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

as at 31 December 2010

Finanzgruppe

NORD/LB
Die norddeutsche Art.

1 Preamble

The German Solvency Regulation (SolvV) entered into force on 1 January 2007. It 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 2010 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. For example, values as at the previous reporting date are shown in the tables to allow a direct comparison.

Further changes in this report are the result of additional or revised disclosure requirements in the Solvency Regulation. The additional reporting requirements are pointed out at the relevant points in the report. They are based on the regulation which implements the revised Banking Directive and the revised Capital Adequacy Directive (SolvVuaÄndV) and came into force on 31 December 2010. Where only clarifications or more precise definitions were made, these are considered in this report, but they are not explicitly pointed out as they did not result in any changes in content.

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 material risks and the corresponding system of risk management as well as methods of risk control are described. The overall risk profile of the NORD/LB Group is reviewed and its material risks are identified in the risk inventory, which takes place at least annually. This currently includes counterparty risk (credit risk and investment risk), market price risk, liquidity risk and operational risk.

Quantitative disclosures contained in this report are 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. and NORD/LB COVERED FINANCE BANK S.A. are exceptions here too, since their quantitative disclosures are based on Lux GAAP (disclosures 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 material risk type in the period under review and an outlook for developments anticipated in future.

In accordance with § 320 para. 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 was announced in the electronic German Federal Register (www.ebundesanzeiger.de) in accordance with § 320 para. 2 of the Solvency Regulation.

2 Application

Solvency Regulation requirements for disclosure refer to regulatory groups of institutes in accordance with § 10a 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 materiality concept 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) as well as NORD/LB COVERED FINANCE BANK S.A., Luxembourg (NORD/LB CFB), are included in this report as significant Group institutes. All qualitative and quantitative disclosures therefore refer 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 non-material level of individual risk. Risks concerning these companies are treated as investment risk and if necessary explained by a qualitative report on investment risk. The audit of the Group companies significant for risk reporting considers both the consolidated companies in accordance with IFRSs and the companies included in the regulatory 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 para. 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 (parent company)	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 presence 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 segments of Private and Commercial Customers, Savings Bank Network, Financial Markets/Institutional Customers, Corporate Customers, Energy and Infrastructure Customers, Ship and Aircraft Customers and Real Estate Banking Customers.

Bremer Landesbank sees itself as a universal bank acting as a regional commercial bank with special international business while at the same time performing its role as a state bank and a central bank for the savings banks. Its core business region is North West Germany, from where the bank supports its regional and international customers in Europe. 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, Corporate Banking and Financial Markets.

Deutsche Hypo, which was established in 1872, is a well-positioned mortgage bank with a rising volume of commercial real estate business. The pooling of know-how raises the significance, image and acquisition power of the NORD/LB Group among customers, partners and investors in the market for providing finance for commercial real estate. 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 publiques (covered bonds in 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 114 companies which are not significant for risk reporting and in which NORD/LB holds direct or indirect interest. These include seven banks, two financial services institutions, 52 financial companies, two insurance companies and 51 other companies.

Of these companies, 25 are fully consolidated under regulatory law, 31 are subject to the deduction method and 17 are exempted from inclusion in the consolidated reports in accordance with § 31 para. 3 of the German Banking Act. 41 companies included in the IFRS basis of consolidation are not consolidated under regulatory provisions. 47 companies are fully consolidated in accordance with IFRSs and 15 are measured using the equity method. 52 companies included in the regulatory basis of consolidation are not consolidated in accordance with IFRSs.

A complete list of equity holdings in accordance with § 313 para. 2 of the German Commercial Code is published in the notes to the consolidated financial statements.

The Group companies which are not significant for risk reporting 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 2009 are also the result of 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 para. 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 German Banking Act, for example instructions concerning equity, large-scale loans and internal control systems according to § 25a para. 1 of the German 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 para. 2 of the Solvency Regulation.

