. The rating classes of the 18-step DSGV rating master scale used in NORD/LB can be transferred directly into the IFD classes.

NORD/LB uses segment-related rating methods for estimating the anticipated probability of default of an external counterparty. The methods developed in cooperation projects are standardised to comply with the probabilities of default in the DSGV rating master scale. The master scale shows risks in comparable stages, makes the ratings of various segments comparable and facilitates communication. It is also comparable with external ratings. Each rating method results in a discrete probability of default (PD) as a measure of the expected rate of default and the related rating grade. Both the rating excluding transfer risk (local currency rating) and the rating after offsetting a transfer risk (foreign currency rating) are reported.

At present 13 internal rating methods developed by NORD/LB in collaboration with its cooperation partners have been authorised by the regulatory authorities for the IRBA system. The rating methods for country and transfer risks as well as for international authorities are predominantly allocated to the Central Government exposure class, and the rating method for banks to Banks exposure class. The other rating methods are all included in the Corporate exposure class, i.e. corporates, insurance companies, leasing companies, standard rating, minor customer rating, real estate business rating, ship financing, project financing, international real estate financing and SPC real estate leasing.

NORD/LB also employs a rating method in accordance with the internal assessment approach (IAA) which was developed internally and has also been authorised by the regulatory authorities for securitisation transactions. In this case a rating grade in accordance with the Standard & Poor's rating scale is ascertained for IAA-eligible securitisation positions.

The allocation of borrowers to the rating systems is regulated by the scope of application defined in the rating process. The principle of dual control is applied for all the ratings. A rating can only be released in this case by the relevant back office unit.

Retail banking transactions were still shown in the CRSA in 2009, so that scorings resulting from an automatic scoring procedure were not yet employed in regulatory terms. The giro, construction loan and consumer credit application scorings, giro conduct scorings and consolidated portfolio scoring for natural persons previously in use were revised in November 2009 and have now been merged in the newly integrated savings bank customer scoring.

There is no rating procedure for investments. If they are processed in the IRBA system, simple risk weights in accordance with § 98 of the Solvency Regulation are used.

The rating and scoring methods named, with the exception of the rating method for securitisation transactions, were developed in association projects, with NORD/LB cooperating with the savings bank organisation. They are updated, validated and improved by the maintenance units of the DSGV (SR GmbH) and the Landesbanken (RSU GmbH & Co. KG).

Mathematical-statistical methods are used to develop the processes. On the one hand (borrower-oriented) scorecard methods which assess quantitative and qualitative factors are used. These are converted to point scores and allocated to probabilities of default and rating grades in the form of a total number of points. On the other hand (asset-related) simulation methods in which projected payment flows are analysed and in turn supplemented with qualitative information are also used. A common element of all the methods is that they assess a credit rating on the basis of characteristics relevant to creditworthiness and condense them to produce a rating grade that is calibrated on the PD master scale.

The rating methods are all subjected to an annual process of validation comprising both quantitative and qualitative analyses. In this case rating factors, the definition and the calibration of methods, data quality and the entire structure of the model are reviewed on the basis of statistical and qualitative analyses as well as user feedback. The aim of calibration here is to match the empirical defaults actually observed as closely as possible to the probabilities of default predicted with the help of the rating methods.

At NORD/LB the Reporting/Methods department is responsible for monitoring counterparty risk. It is responsible for controlling ratings, which must be done by each institute, in an internal validation of rating methods. This includes the following tasks:

- Administrating and supervising the rating methods
- Cooperating in SR/RSU validation activities
- Proving of the representativeness of the rating methods based on data pooling
- Monitoring and reporting rating results and histories
- Implementing and monitoring the default and recovery concept
- Ensuring the correct application of the rating methods and communicating the results of plausibility tests

For counterparties which cannot be allocated to any of the specified rating methods, a quality-based credit rating method is used, with credit ratings ranging from A (very good) to F (undergoing liquidation).

Bremer Landesbank uses the same rating methods as NORD/LB provided that these methods are relevant for the bank's own business. NORD/LB Luxembourg and NORD/LB CFB assess credit risk in close cooperation with NORD/LB on the basis of the rating methods specified. Deutsche Hypo has used the same rating method as NORD/LB for real estate customers within the scope of IRBA since 2008. Since 2009 it has also used the Group's rating method for loans to countries and international authorities. Other rating methods are in use for banks at Deutsche Hypo; these are gradually being replaced by the NORD/LB method.

5.1.4.2 Using Internal Assessments for Purposes Other than Ascertaining Risk-Weighted Exposure Values in Accordance with the IRBA

In addition to ascertaining risk-weighted exposure values, internal estimations of the PD and the LGD are important parameters for risk control and credit processes.

In preliminary costing (pricing) target margins, i.e. minimum margins and full-cost margins, are calculated. In the CPC calculation tool (credit pricing calculator) for risk-adjusted pricing in lending business, the probabilities of default from internal rating procedures and estimated loss rates are included in calculating risk cost as a premium for expected loss and for calculating the cost of equity as a premium for unexpected loss.

As already described in Section 5.1.1.2 on credit risk management structure and organisation, the level of credit decision authority is also contingent on the rating of a borrower. Allocation to the segment for problem loans and the authority of the Special Credit Management Division is undertaken on the basis of rating grades.

The NORD/LB Group regulates its risk-bearing capacity in accordance with economic aspects. The results of the internal rating procedures are included in the examination of the risk-bearing capacity. Details on the risk-bearing capacity model can be seen in Section 4.2.4 on risk-bearing capacity.

5.1.4.3 Credit Volumes and Losses in the IRBA Portfolio

Table 11 shows the aggregate credit volume included in the IRBA, broken down by PD grades, in accordance with § 335 Paragraph 2 Nos. 1 and 2a and c of the Solvency Regulation. In addition to the exposure at default (EAD), average probabilities of default (Ø PD) and average risk weights (Ø RW) are reported. Exposure values after credit risk mitigation are used as a basis.

Retail business is not included since this is handled in the CRSA system. Investments only need to be disclosed as a separate portfolio when the PD/LGD approach is used for investment exposures in the investment book. This currently does not apply in the NORD/LB Group. A separate presentation of items in accordance with § 335 Paragraph 2 No. 1, for which separate LGD and CCF estimations are made, is not carried out since the advanced IRBA is not relevant for the NORD/LB Group.

Compared to the previous reporting date, the average PD (excluding default) has risen from 0.5 per cent to 1.0 per cent and the average risk weight (excluding default) has risen from 38.6 per cent to 48.7 per cent. Both are in particular the result of the rating migrations due to the crisis.

Table 11: Aggregate credit volume by PD grades (excluding retail)

Portfolio	EAD in € million*)	Ø PD in %	Ø RW in %
		0% ≤ PD ≤ 0.5 %	
Central governments	8,132	0,0	8,0
Banks	49,232	0,1	20,4
Corporates	47,224	0,2	36,3
Investments	–	–	–
Total	104,587	0,1	26,6
		0.5% < PD ≤ 5%	
Central governments	124	0.9	91.3
Banks	2,593	0.9	90.1
Corporates	24,928	1.5	97.5
Investments	–	–	–
Total	27,645	1.5	96.8
		5% < PD < 100 %	
Central governments	20	6.7	175.8
Banks	113	7.8	183.9
Corporates	6,305	12.7	202.0
Investments	–	–	–
Total	6,438	12.6	201.6
		Total (excl. default)	
Central governments	8,276	0.1	9.7
Banks	51,938	0.1	24.3
Corporates	78,457	1.6	69.1
Investments	–	–	–
Total	138,670	1.0	48.7
		Default	
Central governments	18	100.0	0.0
Banks	142	100.0	0.0
Corporates	2,980	100.0	0.0
Investments	–	–	–
Total	3,141	100.0	0.0

*) Total differences are rounding differences.

Table 12 shows a comparison of expected and actual losses incurred in lending business for the current and previous reporting period in accordance with § 335 Paragraph 2 No. 6 of the Solvency Regulation.