3 Risk Management

3.1 Risk Management Strategies and Processes

The business activities of a bank inevitably involve the conscious 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 results and projected results of business activity. Identifying, assessing, reporting, controlling and monitoring 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 (KWG). 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 NORD/LB Group's business policy is deliberately conservative. Accordingly the responsible handling of risks is the uppermost priority. The Group risk strategy, drafted with this in mind, overrides the risk strategies of the significant companies in the NORD/LB Group and is, taking into account the respective business models, substantiated by their risk strategies.

The risk strategies of the significant Group companies 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 management and on sub-strategies for risks relating to the material risk types.

The core element of the risk strategy is the risk-bearing capacity model (RBC model), on the basis of which risk appetite is specified and the allocation of risk capital to the material risk types is undertaken.

For the NORD/LB Group it was conservatively determined that normally at most 80 per cent of the economic risk coverage may be covered with risk potential. The relevant approach in the RBC model (status quo of economic capital adequacy) should therefore provide a minimum coverage of 125 per cent. At the level of the significant companies, this specification applies for each individual institute.

The maximum risk capital is also allocated to the material risk types in the risk strategies. Most of the coverage is associated with credit risk, reflecting the NORD/LB Group's focus on customer-oriented lending business. The individual institutes are responsible for determining the allocation relevant for them.

The Group risk strategy and the risk strategies of the significant companies were reviewed and adjusted in 2010 and discussed with the Supervisory Board after being passed by the Managing Board. The revision focused on the integration of the overall risk profile and the further-developed RBC model into the risk strategies.

The risk strategies aim to achieve an optimal management of all material risk types and to achieve the transparent presentation of these risks to the management, the supervisory bodies and other third parties with a justified interest.

Based on this, the significant companies of the NORD/LB Group have a range of further instruments at operational level which ensure that there is sufficient transparency of the risk situation and structure the required limitation and portfolio diversification in a way which can be controlled and monitored. These instruments are described in detail in the NORD/LB Group's risk handbook and in the risk handbooks and relevant documents of the individual institutes.

The NORD/LB Group has, in accordance with MaRisk AT 4.5, 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 of the NORD/LB Group's significant companies involved in the process of risk control. Furthermore, an efficient risk management process with clearly defined tasks and authorities, backed up by an adequate IT infrastructure and qualified employees, ensures smooth procedures. 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 companies of the NORD/LB Group comprise standard principles concerning risk management structures and processes which have been laid down for the entire Group.

The NORD/LB Group has implemented risk management processes which cover all institutes and divisions. The sub-processes apply to all risk types:

- Risk identification: Identification of the relevant risks (overall risk profile) in the risk inventory based on the risk universe and distinction between material and non-material risks (reviewed at least annually and as and when required)

- Risk assessment: Regular quantitative and qualitative assessment of risks using predefined methods

- Risk reporting: Reporting on the risk situation (internal and external, risk-type specific and covering all risk types, regular and ad-hoc)

- Risk control and monitoring: Limiting and management (acceptance, mitigation, transfer, avoidance) of risks and monitoring of limits (limit / utilisation comparison)

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 risk management sub-processes are laid out in the NORD/LB Group's risk manual and the relevant working instructions of the individual institutes.

For more detailed information on risk management strategies and processes in accordance with §322 of the Solvency Regulation, chapter 5 on the individual risk types is referred to.

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 coordinates the 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 the Group risk strategy has been passed by the Managing Board of NORD/LB, it is submitted to the Supervisory Board of NORD/LB for its information and discussed with it.

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 material risks including the risk reporting at Group level. At individual institute level responsibility lies with the respective Managing Board member or the Risk Officer.

Functional risk management is performed decentrally in the significant Group companies. In order to ensure the greatest possible comparability with regard to the assessment, monitoring, controlling and reporting of all material risks, the instruments used for this purpose are agreed with the relevant institutes.

In addition to the Erweiterter Konzernvorstand, the control of the NORD/LB Group is supported by a system of Konzernsteuerungskreise (Group Control Committees), whose members are, depending on the Konzernsteuerungskreis, various members of the Managing Board and divisional heads of the companies significant for risk reporting. From a risk point of view in particular the Risk / Finance Konzernsteuerungskreis 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 Risk/Finance Konzernsteuerungskreis and comprises the Chief Risk Officer, the board members of the market divisions and the heads of the divisions Central Management Risk, Risk Control, Research/Economy and the credit administrative office 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 risk types and strengthening Group integration.

The structure and organisation of risk management in the NORD/LB Group complies with the requirements of MaRisk. The process of risk management 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 Risk Control Division is responsible for updating and developing the RBC model and regularly reviewing the risk strategies of the NORD/LB Group and NORD/LB.

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 the monitoring of 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 Erweiterter Konzernvorstand was passed by the Managing Board in December 2009 and came into effect on 1 January 2010.

The Group audit is carried out in addition to the internal audits in the subsidiaries. The focus is on NORD/LB Group's risk strategy, Group-wide risk-bearing capacity, Group accounting and Group reporting, reporting on Group control and the reliability of the internal audits of the subsidiaries. In addition to the audits of Group audits, joint audits of the Group audit with the internal audits (cooperative Group audits) also take place.

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.

For more detailed information on the structure and organisation of risk management in accordance with § 322 of the Solvency Regulation, chapter 5 on the individual risk types is referred to.

3.3 Hedging and Mitigating Risk

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

3.4 Risk Reporting

The reports drawn up at least quarterly 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 respective Managing Board and the supervisory bodies. Compliance with the specifications of the risk strategy on risk appetite and on the allocation of risk capital to the material risk types is therefore reviewed regularly.

In addition to receiving the report on risk-bearing capacity, the Managing Boards of the institutes subject to the Covered Bond Act (Pfandbriefgesetz) are also informed about risks relating to covered bond business on at least a quarterly basis. The reports prepared at individual institute level meet the requirements of §27 of the Covered 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 risk types is regularly reported to the Managing Board and to bodies, committees and specialised bank divisions. For details on reporting within the system of risk management in accordance with §322 of the Solvency Regulation, chapter 5 on the individual risk types is referred to.

3.5 Risk Types

3.5.1 Credit Risk

Credit risk is a component of counterparty risk and is broken down into traditional credit risk and counterparty risk in trading. Credit risk defines the risk of loss involved when a credit borrower defaults or when the credit rating of such a credit borrower deteriorates. Counterparty risk in trading defines the risk of loss involved when a borrower or contract partner in trading transactions defaults or when the credit rating of such a borrower or contract partner deteriorates. It is broken down into default risk in trading, replacement risk, settlement risk and issuer risk:

- Default risk in trading defines the risk of loss involved when a borrower defaults or when the credit rating of such a borrower deteriorates. It equates to traditional credit risk and relates to money market transactions in the Money Market and Treasury divisions.

- Replacement risk defines the risk of the contract partner in a pending transaction with a positive present value defaulting and this transaction having to be replaced with a loss.

- Settlement risk is broken down into advance payment risk and clearing risk. Advance payment risk defines the risk when the bank has completed a payment of the counter-payment not being made by the contract partner or, if payments are offset, the balance not being paid. Clearing risk defines the risk of transactions of transactions not being able to be cleared by either party upon or after the expiry of the contractually agreed performance date.

- Issuer risk defines the risk of loss involved when an issuer or reference entity defaults or when the credit rating of such an issuer or reference entity deteriorates.

In addition to the original credit risk, cross-border capital transfer services involve country risk (transfer risk). This is the risk that, despite the ability and willingness of the individual counterparty to meet payment claims, a loss will occur as a result of overriding government hindrances.

3.5.2 Investment Risk

Investment risk is another component of counterparty risk and defines the risk of incurring losses when making equity available to third parties. A potential loss due to other financial liabilities is also a component of investment risk, unless it was considered in the other risks.

In addition to the original investment risk, cross-border capital transfer services involve country risk (transfer risk).

3.5.3 Market Price Risk

Market price risks is defined as potential losses which may be incurred as a result of changes in market parameters. With market price risk a distinction is made between interest rate risk, currency risk, share price risk, fund price risk, volatility risk as well as the credit spread risk and commodity 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. This also includes the credit spread risk in the trading book.