The loss estimation in this case is defined as the expected loss – EL – after credit risk mitigation and is based on the assumptions for regulatory loss rates in the event of default in accordance with § 93 and § 94 of the Solvency Regulation. This is the expected loss of risk assets which have not defaulted in traditional lending business, i.e. excluding securities in the investment book and excluding derivatives. Traditional off-balance sheet business, such as credit commitments, is taken into account.

Actual losses comprise specific bad debt allowances and direct write-offs less receipts for written-off loans. They are only shown as an aggregated amount and are not broken down by portfolio. Compared to the previous reporting period actual losses have increased by € 64 million. This increase is in particular the result of the crisis in the real economy caused by the financial market crisis, with an increase in the number of borrowers defaulting.

Investments only need to be disclosed as a separate portfolio when the PD/LGD approach is used for investment exposures in the investment book. This currently does not apply in the NORD/LB Group.

Table 12: Expected and actual losses in lending business

Portfolio (in € million)	1 Jan. 2009 – 31 Dec. 2009		1 Jan. 2008 – 31 Dec. 2008	
	Expected loss (EL)	Actual loss	Expected loss (EL)	Actual loss
Central governments	10	–	–	–
Banks	83	–	99	–
Corporates	1,633	–	1,026	–
Investments	–	–	–	–
Total	**1,726**	**196**	**1,125**	**132**

5.1.5 Information on Standard Risk-Weighted CRSA and IRBA Exposures

For risk weighting CRSA exposures, the rating agency Standard & Poor's was named for the exposure classes countries and banks. Rating agencies Standard & Poor's, Moody's and Fitch Ratings were named for securitisation exposures.

External ratings are used for issuer, issue and country credit rating assessments, with the issue rating initially being used as a basis; the issuer rating is only referred to in the absence of an issue rating. Issue ratings are not applied to unrated CRSA exposures (e.g. loans). Country classifications by export insurance agencies are not taken into account.

At Bremer Landesbank rating agencies Standard & Poor's, Moody's and Fitch Ratings are named for all the CRSA positions. Deutsche Hypo has also chosen these three rating agencies for the CRSA exposure classes central governments, regional governments and local authorities, other public-sector entities, multilateral development banks, corporates and securitisation transactions. NORD/LB Luxembourg and NORD/LB CFB have only named Standard & Poor's and use the ratings for the central and regional government and bank exposure classes.

In accordance with § 328 Paragraph 2 of the Solvency Regulation, Table 13 contains an overview of CRSA exposure values before and after credit risk mitigation. CRSA credit risk mitigation techniques take account of indemnities and financial collateral. Mortgage liens as collateral are not considered as mitigating credit risk in the CRSA; instead the secured receivables are reported in the exposure class "exposures secured with real estate".

In some cases exposure values are higher in the "after credit risk mitigation" column. This is due to the allocation of exposure values or parts of exposure values at other risk weights after risk mitigation as well as from IRBA exposures in accordance with § 84 Paragraph 1 of the Solvency Regulation which are secured by a CRSA guarantor and are hence reported as CRSA exposures after risk mitigation.

IRBA exposure values are also shown in accordance with § 329 Paragraphs 1 and 2 of the Solvency Regulation, for which simple risk weights are applied for special financing (operating leases for NORD/LB aircraft loans) and investments (investment funds that have not been rendered transparent).

The fall in exposures with a risk weighting of 20 per cent compared to the previous reporting date is attributable to a methodological change.

Table 13: Counterparty default risk exposures for portfolios in the CRSA and IRBA on application of regulatory risk weights

	Total exposure values		
Risk weight (in %)	CRSA Before credit risk mitigation (in € million)	CRSA After credit risk mitigation (in € million)	IRBA (special financing and investments) (in € million)
0	88,714	94,154	10
10	98	98	–
20	3,945	3,484	–
35	802	1,356	–
50	568	650	68
70	–	–	883
75	4,721	4,082	–
90	–	–	138
100	13,205	9,253	–
115	–	–	157
150	139	119	–
190	–	–	–
250	–	–	149
290	–	–	–
350	–	–	–
370	–	–	24
1250	–	–	–
Capital deduction	–	–	–

5.1.6 Derivative Counterparty Default Risk Positions and Netting Positions

The NORD/LB Group employs derivative financial instruments for securing purposes in asset/liability management. Trading is also conducted in derivative financial transactions. Derivative financial instruments in foreign currencies are mainly concluded as forward-exchange contracts, currency swaps, interest rate/currency swaps and currency options. Interest rate derivatives primarily comprise interest rate swaps, forward rate agreements, interest rate futures and interest rate options. Futures contracts are also concluded for fixed interest rate securities. Equity derivatives are mainly concluded as stock options and equity swaps. Credit derivatives were also concluded.

Netting agreements covering derivatives are used in accordance with §207 of the Solvency Regulation. Eligible netting positions from derivatives are recognised at their marked-to-market replacement cost in accordance with §211 Paragraph 2 of the Solvency Regulation. The net measurement base for netting positions from derivatives is the amount resulting from the difference of positive and negative fair values of the transactions covered by the netting agreement plus a regulatory premium. The LeDIS system is used to check eligibility for netting.

Internal capital allocation for derivative counterparty default risk positions and netting positions is carried out as part of the allocation of equity to credit risks described in Section 4.2.4 on risk-bearing capacity.

Trades are only entered into with contractual partners for whom counterparty limits have been granted. All the trades concluded with a specific counterparty are offset against this limit. The risk subject is the counterparty/contractual partner for the trade. Replacement risks and settlement risks are taken into account in terms of limit utilisation.

Replacement risk measures the risk that in the event of default by a counterparty, a loss will be incurred by transactions with a positive fair value having to be settled at a loss. §19 of the Solvency Regulation is hence applied for current potential replacement costs and §20 of the Solvency Regulation for expected future increases in current potential replacement costs.

In terms of the limiting of credits to counterparties the same rules apply as those described in Section 5.1.1.3 for covering and mitigating credit risks.

With regard to collateral, reference is made to Section 5.1.7 on credit risk mitigation techniques.

Provisions / impairments are recognised to account for the risk of losses. More information can be found in Section 5.1.3 on risk provisions.

A downgrade in NORD/LB's external rating would not have any significant effect on collateral to be provided since NORD/LB generally does not accept any such contractual terms.

The measurement base for derivative counterparty default risk positions follows the current exposure method. Eligible netting positions from derivatives are included at marked-to-market replacement cost. Table 14 shows the valuation of derivative counterparty default risk positions before and after netting and collateral in accordance with §326 Paragraph 2 No. 1 of the Solvency Regulation. The term "positive replacement value" means the current potential replacement cost in accordance with §19 of the Solvency Regulation. This is equivalent to the current positive fair value. Compared to the previous reporting date there has been a general decline in business with derivative financial instruments.

Table 14: Positive net replacement cost

(in € million)	Positive net replacement cost before netting and collateral	Netting options	Eligible collateral	Positive net replacement cost after netting and collateral
Interest rate-based contracts	8,103			
Currency-based contracts	1,534			
Equity/index-based contracts	55			
Credit derivatives	14			
Commodity-based contracts	20			
Other contracts	–			
Total	**9,726**	**6,139**	**591**	**2,996**

The recognisable counterparty default risk in accordance with §326 Paragraph 2 No. 2 of the Solvency Regulation is ascertained with the current exposure method and can be seen in Table 15. The counterparty default risk position is determined here as a positive replacement cost after netting and collateral plus an add-on for expected future increases in value.

Table 15: Counterparty default risk

(in € million)	Original exposure method	Current exposure method	Standard method	Internal model
Counterparty default risk position	–	6,104	–	–

Table 16 shows hedge transactions with credit derivatives in accordance with §326 Paragraph 2 No. 3 of the Solvency Regulation, which are used in terms of the Solvency Regulation to mitigate risk.