- Credit spread risk defines potential changes in value which would result if the credit spread applicable for the respective issuer, borrower or reference entity used for the market value of the item changed. In order to prevent risks from being counted twice, credit-rating-induced changes to ratings can be ignored when establishing credit spread risks in the banking book as they are considered in issuer risk.

- Other partial risks relevant for NORD/LB include the risk that the value of an item reacts to changes in one or more currency exchange rates (currency risk), share prices or share indexes (share price risk), fund prices (fund price risk) or volatilities applied for valuing options (volatility risk) and the changes result in a reduction in the item's value.

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, investment or new issue business or deterioration in the bank's own refinancing conditions. The NORD/LB Group understands placement risk to be a component of liquidity risk. It describes the risk of own issues not being placed in the market or only placed at poorer conditions. Liquidity risks are broken down into traditional liquidity risk, refinancing risk and market liquidity risk:

- Traditional liquidity risk is the risk that payment obligations cannot be met or cannot be met on time. Potential causes can be a general disruption in the liquidity of money markets which affects individual institutes or the entire financial market. Market disruptions may in particular result in significant asset classes not being available for use as collateral. Alternatively unexpected events in lending, investment or new issue business may also result in liquidity shortages. 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 banking 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. This definition includes legal risks and reputation risks as consequential risks. The NORD/LB Group understands compliance risk and outsourcing risk to be components of operational risk as well.

- Legal risk defines the risk of losses occurring due to the non- or insufficient consideration of the legal framework specified by legal regulations and case law. Legal risk only exists in the bank's external relations.

- Reputation risk defines the risk of a loss occurring due to a loss of confidence among customers, business partners or guarantors.

- Compliance risk defines the risks of penalties being handed out by courts, authorities or disciplinary bodies as a result of improper procedures, processes etc. (due to non-compliance with laws, regulations, codes of conduct and standards) in the bank's internal relations.

- Outsourcing risk defines the risks resulting from the outsourcing of activities and processes.

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 para. 6 of the German Banking Act comprise the core capital and the supplementary capital allocated to the Group companies as well as certain deductions.

The core capital of the NORD/LB Group as at 31 December 2010 amounts to € 7 945 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 company (€ 1 085 million), shares in the share capital or capital stock of subordinate companies (€ 76 million) and an indefinite contribution to capital in accordance with §15 para. 1 of the NORD/LB state treaty (€ 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 2009 these reserves have fallen by approximately € 46 million due primarily to losses of Group companies from the profit in 2009.

The inclusion of contributions from silent partners is based from 31 December 2010 on the revised regulations in accordance with §10 paras. 2, 2a and 4 of the German Banking Act in conjunction with the transitional regulations in accordance with §64m of the German Banking Act. Accordingly, contributions from silent partners received before 31 December 2010 are either included as additional capital, other capital or only as supplementary capital, depending on the individual contractual arrangements. Additional capital is to be included 100 per cent as core capital. Other capital may in accordance with §10 para. 2 clause 4 of the German Banking Act make up at most 35 per cent of the core capital for solvency purposes. Other capital which is temporary or involves a repayment incentive for the issuer due to the contractual arrangements may, in deviation to this, make up at most 15 per cent of the core capital for solvency purposes in accordance with §10 para. 2 clause 3 of the German Banking Act. However, all contributions from silent partners received before 31 December 2010 may, on a transitional basis and in accordance with §64m para. 1 of the of the German Banking Act,

- be included until the end of 2020 in full as core capital;
- be neither additional nor other capital, and between 2021 and 2030 not make up more than 20 per cent and between 2031 and 2040 not make up more than 10 per cent of core capital for solvency purposes.