Table 16: Credit derivatives – nominal value of hedge transactions

(in € million)	Nominal value of hedge transactions
Credit derivatives (assignees)	88

Table 17 shows a breakdown of the nominal value of credit derivatives in acquisitions and sales in accordance with §326 Paragraph 2 No. 4 of the Solvency Regulation. The NORD/LB Group did not conduct any intermediation activities for credit derivatives in the period under review. Compared to the previous reporting date there has been a significant fall in the CDS portfolio due to the general financial market situation.

Table 17: Credit derivatives – purpose

Nominal value (in € million)	Used in the bank's own credit portfolio		Brokerage activities
	Purchased	Sold	
Credit Default Swaps	1,774	7,754	–
Total Return Swaps	–	637	–
Credit Linked Notes	–	–	–
Credit Options	–	–	–
Other	–	–	–

5.1.7 Credit Risk Mitigation Techniques

5.1.7.1 Collateral Management

For the assessment of credit risks, in addition to the credit rating of borrowers or counterparties reflected in the rating, the customary bank securities available and other risk reduction methods are of importance. The NORD/LB Group therefore accepts domestic and foreign securities in the form of property and rights (collateral) to reduce credit risk. When accepting securities the cost-benefit relationship of the security is considered.

The securities are assessed both at the time the loan is granted and during the subsequent ongoing (normally at least once a year) monitoring as to whether they appear to be disposable at the assumed value based on foreseeable economic developments during the (remaining) term of the loan. They are therefore reviewed on a case-to-case basis as to whether the valuation appears to be justified based on the respective type of security and based on its legal and economic applicability in respect of the person of the borrower and the type of loan. If factors relevant to the assessment have changed, the assessment is adjusted accordingly.

The credit guidelines and lending principles of the NORD/LB Group specify which fundamental types of security and the maximum loan (lending limit) which may be lent against the collateral. Sureties, credit securities similar to sureties, assignments of receivables and other rights, chattel mortgages, property, receivables and other rights and collateral assignment of chattel are accepted as credit security. Other securities can be contracted with the borrower, but these do not reduce the unsecured portion of the exposure.

The legal portfolio of collateral is maintained in the dedicated Collateral Management System (CMS) which is also used for the inclusion of collateral when ascertaining minimum capital requirements and for regulatory reports.

In order to ensure the legal validity and enforceability of collateral, standard contracts are mainly used or external legal opinions are obtained and the relevant jurisdictions are permanently monitored. For foreign collateral, monitoring is performed by international law firms.

5.1.7.2 Collateral to Ease Equity Requirements

The NORD/LB Group applied for the authorisation of mortgage liens as collateral, other IRBA physical collateral (ships and aircraft as well as wind energy plants in the case of Bremer Landesbank), guarantees and financial collateral as credit risk mitigation techniques to ease capital requirements; authorisation was given by the German Federal Financial Supervisory Authority (BaFin). Internal processes and systems operated ensure that only collateral which fulfils all the requirements of the Solvency Regulation in terms of credit risk mitigation techniques is employed.

Mortgage liens as collateral relate to commercial and residential real estate. The properties are generally valued by independent internal appraisers and also by external surveyors should this become necessary. The market fluctuation concept of the German Federal Association of Public-Sector Banks (Bundesverband Öffentlicher Banken Deutschlands) is referred to support the ongoing monitoring of real estate values. This method is recognised as a statistical method in accordance with § 20a Paragraph 6 of the German Banking Act. The value of real estate is reviewed in three-year cycles if the mortgage lending value of property and loans secured by the property exceeds specified limits.

Ships and aircraft must be entered in a public register and fulfil certain requirements such as marketability and age. An additional requirement in the case of ships is that they must have been constructed under supervision of a recognised ship surveying firm. Aircraft must have been awarded internationally-recognised aircraft certification and an air operator's certificate. They are valued on the basis of external reports and values are reviewed at least once a year.

The location of wind energy plants is decisive for their value. Before a plant is constructed, wind power is forecast in external reports and the effective exploitation of wind is compared with these forecasts at least once a year when the plants are in operation. The value of a plant is derived from its yield in connection with the legally specified compensation for feeding electricity into the grid. The value of a wind energy plant is recalculated and lending values are re-stipulated in the event of significant deviations from forecasts. In order to be in a position to operate a wind energy plant alone if the need arises, Bremer Landesbank has significant operator rights relating to location and rights resulting from supply contracts assigned to it.

Warranties are predominantly sureties and guarantees. The carrying amounts are based on the credit rating of the guarantor. The same rating rules apply as those for borrowers who are rated at least once a year. The main types of guarantors are public institutions and banks with a very good rating. Concentration risks resulting from the acceptance of guarantees are monitored in connection with the direct exposure of the guarantor within the framework of credit portfolio management. There are currently no risk concentrations here.

Financial collateral is currently not a significant type of collateral in the lending business conducted by the NORD/LB Group, so no concentrations arise here. This collateral predominantly comprises cash deposits. In the Trading Division, financial collateral is relevant in repurchase transactions. Only cash collateral (NORD/LB Group as the transferor) as well as securities whose issuers have a very good rating (NORD/LB Group as the transferee) is accepted. Securities are generally public-issuer securities. Transactions are therefore low risk. They are valued automatically every day and the back office of the Trading Division monitors counterparty and issuer lines daily on the basis of these valuations so that no concentration of risk arises.

Table 18 contains an overview of collateralised CRSA and IRBA exposure values in accordance with § 336 Paragraph 2 of the Solvency Regulation. Investments only need to be disclosed as a separate portfolio when the PD/LGD approach is used for investment exposures in the investment book. This currently does not apply in the NORD/LB Group.

Financial collateral has switched since the previous reporting date from the in the exposure class "corporates" from IRBA to CRSA. This is in particular the result of the termination of securities lending transactions in IRBA and new securities lending transactions in CRSA.

Table 18: Aggregate amount of collateralised exposure values (excluding securitisations)

(in € million)	Financial collateral in acc. with § 154 Clause 1 No. 1		Other eligible collateral in acc. with § 154 Clause 1 No. 3		Eligible guarantees in acc. with § 154 Clause 1 No. 2	
Exposure class	CRSA	IRBA	CRSA	IRBA	CRSA	IRBA
Central governments	–	–	–	33	950	197
Regional governments and local authorities	–	–	–	–	1,558	–
Other public-sector entities	–	–	–	–	68	–
Multilateral development banks	–	–	–	–	20	–
International organisations	–	–	–	–	–	–
Banks	771	11,536	–	65	1,409	1,174
Covered bonds issued by banks	–	–	–	–	42	–
Corporates	1,138	536	–	16,425	3,029	3,152
Retail	1	–	–	–	–	–
Exposures secured by real estate	–	–	612	–	–	–
Investment certificates	–	–	–	–	–	–
Investments	–	–	–	–	–	–
Other exposures	–	–	–	–	–	–
Past due exposures	–	–	20	–	–	–

5.1.7.3 Netting Agreements

In order to mitigate counterparty default risk in trades the NORD/LB Group employs netting agreements covering derivatives.

Netting agreements are basically bilateral. Only standard general agreements are used, all of which provide for an obligation to make additional payments. The Legal department is responsible for the conclusion of new contracts. Legal enforceability in the different jurisdictions is ensured by means of regularly obtaining legal opinions.

Contract data is stored centrally in the dedicated LeDIS standard application. This system of data management enables an automatic examination to be carried out by the users of this information, for example the employees responsible for processing reports.

Netting agreements on money receivables and cross-product netting agreements are not used.

The volume of netting agreements covering derivatives can be seen in Table 14 in Section 5.1.6 on derivative counterparty default risk positions and netting positions.

Only cash collateral is currently accepted in derivative transactions. Standard general agreements are also used here.

5.1.8 Securitisations

5.1.8.1 Aims, Functions and Scope of Securitisations

Securitisation transactions are a further instrument used to manage credit risks in the NORD/LB Group. The aim of these securitisation activities is to optimise the yield/risk profile of the loan portfolio and to ease regulatory equity requirements.

In order to diversify the loan portfolio, credit risks in the bank's own books are transferred to other market participants (NORD/LB as an originator) or additional credit risks are taken (NORD/LB as an investor resp. sponsor). NORD/LB also conducts securitisation activities as an arranger of structured transactions in the interest of customers.

Risk control is carried out in synthetic securitisation transactions using various hedging instruments and in true sale transactions by acquiring asset-backed securities issued through special purpose entities (SPEs). As a sponsor, NORD/LB makes liquidity facilities and credit enhancements available in order to improve the loan quality of the institute's own asset-backed commercial paper (ABCP) conduit programmes.

NORD/LB pursues a conservative exposure strategy in its role as investor and sponsor.

Securitisation transactions are all subject to a strict process of approval and monitoring, so that potential risks before and after the conclusion of a contract can be identified and regulated.

Bremer Landesbank last appeared as an investor in 2004 and retains an insignificant portfolio. Deutsche Hypo has only appeared as an investor in securitisation transactions on a small scale, most recently in 2007. There is a strategy to reduce the remaining portfolio. Securitisation business has so far not been relevant for NORD/LB Luxembourg and NORD/LB CFB.

The scope of securitisation activities in the NORD/LB Group can be seen in Section 5.1.8.4 on quantitative information.

5.1.8.2 Procedures for Determining Risk-Weighted Exposure Values and Named Rating Agencies for Securitisations

NORD/LB employs the following methods for ascertaining risk-weighted exposure values, depending on the pool of receivables:

IRBA pool of receivables

- In the rating-based approach (RBA), risk weights depend on external ratings, the granularity of the pool of receivables and the seniority of tranches.
- The supervisory formula approach (SFA) is used for external unrated positions for which NORD/LB has sufficient up-to-date information on the composition of the securitised portfolio and is able to determine capital requirements prior to the securitisation transaction.
- Unrated securitisation positions in the ABCP programme (excluding asset-back money-market securities) are valued with the internal assessment approach (IAA) method. Ratings obtained with the IAA are included in the RBA in order to determine risk-weighted assets.
- The transparency method applies for investment funds. With the transparency method the (external) credit ratings of the securitisation positions in the investment fund are considered.

CRSA pool of receivables

- If an external rating is available it is used for specifying the CRSA securitisation risk weight.
- For unrated CRSA securitisation exposures, the CRSA securitisation risk weight is the product of the CRSA average risk weight of the securitised portfolio for the relevant CRSA securitisation transaction and the risk concentration rate. NORD/LB has access to sufficiently up-to-date information on the composition of the securitised portfolio underlying the securitisation transaction so that the bank is in a position to determine the CRSA average risk weight of the securitised portfolio.

For Bremer Landesbank and Deutsche Hypo, the methods used also depend on the underlying pool of receivables. At Bremer Landesbank, the RBA and the SFA are used for IRBA receivables and CRSA receivables are risk weighted using the rating-based approach. Deutsche Hypo uses the RBA for IRBA receivables only: it uses the rating-based approach for CRSA receivables. As securitisation transactions have so far not been relevant for NORD/LB Luxembourg and NORD/LB CFB, no process has been implemented here.

Short-term and long-term Standard & Poor's, Moody's und Fitch external ratings are generally used.

5.1.8.3 Accounting Policies for Securitisations

Since reports in accordance with the Solvency Regulation are currently made on the basis of the accounts prepared in accordance with the German Commercial Code in the NORD/LB Group, information is also provided on accounting policies in accordance with the German Commercial Code at this point.

The method of reporting securitisation transactions depends on the type of securitisation. Assets relating to synthetic securitisation remain on the balance sheet. In the case of true sale securitisation, the assets are written off if the opportunities and risks relating to these assets have (virtually) been fully transferred to the SPE. With the NORD/LB Group's securitisation transactions normally (virtually) all of the opportunities and risks are transferred to the SPE or the buyer. Assets of consolidated SPEs remain in the NORD/LB Group's consolidated balance sheet.

The accounting methods employed for reported investment securities apply for securitisation transactions. Write-downs to the lower of cost or market are made for securities with carrying amounts above par, but only down to a book price of a maximum of 100 per cent. Write-downs to the lower of cost or market are not charged for securities with carrying amounts below par. Write-ups (appreciation in value in accordance with §280 Paragraph 1 of the German Commercial Code) are made up to the cost of acquisition, even in excess of 100 per cent. Furthermore, impairment losses are charged to the fair value for lasting impairments.

5.1.8.4 Quantitative Information on Securitisations

In accordance with §334 Paragraph 2 Nos. 1 and 5 of the Solvency Regulation, securitisation activities conducted with the NORD/LB Group as the originator are shown in Tables 19 and 20. Receivable amounts are unweighted exposure values. Please note that the NORD/LB Group does not maintain any securitisation exposures in connection with revolving counterparty default risk positions or act as a servicer in the case of securitised receivables so no information is provided on non-performing or defaulted securitised receivables or on losses realised in the current period in accordance with §334 Paragraph 2 No. 2 of the Solvency Regulation. In the period under review no receivables were securitised by the NORD/LB Group.

Table 19: Aggregate amount of securitised receivables

Portfolio (in € million)	Securitised receivables
True sale securitisations Commercial real estate	235
Synthetic securitisations –	–
Total	**235**

Table 20: Securitisation transactions in the reporting period

Portfolio (in € million)	Securitised receivables		Profits/losses from true sale transactions (in € million)
	True sale	Synthetic	
–	–	–	–
–	–	–	–
–	–	–	–
Total	**–**	**–**	**–**

In accordance with § 334 Paragraph 2 Nos. 3 and 4 of the Solvency Regulation, securitisation activities of the significant entities in the NORD/LB Group are not only shown in their function as originator; they are also shown in their function as an investor and sponsor in Tables 21 and 22. Compared to the previous reporting date the exposure values have generally fallen. The effects of the changes in method in the period under review are shown in Table 21.

Table 22 shows that investments are primarily made in tranches with a low risk weight, whereby there has been a shift compared to the previous reporting date to the risk weight bands above 50 per cent. The reason for this is in particular the rating migrations due to the crisis, which have also resulted in a corresponding increase in capital requirements.

Table 21: Aggregate amount of retained or purchased securitisation exposures

Securitisation exposures (in € million)	Retained/purchased securitisation exposures	
	Exposure values CRSA	Exposure values IRBA
On-balance-sheet items		
Receivables	746	3,077
Investments in ABS transactions	–	354
Aggregated on-balance-sheet items	**746**	**3,431**
Off-balance-sheet items		
Measures to improve credit quality	511	2,327
Derivatives	–	–
Aggregated off-balance-sheet items	**511**	**2,327**

Table 22: Capital requirements for retained or purchased securitisation exposures by risk weight bands

	Retained/purchased securitisation exposures		
Risk-weight bands (in € million)	Exposure values *)	Capital requirement CRSA	Capital requirement IRBA
≤ 10 %	2,401	–	12
> 10 % ≤ 20 %	2,435	16	16
> 20 % ≤ 50 %	893	2	19
> 50 % ≤ 100 %	608	10	26
> 100 % ≤ 650 %	463	1	96
> 650 % < 1 250 %	76	12	35
1250 %/capital deduction	140	30	110
Total	**7,015**	**71**	**314**

*) Total differences are rounding differences.

5.2 Investment Risk

5.2.1 Investment Risk Management

5.2.1.1 Investment Risk Management Strategies and Processes

Securing and improving the bank's own market position is the primary motive behind the investment strategy of the NORD/LB Group. Generally the acquiring of investments serves to effectively consolidate the universal activities of the bank and to fulfil joint responsibilities resulting from the function as a state bank and a central bank for the savings banks. In order to support the NORD/LB Group's business model there is a deliberate focus on banks and financial institutes.

Group interests are maintained in relation to investments primarily by centrally specifying key business ratios or specific tasks. The aim is to ensure that the Group is effectively managed and that transparency is guaranteed for third parties.

Investments are regularly monitored by analysing reports drawn up during the year, interim and annual reports as well as audit reports drawn up by the auditors. Control is carried out by NORD/LB representatives or the supervising subsidiaries in the supervisory boards, advisory boards, shareholders' meetings, annual general meetings and guarantors' meetings as well as by means of holding operative mandates in the companies.