The contributions from silent partners existing as at 31 December 2010 have the following varying contractual arrangements and are to be categorised for inclusion in core capital as follows:

- Indefinite contributions without any cancellation privilege on the part of the subscribers which do not involve a repayment incentive for the issuer (in total € 1 786 million), issued since 2005. Compared to the end of 2009, the volume of these contributions has increased by € 68 million due to 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. All of these contributions meet the requirements of other capital in accordance with §10 para. 2a clause 1 no. 10 of the German Banking Act in conjunction with §10 para. 4 of the German Banking Act.
- Indefinite contributions without any cancellation privilege on the part of the subscribers which contractually involve a repayment incentive for the issuer (€ 336 million), issued since 2009. The interest for this contribution is fixed for at least the first ten years of the contract in the amount of the capital market yield at the time of issue plus a standard market risk premium. After this time, and then every further five years of the contract, the interest is reset at the level fixed in the contract at the time of issue. Interest payments are excluded under certain conditions. This contribution meets the requirements of other capital in accordance with §10 para. 2a clause 1 no. 10 of the German Banking Act in conjunction with §10 para. 4 of the German Banking Act, but falls

due to the repayment incentive resulting from the fixed level of interest in the contract below the above-mentioned upper limit for inclusion in accordance with §10 para. 2 clause 3 of the German Banking Act of at most 15 per cent of core capital for solvency purposes. This upper limit is complied with as at 31 December 2010.

- Indefinite contributions without any cancellation privilege on the part of the subscribers (in total € 733 million), issued between 1994 and 2001. These contributions are mainly cancelled by the subscribers and by the issuer at the earliest at the end of the tenth calendar year after they were issued. In 2010 the cancellation of contributions totalling € 52 million was announced and effected by subscribers. These cancelled contributions are therefore no longer included as core capital as at 31 December 2010. The interest for all of these contributions 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. These contributions do not fully meet the requirements of other capital in accordance with §10 para. 2a clause 1 no. 10 of the German Banking Act in conjunction with §10 para. 4 of the German Banking Act and are therefore only included as other capital in the core capital on a transitional basis in accordance with §64m para. 1 of the German Banking Act.

- In addition to this, in 2010 temporary contributions totalling € 44 million were no longer eligible for inclusion as core capital as the term to the end of their contract was less than two years.

Contributions from silent partners eligible for inclusion as other capital therefore total € 2 855 million and make up as at 31 December 2010 42 per cent of core capital for solvency purposes. They therefore exceed the above-mentioned upper limit for inclusion in accordance with §10 para. 2 clause 4 of the German Banking Act of 35 per cent for other capital in core capital for solvency purposes by 7 percentage points or in absolute terms by € 465 million. The NORD/LB Group shall in future strive to gradually reduce the amount by which this upper limit is exceeded.

The above-mentioned upper limit for inclusion in accordance with §64m para. 1 of the German Banking Act, according to which contributions from silent participations received before 31 December 2010 which are neither additional nor other capital may from the start of 2021 make up at most 20 per cent of core capital for solvency purposes, is already complied with as at 31 December 2010.

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 investments which are fully or proportionately consolidated and whose carrying amount in the superordinate company exceeds the total of that investment's share capital and reserves. Half of these asset-side differences (altogether approx. € 22 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 € 1 116 million). The resulting core capital for solvency purposes totalled € 6 829 million as at 31 December 2010.

Supplementary capital as at 31 December 2010 totalled € 3 892 million and primarily comprised the following components:

- Provision reserves in accordance with §340f of the German Commercial Code (€ 174 million).

- Participatory capital liabilities (totalling € 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 in accordance with §10 para. 5 of the German Banking Act have been fulfilled.

- Subordinated liabilities (totalling € 3 443 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 in accordance with § 10 para. 5a of the German Banking Act have been met. In 2010 longer-term subordinated liabilities totalling over € 700 million were taken on.

- The half of asset-side differences to be deducted (totalling € 22 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 (totalling € 1 116 million). The supplementary capital for solvency purposes calculated in this way totals € 2 776 million as at 31 December 2010.

The deductions from core capital and supplementary capital amounted to € 2 232 million of 31 December 2010 and comprise

- the carrying amounts of investments in accordance with § 10 para. 6 clause 1 nos. 1 and 5 of the German Banking Act and

- deficits in valuation allowances in accordance with § 10 para. 6a no. 1 of the German Banking Act.