A distinction is made between two categories for measuring investment risk in terms of risk-bearing capacity:

1) Significant participating interests, which make a significant contribution towards general risk at Group level.

2) Insignificant participating interests which only contribute immaterially to general risk at Group level.

Allocation to significant and insignificant investments from a risk point of view is regularly examined by the Risk Control Division on the basis of quantitative criteria. In the period under review, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB were identified as significant participating interests from a risk point of view.

Risks resulting from significant participating interests are integrated into the risk management system of the Group on the basis of quantified risk potential in accordance with the type of risk. Risks resulting from insignificant participating interests on the other hand are included by reporting risk potential within the investment risk subcategory or by directly reducing risk capital.

The risk potential is quantified based on the respective book values of the investments and the probability of default assigned to them with the help of a credit risk model for four different confidence levels and a time frame of one year. The calculation is based on the Gordy model, which is used by the Basel Bank Supervisory Committee for aligning equity requirements within the framework of Basel II.

The credit risk model determines contributions made by individual investments towards unexpected loss at portfolio level, which together add up to unexpected loss for the full portfolio. The parameters for the model are set in accordance with the standard parameters of Basel II.

5.2.1.2 Investment Risk Management Structure and Organisation

Risks resulting from investments at various levels in the Group are controlled by the Investment Management Organisational Unit of NORD/LB in close cooperation with other divisions, in particular the Finance Division. Domestic and foreign investments are all supervised centrally by the Investment Management unit or by the corresponding units in the subsidiaries. Minor exposures are controlled and supervised by the divisions initiating the exposure in each case due to the close factual connection. This is done in close cooperation with Investment Management.

5.2.1.3 Investment Risk Cover and Mitigation

In order to enhance earnings potential and reduce capital tied and potential risk relating to investments the NORD/LB Group has, on the basis of a critical review of the investment portfolio, disposed of a range of investments since 2005. This strategy was continued in 2009.

5.2.1.4 Investment Risk Reporting

Risk management comprises the identification, analysis, valuation, documentation and communication of any risks. Current income (earnings and depreciation) is regularly evaluated and reported to the NORD/LB Managing Board in the case of significant participating interests.

5.2.2 Quantitative Information on Investment Risk

In accordance with § 332 Nos. 2a and b of the Solvency Regulation, Table 23 contains an overview of the carrying amounts of investment exposures in the investment book which are not consolidated for regulatory purpose and not deducted from capital. Such investments are currently not relevant for NORD/LB Luxembourg and NORD/LB CFB.

Since reports in accordance with the Solvency Regulation are currently prepared on the basis of accounts prepared in accordance with the German Commercial Code in the NORD/LB Group, information is also provided on valuations in accordance with the German Commercial Code at this point. Investments are reported at acquisition cost or at the lower fair value in the case of permanent impairment.

With regard to Table 23, when a listed value is ascertained, this is normally the fair value, for funds which are not listed the repurchase value is used. In cases in which a current value is ascertained for internal or external purposes, this is the fair value, otherwise the carrying amount is used.

Investments are allocated to one of five investment groups. Strategic investments are made in order to support and expand banking business in the context of the corporate strategy. Investments in the market serve the interests of the business segment and support operative business. Yield investments are made with the aim of making a profit. Investments resulting from the Landesbank function are made in order to fulfil structural strategic tasks. This group also includes investments relating to the savings bank network, i. e. investments in members of the savings bank financial group. Investments made in joint institutions to promote cooperation are also included in this group. Participating interests that cannot be allocated to any of the above-mentioned groups are consolidated in the group of other investments.

Compared to the previous reporting date in particular yield investments have increased. Other participating interests have fallen though.

Table 23: Carrying amounts of investment exposures

Group of investment exposures (in € million)	Carrying amount	Fair value	Market value
Strategic investments			
listed	–	–	–
not listed but included in a sufficiently diversified investment portfolio	1	11	
other investment exposures	–	–	
Investments in the market			
listed	17	18	18
not listed but included in a sufficiently diversified investment portfolio	24	25	
other investment exposures	–	–	
Yield investments			
listed	106	106	105
not listed but included in a sufficiently diversified investment portfolio	811	779	
other investment exposures	–	–	
Investments resulting from the Landesbank function, investments relating to the savings bank network and investments in joint institutions			
listed	3	4	4
not listed but included in a sufficiently diversified investment portfolio	227	228	
other investment exposures	–	–	
Other investments			
listed	–	–	–
not listed but included in a sufficiently diversified investment portfolio	63	71	
other investment exposures	25	25	

In accordance with §332 No. 2c and d of the Solvency Regulation, Table 24 contains an overview of the realised and unrealised gains or losses in the investment book which are not consolidated for regulatory purposes and not deducted from capital. Such investments are currently not relevant for NORD/LB Luxembourg and NORD/LB CFB.

While a profit from sales was achieved in the previous period, in the current period a loss has been realised. Latent revaluation losses have fallen compared to the previous reporting date.

Table 24: Realised and unrealised gains/losses from investment exposures

(in € million)	Realised gain/loss from sale/liquidation	Latent revaluation gains/losses	
		Total	of which included in supplementary capital
Total	**– 21**	**– 11**	**–**

5.3 Market Price Risk

5.3.1 Market Price Risk Management

5.3.1.1 Market Price Risk Management Strategies and Processes

The activities of the NORD/LB Group associated with market price risks are concentrated on selected markets, customers and product segments. The positioning on money, currency and capital markets should be in line with the significance and dimension of the bank and is primarily geared towards the needs of customers and supporting the control measures of the bank as a whole. Positions are also taken opportunistically within the scope of the remaining market price risk limits.

Trading activities focus on interest rate risk. Here the NORD/LB Group aims, within the scope of set limits, to employ term transformation or interest-spread trading and to participate in general market developments within the framework of these risk limits.

Significant credit spread risks also result from existing investments in securities and credit derivatives in the investment book. NORD/LB generally aims to use the credit spread to maturity and achieve maturity-congruent refinancing of investments. The credit investment books which are currently frozen are managed by the central Credit Investments task force.

Trading book positions are valued daily at current market prices. Valuation is carried out bank-wide at a specific time. Market prices and valuation parameters such as interest rate curves and spreads are reviewed daily by the Market Risk Control department which is independent of trading.

Gains/losses are mainly determined in the front office systems. The valuation algorithms that are stored there have been approved by the Market Risk Control department. Risk is ascertained in a risk control system supplied with quality-assured market data from the front-office systems.

Value-at-Risk (VaR) methods are generally employed for all significant portfolios to manage, monitor and limit market price risks.

The Value-at-Risk ratios are calculated daily using the historical simulation method or, in the case of Bremer Landesbank and Deutsche Hypo, based on a variance-covariance approach. In the process a Group-wide unilateral confidence level of 95 per cent and a holding period of one trading day are used. At the end of each quarter the bank also prepares a Value-at-Risk calculation for the NORD/LB Group based on the above parameters when calculating the risk-bearing capacity.

The analysis is based on historical changes to risk factors over the previous twelve months. The models take account correlation effects between risk factors and sub-portfolios.

Credit spread risks in the investment book are currently not regulated Group-wide with the help of a Value-at-Risk method; instead they are ascertained in a scenario analysis and separately limited.

The prediction quality of the Value-at-Risk model is verified with comprehensive back-testing analyses. This involves a comparison of the daily change in value of the respective portfolio with the Value-at-Risk of the previous day. A back-testing exception exists if a negative change in value observed exceeds the Value-at-Risk. The number of back-testing exceptions fell during the course of the year under review and was as at the reporting date amber for Deutsche Hypo and green for the other significant companies of the NORD/LB Group.