Compared to the 2009 year-end, the change in total deductions was not significant. However, deductions from carrying amounts of investments fell in particular due to the sale of investments by € 453 million, while deficits in valuation allowances rose by € 446 million. This increase in deficits in valuation allowances is however also partly the result of valuation allowances for loans and advances made in 2010 not being eligible under banking regulations as at 31 December 2010 because at this time no certified annual financial statements for the Group companies were available. After the valuation allowances from 2010 are allowed under banking regulations during the course of 2011, the deficits in valuation 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 para. 2 of the Solvency Regulation. This paragraph has been supplemented with effect of 31 December 2010 by reporting requirements for other capital in accordance with § 10 para. 4 of the German Banking Act, including in particular capital for which a payment incentive has been agreed. Due to the new regulatory requirements and the associated restructuring of the table, no comparative values are shown. Overall, capital rose compared to the 2009 year-end (31 December 2009: € 8 976 million).

Table 2: Capital structure

Components of capital	(in € million)
Share capital paid in	1 213
Other eligible reserves	2 823
Other capital in accordance with § 10 para. 4 of the German Banking Act	2 855
of which: Other capital, temporary or with repayment incentives	336
Special item for general banking risks in accordance with § 340g of the German Commercial Code	1 082
Asset-side differences	22
Other deductions in accordance with § 10 para. 2a clause 2 of the German Banking Act	– 50
Total core capital in accordance with § 10 para. 2a of the German Banking Act	**7 945**
Total supplementary capital in accordance with § 10 para. 2b of the German Banking Act and tier three funds in accordance with §10 para. 2c of the German Banking Act	**3 892**
Total capital deductions in accordance with § 10 paras. 6 and 6a of the German Banking Act	**– 2 232**
of which deficits in valuation allowances and anticipated losses in accordance with § 10 para. 6a nos.1 and 2 of the German Banking Act	– 1 536
Total of modified available equity in accordance with § 10 para. 1d of the German Banking Act and eligible tier three funds in accordance with § 10 para. 2c of the German Banking Act	**9 605**

4.2 Capital Adequacy

4.2.1 Approaches for Ascertaining Capital Requirements

4.2.1.1 Credit Risks

In order to calculate capital requirements 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. 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 the beginning of 2013.

Since 30 November 2010 NORD/LB has been using a new rating method for aircraft financing. With the rating method finance leases, operating leases and direct loans can be assessed. Use is restricted to single-airline financing. Multi-airline financing and warehouse facilities are not assessed using this rating method to establish capital requirements, but are shown in the CRSA. At Bremer Landesbank aircraft financing is being phased out. Aircraft financing is also not relevant at NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB.

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 and Lombard loans. 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 2011.

In the case of securitisation transactions, the choice of method at NORD/LB, Bremer Landesbank and Deutsche Hypo for calculating capital requirements, CRSA or IRBA, also depends on the underlying pool of receivables. 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 Risks and Investment Funds

NORD/LB always treats investments using the IRBA, apart from the transition rules and exceptions defined in the Solvency Regulation.

Investments that were held in the portfolio prior to 1 January 2008 are treated based on the CRSA grandfathering rule in accordance with § 338 para. 4 of the Solvency Regulation. Investments that are not covered by grandfathering rule 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. The same applies for Bremer Landesbank.

NORD/LB Luxembourg uses the grandfathering rule and the indefinite exemptions from the IRBA. The investments made by Deutsche Hypo are also treated using the IRBA or indefinitely exempted from the IRBA. Investments are not relevant for NORD/LB CFB.

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

4.2.1.3 Market Price Risks

In terms of market price risks, 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 specific 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 Risks

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 para. 2 nos. 1 – 4 and § 330 para. 1 of the Solvency Regulation for the NORD/LB Group, broken down by material risk types and the methods employed. Due to numerous rating migrations to default, at the same time a fall in capital requirements and a rise in the shortfall has been recorded compared to the previous year. In particular ship financing has been affected. Overall, and particularly in the item Banks, the fall in risk-weighted assets (RWA) is primarily attributable to a reduction in exposures at default (EAD). In many segments rating migrations have reduced significantly.

Table 3: Capital requirements

Capital requirements (in € million)	31 Dec. 2010	31 Dec. 2009
1. Counter party risks	**6 468**	**6 934**
CRSA credit risks	**798**	**961**
Central governments	10	4
Regional governments and local authorities	35	33
Other public-sector entities	7	6
Multilateral development banks	–	–
International organisations	–	–
Banks	24	58
Covered bonds issued by banks	2	1
Corporates	424	530
Retail	171	246
Exposures secured by real estate	85	58
Investment certificates	–	–
Other exposures	14	7
Past due exposures	26	18
IRBA credit risks	**5 176**	**5 471**
Central governments and central banks	88	61
Banks	694	919
Retail	–	–
Corporates	4 324	4 410
Other non-credit-obligation assets	70	81
Securitisations	**391**	**385**
CRSA securitisation transactions	29	71
IRBA securitisation transactions	362	314
Investments	**103**	**117**
CRSA shares	92	104
IRBA shares	11	13
2. Market price risks	**183**	**227**
Market price risks in the standard approach	122	122
of which: interest rate risk	80	101
of which: share price risk	–	–
of which: currency risk	42	21
of which: commodity risk	–	–
of which: other	–	–
Market price risks is in the internal model approach	61	105
3. Operational risks	**297**	**245**
Operational risks in the basic indicator approach	–	–
Operational risks in the standard approach	297	245
Operational risks in the advanced measurement approach	–	–
Total	**6 948**	**7 406**

4.2.3 Capital Ratios

As shown in Table 4 in accordance with § 325 para. 2 no. 5 of the Solvency Regulation, the overall ratio in accordance with § 2 para. 6 clause 2 of the Solvency Regulation 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 reporting date. Regulatory capital adequacy was given throughout the entire reporting period.

Compared to the previous reporting date both the overall ratio in accordance with § 2 para. 6 clause 2 of the Solvency Regulation and the core capital ratio of the NORD/LB Group have risen. The reasons for this are the RWA effects described above and an increase of over € 600 million in the NORD/LB Group's capital.

Tabelle 4: Capital ratios

(in %)	Overall ratio in accordance with § 2 para. 6 clause 2 in %		Core capital ratio in %	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Consolidation bank group				
NORD/LB Group	11.1	9.7	9.1	8.7
Parent company (as a single institute)				
Norddeutsche Landesbank Girozentrale	14.3	11.8	11.0	9.9
Subsidiaries				
Bremer Landesbank Kreditanstalt Oldenburg – Girozentrale –	11.0	11.9	9.0	10.0
Norddeutsche Landesbank Luxembourg S.A.	19.4	16.3	16.9	16.3
Deutsche Hypothekenbank (Actien-Gesellschaft)	10.6	9.1	9.8	8.3
NORD/LB COVERED FINANCE BANK S.A.	14.9	13.1	10.0	7.8

4.2.4 Risk-bearing Capacity

The risk-bearing capacity model constitutes the methodical basis for monitoring 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 NORD/LB's Risk Control Division is responsible for the overall control and development of the model.

The aim of the model is to aggregate and duly present the bank's risk-bearing capacity (RBC) at both individual institute and Group level by comparing risk potential resulting from the material risks and the risk capital. The monitoring and reporting process is conducted regularly and guarantees that the responsible bodies are promptly informed about risk-bearing capacity situation of the significant companies of the NORD/LB Group and the NORD/LB Group as a whole.

The NORD/LB Group revised and extended its existing RBC model in the year under review. The revision focused on the further optimisation of the Group-wide bank control system and in particular on the implementation of the requirements of the second MaRisk amendment with regard to extended consideration of stress scenarios covering different risk types.

The NORD/LB Group's extended RBC model consists of the three perspectives of going concern, economic capital adequacy and regulatory capital adequacy, in which the respective material risks (risk potential) are compared with the defined risk capital of the individual institutes and the Group. The economic and regulatory capital adequacy are both broken down further into the perspectives of status quo and under stress.

The first perspective presents the going-concern case, which assumes the continuation of the NORD/LB Group's current business model. It acts as an early-warning stage and compares, using a lower confidence level than the other two perspectives, the economically calculated risk potential with risk capital in the form of free regulatory capital based on a defined overall ratio. In addition to this, risk capital effects during the year are considered in an indexation process.