In daily stresstest analyses, in addition to the Value-at-Risk method, the effects of extreme market changes on the risk position of NORD/LB are examined. Various stress scenarios were defined for each of the types of market price risk, namely interest rate, currency, share price, fund price and volatility risk, as well as for credit spread risks in the investment book, and these approximately reflect the most considerable changes in the respective risk factors which were observed in the past for a period of ten trading days. The risk factors observed were selected in such a manner that significant risks relating to the entire portfolio of NORD/LB and to the individual sub-portfolios of the trading divisions are covered. In addition, other stress test analyses are conducted at least once a month, for example strategy-related stress tests for selected trading items. The stress test parameters are reviewed on at least an annual basis and adjusted to changes in the market situation as and when required.

The Value at Risk for the NORD/LB Group is also calculated on the basis of the respective regulatory parameters (confidence level of 99 per cent and a holding period of ten days).

5.3.1.2 Market Price Risk Management Structure and Organisation

Divisions handling items bearing market price risks which also account for profits and losses resulting from shifts on markets are all included in the control process for market price risks. At NORD/LB this includes the Treasury, Markets and Portfolio Investments divisions. Within the scope of their Global Head function, the divisions are also responsible for trading activities conducted at the foreign branches in London, New York, Singapore and Shanghai.

Trade transactions are processed and controlled in separate divisions, while support services are provided by the Financial Markets Business Development division.

In the second quarter of the year under review a strategic realignment of NORD/LB's whole Financial Markets division took place. The focus of the division now lies on customer business and supporting control measures for the bank as a whole.

Risks are monitored by the Risk Control Division, which in accordance with MaRisk operates independently of divisions responsible for market price risk management in terms of both function and organisation and performs various monitoring, limiting and reporting activities for NORD/LB (including the foreign branches) and the NORD/LB Group. These activities also include calculating amounts eligible for monthly SolvV reporting for those risk types in market price risk for which regulatory approval of the internal model has been granted. The SolvV report for the German Federal Financial Supervisory Authority (BaFin) is prepared by the Credit Risk Control Division.

The Treasury Division presents the current maturity profile for strategic planning and, if necessary, makes proposals to the planning committee (Dispositionsausschuss) concerning the method of strategic planning in future. This committee, which convenes monthly, is an advisory body of the Financial Markets director and its members include representatives from the Treasury, Markets, Research/Economy, Finance and Risk Controlling divisions as well as Bremer Landesbank, NORD/LB Luxembourg and Deutsche Hypo. The Treasury Division is responsible for implementing the measures within the framework of basic instructions issued by the Managing Board and of the risk limit for strategic planning.

In the Credit Investments task force the Portfolio Investments Division shows positioning in maturity-congruent refinanced securities and credit derivatives in the investment book and makes proposals for the risk management of the portfolio. The task force meets as and when required and advises the Managing Board on the management of risk and demonstrates related economic effects. Due to the investment stop resolved by the Managing Board, the measures proposed in the year under review almost all serve to reduce risk relating to the portfolio. Members of the Credit Investment task force include the Financial Market and Risk Control Directors and representatives from the divisions of Portfolio Investments, Risk Control, Credit Risk Management and Finance. The Portfolio Investments Division implements measures agreed by the Managing Board.

The market price risks of Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB are managed decentrally by the local trade and treasury divisions. They have their own risk control units which are responsible for monitoring the risks. The data is integrated into the reporting at group level.

5.3.1.3 Market Price Risk Cover and Mitigation

Limits derived from loss limits specified by the Managing Board for each trading division are stipulated for Value-at-Risk data. Any trading book and selected investment book losses are immediately added to the loss limits, hence resulting in a reduction in Value-at-Risk limits in accordance with the principle of self-absorption. Correlation effects between the portfolios are included in calculating Value-at-Risk and in the delegation of sub-limits. In some areas specific sensitivity limits are added to the Value-at-Risk limits. Investment book credit spread risks are limited separately.

5.3.1.4 Market Price Risk Reporting

In compliance with MaRisk requirements, the Risk Control Division, which is independent of the divisions responsible for the items, reports daily on market price risks to the respective Director. The Directors are therefore also informed about the effect of stress scenarios beyond the scope of Value-at-Risk scenarios. A weekly report is also provided on the credit spread risks in the investment book. The Managing Board is informed in detail once a month about market price risks and the earnings position.

5.3.2 Quantitative Information on Market Price Risk

VaR data relating to general interest rate risks and general and specific share price risks determined in the internal model is shown in Table 25. The schedule contains the VaR on the balance sheet date, the highest and lowest VaR during the reporting period and the annual average. VaR values are calculated on the basis of regulatory parameters (confidence level of 99 per cent and a holding period of ten days). The VaR at the end of the period under review was less than at the previous reporting date, while the VaR values during the period reported in the table were greater than at the previous reporting date.

Tabelle 25: Overview of the VaR of portfolios in the trading book (internal model)

Trading book portfolios (general interest rate risk and share price risk)	VaR at the close of the reporting period (in € million)	VaR values during the period		
		Highest value (in € million)	Lowest value (in € million)	Reporting periods Ø (in € million)
Combined VaR	**24**	**116**	**22**	**41**

The overall VaR for all the types of market price risk can be seen in the risk report contained in the Group Management Report.

Reference is made to Table 3 in Section 4.2.2 on capital requirements for information on capital charge for market price risks, presented separately for the standard approach and the internal model approach.

5.3.3 Special Information on the Interest Rate Risk in the Investment Book

Interest rate risks in the investment book mainly arise from new business or strategic interest management. In order to quantify the risk content of these positions at individual institute level on a daily basis, the VaR model, which is also used for the trading book, is applied. However, the quarterly calculation of the interest rate shock in the investment book at Group level is based on the regulatory stress test involving a parallel shift in the interest rate curve by 130 basis points upwards or 190 basis points downwards.

The models used in daily control measures are also used for interest rate shocks. This involves mapping onto the fixed interest period for products with fixed terms and various models of stochastic products. The majority of open-end investments are shown in moving average models. Unsecured cancellation rights for loans are restricted by imposing limits. Only equity and investments are not included, in accordance with regulatory provisions.

Table 26 in accordance with § 333 Paragraph 2 of the Solvency Regulation shows changes in the present values given an interest rate shock of 130 basis points upwards and an interest rate shock of 190 basis points downwards. Increases in present values are shown as positive figures while decreases in present values are preceded by a minus sign.

The fall in the values compared to the previous reporting date is the result of and adjustment to the models for individual items without fixed interest against the background of the MaRisk amendment. The adjustment has been made to standardise internal and external reporting.

Table 26: Interest rate risks in the investment book

	Change in present value*)	
Currency	Interest rate shock +130 basis points (in € million)	Interest rate shock –190 basis points (in € million)
EUR	–329	528
USD	–13	16
JPY	2	–
GBP	–1	–
CHF	–1	5
Other	–	–
Total	**–343**	**550**

*) Total differences are rounding differences.

5.4 Liquidity Risk

5.4.1 Liquidity Risk Management

5.4.1.1 Liquidity Risk Management Strategies and Processes

Securing perpetual liquidity for the NORD/LB Group is strategically essential. While classical liquidity risk is principally to be avoided through maintaining a sufficient supply of liquid assets (in particular central bank eligible securities), a structural transformation of liquidity terms is undertaken for the refinancing risk. Risks are constrained with suitable limits in both cases.

The limit for classical liquidity risk serves to secure the ability to make payment even in a conservative stress scenario, while the limit for the refinancing strategy is derived from the risk strategy and the risk-bearing capacity of the NORD/LB Group and allows term transformation to contribute to earnings.

In order to limit market liquidity risk the NORD/LB Group primarily operates in liquid markets. This applies in particular to all transactions in the trading book. The balances in the trading book primarily consist of securities from prime issuers.

The individual institutes of the NORD/LB Group have liquidity control policies which describe the basic strategic guidelines for ensuring a sufficient supply of liquidity. Liquidity management measures in cases of emergency and in crisis situations are specified in contingency plans.

Risk concentrations on the liabilities side are prevented by a diversified investor base and product range. The focus is on institutional and public investors, which is in line with the risk-based orientation of the NORD/LB Group. The diversification of refinancing sources is also reinforced by the mortgage bond business, which provides the NORD/LB Group with additional access to the funding market.

NORD/LB calculates the utilisation of volume structure limits for the various maturity bands on the basis of a liquidity progress review of the entire item, which essentially reflects the standard case. Liquidity risk is quantified in a risk-bearing capacity concept for the entire bank resulting from a present-value consideration of the refinancing risk.

Calculation of dynamic and static stress scenarios for modelling classical liquidity risk is based on current liquidity progress reviews. These are stressed until they reflect a crisis. For example, a reduced amount of accounting liquidity and an increased utilisation of credit commitments is presumed. The stress scenarios can be used to show the effect of unexpected events on the liquidity situation of the bank, enabling the bank to plan for the future and to be well-prepared for cases of emergency.

The analysis of stress scenarios takes into consideration the overriding significance of the market liquidity of all of the securities in the portfolio. In addition, a separate credit spread risk calculation is made for securities in the investment book. Since the spreads observed on the market reflect both the credit rating of an issuer and the market liquidity of the securities and since the parameters applied for calculating a scenario are specified in relation to current market spreads, the risk report also indirectly takes into account the market liquidity of the securities. No separate risk dimension is applied for market liquidity risks.

5.4.1.2 Liquidity Risk Management Structure and Organisation

The global trading divisions Markets, Treasury, Portfolio Investments and Portfolio Management & Solutions and the Risk Control Division are included in the process of liquidity management at NORD/LB.

The trading divisions and Treasury assume the management role for items bearing liquidity risks and produce the profits and losses resulting from changes in the liquidity situation (in general or specific to NORD/LB).

The Treasury also presents the liquidity progress review to the planning committee. It also reports to this committee on the refinancing risk and makes recommendations for activities in terms of the future approach towards strategic planning if necessary.

The Risk Control Division is in charge of the implementation and development of internal procedures for measuring, limiting and monitoring liquidity risks. The Risk Control Division also ascertains and monitors classical liquidity risk and monitors refinancing risk. It also ascertains and monitors regulatory indicators in accordance with German Liquidity Regulations (LiqV).

A Global Liquidity Management crisis team is available in the event of a liquidity crisis and assumes responsibility for liquidity management in close cooperation with the Managing Board.

The liquidity risks of Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB are managed decentrally by the local Treasury units and monitored by their own Risk Control units. In order to coordinate the decentralised units of the NORD/LB Group, information is regularly exchanged between the significant companies to address both issues relevant to control in the Treasury Division and also model-relevant issues in the Risk Control Division.

5.4.1.3 Liquidity Risk Cover and Mitigation

The refinancing risk of NORD/LB and the significant subsidiaries is regulated by restricting the risk with volume structure limits for various maturity bands which cover the entire range of maturities. Since the start of the year under review liquidity progress is also considered by currency.

Classical liquidity risk is limited by a dynamic stress test scenario. The scenario describes the most likely crisis situation in each case, hence also describing the spread of the financial market crisis in the current market environment. Analysis is based on liquidity cash flows and covers the coming twelve months on a daily basis. Assumptions are made in accordance with the market situation in terms of scheduled new business and refinancing options.

With the help of the limit system it is ensured that in the event of a stress case, surplus liquidity is available for at least three months. This means that securing the ability to make payment at any time in this maturity band is given preference over possible opportunities to generate profits. The aim is to ensure a liquidity surplus for six months on consideration of profitability aspects.

The dynamic stress scenario is supplemented by other statistical stress tests every month. These tests cover a scenario specific to NORD/LB and also the alternative scenario of a comprehensive liquidity crisis as well as a short-term scenario for a market-wide liquidity problem.

Market liquidity risks are implicitly accounted for by means of classifying securities in the liquidity progress review in accordance with their market liquidity. The NORD/LB Group pursues a best-practice approach: securities are allocated to one of eight categories (e.g. trading book, cover fund, central bank eligibility) on the basis of a detailed liquidity category concept. The presentation of the liquidity progress review is contingent on the liquidity category and is carried out in a maturity range extending from call money to the final due date.

For control at group level a Group liquidity progress review is prepared. For this purpose all of the cash flows in euro and the translated foreign currency cash flows of the significant Group companies are compiled in one overview. The monthly reporting in the year under review was also supplemented by the presentation of the liquidity progress reviews in the most important foreign currencies.

5.4.1.4 Liquidity Risk Reporting

Coefficients can be calculated daily and submitted to the Treasury Division for the purpose of regulating liquidity risk. The report in accordance with German Liquidity Regulations for the entire bank and for each control unit is submitted to the Bundesbank, the control divisions and to the Managing Board once a month. The liquidity progress review is presented to the planning committee and discussed on a monthly basis.

The responsible divisional heads are informed several times a week, and depending on the amount of the limit used on a daily basis if necessary, of the NORD/LB Group's classical liquidity risk. In addition to this the NORD/LB Group's biggest investors in new business are monitored regularly.

The Managing Board is informed about the liquidity risk situation on a monthly basis in the report on the risk and earnings situation in the trading divisions and in a quarterly report submitted by the Risk Management Division on the risk-bearing capacity of the bank. The supervisory body receives the reports stated on a quarterly basis.

The monthly reporting in the year under review was also supplemented by the presentation of the liquidity progress reviews in the most important foreign currencies. These progress reviews are presented to the planning committee which meets on a monthly basis for consultation.

5.4.2 Quantitative Information on Liquidity Risk

There are no quantitative regulatory requirements relating to the disclosure of liquidity risk. Reference is made here to the risk report included in the Annual Report of the NORD/LB Group.

5.5 Operational Risk

5.5.1 Operational Risk Management

5.5.1.1 Operational Risk Management Strategies and Processes

Operational risk is imminent in any business activity. For this reason, various measures undertaken in the NORD/LB Group have for a long time now focussed on the management of operational risk. The main aim is to avoid operational risks as far as this is economically viable. The NORD/LB Group understands this as meaning that the bank is to protect itself against operational risks provided that the cost of protecting it against such risks does not exceed the cost of risks that may occur.

The prevention of operational risk should be supported in particular by an appropriate operational and organisational structure, regulations set down in writing, the internal control system (ICS), an appropriate personnel level in terms of quality and quantity, security and contingency plans and appropriate insurance cover.

With continual analysis of loss events, risk indicators and scenarios, causes of risk should be identified and concentrations of risk prevented. The ICS is reviewed regularly in relation to its appropriateness and effectiveness with regard to risk (ICS control group). Appropriate countermeasures are taken as and when required. Contingency plans serve to limit damage in the case of extreme unexpected events.

NORD/LB has been collecting data on loss events resulting from operational risk since the beginning of 2003 and has classified these events by process, cause, and effect. There is no “insignificant” level; however there is a simplified reporting process for gross losses of less than € 2,500. Data in the loss databank provides the basis for analyses in support of risk management and is an important element of a statistical/mathematical risk model. The significant companies of the NORD/LB Group are included in the collection of loss events.

The loss events collected are entered in anonymous form in the DakOR data consortium initiated by the German Federal Association of Public Sector Banks (VÖB). In return the NORD/LB Group receives the loss events collected by the consortium as a data basis. In addition information contained in the ÖffSchOR database is available in which press releases on major losses resulting from operational risk are collected, structured and processed. The two sources of data are used for scenario analyses and for regular benchmarking.

With the help of the self-assessment method which is carried out annually in NORD/LB, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB, the recording of data concerning past losses is supplemented with future components. Expert appraisals provide a detailed insight into the risk situation of the individual bank divisions so that relevant measures can be derived if necessary. Self-assessment is carried out by means of a list of generic questions concerning both qualitative and quantitative issues and individual scenarios.

At the start of 2009 a method for collecting risk indicators was implemented in NORD/LB. The selection of indicators takes place on a risk-oriented basis and is regularly reviewed for its appropriateness. NORD/LB aims to identify potential risks early on and to take countermeasures. Likewise with continual analysis of loss events, risk indicators and scenarios, causes of risk should be identified and concentrations of risk prevented.

NORD/LB has an internal model to measure operational risk. As well as internal data and scenario analyses, external data from the DakOR consortium also goes into this model. Correlation effects are also considered. For this purpose a loss distribution approach is used in which elements of the extreme value theory are considered. Dependencies are modelled with the help of a Gaussian copula. The Value-at-Risk calculated by the model is used as a control variable for operational risks in the RBC model.

The methods and procedures implemented in the NORD/LB Group meet the requirements of § 272 SolvV concerning the use of the standard approach for operational risk. In addition the further developments based closely on the requirements of SolvV already meet essential conditions for the implementation of an advanced measurement approach (AMA).

5.5.1.2 Operational Risk Management Structure and Organisation

The Managing Board, the Risk Control Division and the Internal Auditing Division as well as all the other divisions are involved in the process of controlling operational risks. The Managing Board stipulates the basic method of handling operational risk, taking into account the risk situation at general bank level. Responsibility for the control of operational risk within the general environment specified is decentralised and lies with the individual divisions.

The Risk Control Division is responsible for the central monitoring of operational risks and the independent reporting of these risks. The division is also responsible for specifying methods to be applied, for properly implementing centralised methods and for coordinating the implementation of decentralised methods. The Internal Auditing Division is in charge of independently examining whether methods and procedures are properly implemented and carried out.

All of the previously independent tasks of security and contingency management have been combined in the newly established Group Security division. The aim is to establish a security strategy for NORD/LB and implement uniform standards in order to efficiently and sustainably protect the bank from harm and at the same time meet legal and supervisory requirements.

The operational risks of Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB are managed decentrally. They have their own risk control units which are responsible for monitoring the risks. The methods and guidelines which apply throughout the Group are defined by the Risk Control Division of NORD/LB.

5.5.1.3 Operational Risk Cover and Mitigation

Safety concepts and contingency concepts have been put in place for the purpose of protecting persons and tangible assets; among other things they regulate the utilisation of buildings, the procurement of replacement operating and office equipment and supply of energy. Maintaining the health of employees has top priority. For this purpose extensive preventive measures were taken in the year under review to prepare for pandemics.

Personnel risk is countered by an appropriate personnel level in terms of quality and quantity. The bank pays particular attention to employee qualifications and the qualification status is reviewed with the help of a system of job specifications and employee assessments. Personnel development measures can therefore be initiated in a targeted manner.

Criminal actions are countered in close cooperation with the criminal prosecution authorities. NORD/LB has a central office for permanently improving the prevention of internal and external acts of fraud. The responsibilities of this office include making available adequate security measures relating to the prevention of acts of fraud in accordance with § 25a Paragraph 1 of the German Banking Act and within the framework of a proper business organisation. For this purpose a fraud prevention strategy was implemented, and this has been improved in the year under review by among other things the implementation of a whistle-blowing system and regular training for all employees.

In the IT Division, instructions on procedures, alternative capacities and backups ensure that the IT infrastructure is adequately stable. Security concepts and contingency plans supplement pre-emptive measures in order to prevent loss or damage resulting from the failure or the manipulation of systems and information.

Process-related and structural organisational risks are countered with well-organised structures and procedures. If weaknesses in the organisation are identified, appropriate countermeasures are initiated immediately. The structures in the internal control system which have been further improved in the year under review should support this and permanently guarantee regulated cooperation between all of the divisions involved in the process of controlling operational risks.

The ICS framework introduced for this purpose is based on the COSO framework for internal controls and includes a specific operational and organisational structure. With the use of standardised methods and procedures, an appropriate and effective ICS should be ensured throughout the bank and a lasting improvement sought.

The operational structure of NORD/LB's ICS is geared towards a recurrent control cycle. The overriding goal is the bank-wide assessment of the ICS based on the consideration of the appropriateness and effectiveness of the controls implemented. The control cycle will be supported by an organisational structure optimised for this purpose. This includes roles related specifically to the ICS, the tasks, competencies and responsibilities of which are defined and distinguished from one another. The current reporting to different groups of recipients is part of this control cycle.

The NORD/LB Group has a standard process map. Based on this processes involving particular risk are identified with the help of a scoring model and a detailed analysis with regard to the appropriateness and effectiveness of the ICS is undertaken. In the year under review the scoring model, which enables a detailed analysis, was revised.

The NORD/LB Group's insurance cover is appropriate and is regularly reviewed. The respective legal department is to be consulted in terms of securing legal risks, for example when legal steps are to be initiated and when contracts which are not based on approved sample contracts are concluded.

The quality of external suppliers and service companies is ensured by concluding service level agreements or detailed specifications and subsequently controlling respective key figures. A process for assessing service providers in terms of their significance for risk aspects was installed in order to implement MaRisk requirements concerning outsourcing. For each significant service outsourced a position is nominated which is responsible for managing services and risk relating to the business relationship. An individual contingency concept is also drawn up for each significant service outsourced.

Natural disasters and terrorist attacks are defined as force majeure. These risks are countered in contingency concepts.

5.5.1.4 Operational Risk Reporting

Within the framework of a continuous risk management process, results from the collection of loss events and risk indicators are analysed and communicated to the Managing Board on a quarterly basis and the responsible divisions as and when required and at least once a year. The self-assessment is carried out once a year and analyses are reported to the Managing Board and the divisions. The quarterly RBC reporting includes information from the loss database, the self-assessment and the internal model for operational risks.

5.5.2 Quantitative Information on Operational Risk

Reference is made to Table 3 in Section 4.2.2 on capital requirements for information on minimum capital requirements for operational risks. Information on loss events can be seen in the risk report included in the Annual Report of the NORD/LB Group.

6 Schedule of Tables

The tables are based on the use cases of the expert panel on disclosure requirements of the Deutsche Bundesbank of November 2006.

7 Schedule of Abbreviations

AAKA “Allgemeiner Arbeits- und Kreditausschuss” (General Working and Credit Committee at NORD/LB)

ABCP Asset-Backed Commercial Paper

ABS Asset-Backed Securities

AMA Advanced Measurement Approach

BaFin “Bundesanstalt für Finanzdienstleistungsaufsicht” (German Federal Financial Supervisory Authority)

CCF Credit Conversion Factor

COSO Committee of Sponsoring Organizations of the Treadway Commission

CRO Chief Risk Officer

CRSA Credit Risk Standard Approach

DakOR “Datenkonsortium zur Sammlung von Schadenfällen im Kontext der operationellen Risiken” (Data Consortium for the collection of loss events in the context of Operational Risk)

DSGV “Deutscher Sparkassen- und Giroverband” (German Association of Savings Banks and Girobanks)

EAD Exposure at Default

EL Expected Loss

GRC Group Risk Committee

HGB “Handelsgesetzbuch” (German Commercial Code)

IAA Internal Assessment Approach

ICAAP Internal Capital Adequacy Assessment Process

IFD “Initiative Finanzstandort Germany” (Initiative for Germany as a Financial Location)

IFRSs International Financial Reporting Standards

IRBA Internal Ratings Based Approach

KWG German Banking Act

LGD Loss Given Default

LiqV German Liquidity Regulation

Lux GAAP National Accounting Regulations of the Grand Duchy of Luxembourg

MaRisk Minimum Requirements for Risk Management

NPL Non-Performing Loans

NPP New-Product Process

OECD Organisation for Economic Co-operation and Development

ÖffSchOR “Datenbank Öffentliche Schadenfälle OpRisk” (database of public loss events relating to operational risk)

PD Probability of Default

RBA Rating Based Approach

RBC Risk-Bearing Capacity

RSU Rating Service Unit GmbH & Co. KG

RW Risk Weight

SCM Special Credit Management

SFA Supervisory Formula Approach

SolvV German Solvency Regulation

SPE Special Purpose Entity

SR Sparkassen Rating und Risikosysteme GmbH

VaR Value-at-Risk

VÖB Bundesverband Öffentlicher Banken Deutschlands (German Federal Association of Public-Sector Banks)

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