The second and third perspectives are based in terms of risk potential on a higher confidence level of 99.9 per cent. Economically-calculated risk potentials are used for the economic capital adequacy, while risk potentials calculated based on regulatory specifications are used for the regulatory capital adequacy. On the capital side both the economic and the regulatory capital adequacy tests are based on equity and equity-like components which according to banking regulations are to be classed as equity. In the economic consideration, as in the going-concern case, an indexation process takes into account risk capital effects during the year.

For the Internal Capital Adequacy Assessment Process (ICAAP) required in accordance with MaRisk, primarily the pillar of economic capital adequacy (status quo) is considered. The regulatory capital adequacy in the status quo is to be complied with as a strict supplementary condition. Strategic limits are derived from the consideration of risk-bearing capacity taking into account the allocations of risk capital in the Group risk strategy based on the going-concern case.

When calculating risk-bearing capacity, risk calculations are also considered, both within a risk type as well as across risk types. Concentrations within a risk type essentially concern credit risks as the most material risk type for the NORD/LB Group. These are integrated via the internal credit risk model into the RBC model.

Concentrations across different risk types are considered by stress tests. When selecting the stress scenarios the NORD/LB Group's key business areas and risks are consciously used as guidelines for selection. In the process among other things industries, segments and regions are selected which have a significant impact on the Group's risk situation. These risk concentrations are reported and monitored on a regular basis in the context of risk-bearing capacity with targeted stress tests.

The relevant scenarios are ascertained at the level of the NORD/LB Group and are to be applied consistently in all of the individual companies in order to ensure comparability between the institutes and to ensure that the group values can be aggregated. At individual institute level further stress tests can be determined which take account of the key business areas.

The utilisation of risk capital with risk potential for the individual risk types and the risk coverage in the economic capital adequacy (status quo) for the NORD/LB Group can be found in the risk report in the Annual Report of the Group.

4.2.5 Security Mechanisms at Association Level

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

NORD/LB is included in the security reserve of the Landesbanks 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 of the Savings Bank Financial 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 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 and take into account the conservative orientation of the NORD/LB Group.

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 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 an economic credit risk model for four different confidence levels and a time frame of one year. The credit risk model used by the NORD/LB Group includes correlations and concentrations in the risk assessment and is subject to an annual review and validation.

The credit risk model calculates the unexpected losses at the level of the overall portfolio. 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 exposure management) in order to adequately manage concentrations of risk in the portfolio.

The methods and procedures for risk quantification are agreed on between the risk control units in the significant Group companies in order to ensure standardisation throughout the Group. Risk management is 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 observing these risks.

Tasks relating to analysis and risk observation 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. With exposures with risk concentrations, a credit rate assessment takes place with regard to Large Exposure Management. In a multi-stage reporting system, the division also prepares segment portfolio reports on selected sub-segments at regular intervals.

The Credit and Collateral Management Department 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.

In 2010 the group Credit Portfolio Management was also integrated into the CRM Division. The main task of Credit Portfolio Management is to manage the concentration risks in the credit portfolio of the NORD/LB Group. Concentrations in terms of the magnitude of an extended borrower entity as well as national and industrial concentrations are examined.

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 rating master scale of the German Savings Banks Association (DSGV) (i.e. allocation to the “high risk” category in accordance with the “Initiative Finanzstandort Deutschland” (IFD, initiative for Germany as a financial location)) and exposures which deteriorate by three notches to a rating of 7 (allocation to the “good/satisfactory” category in accordance with IFD) or lower must all be reported to the SCM Division. Other defined risk indicators may also prompt a presentation requirement. The SCM decides whether the processing of a loan is to be taken over or whether the loan is to remain with the CRM. From a rating of 16 (allocation to the IFD Default risk category (non-performing loans)), the SCM Division is obliged to take over responsibility for an exposure. For Financial Institutions, Asset Backed Securities and Corporate Bonds processing remains in the Credit Risk Management Division.

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 controlling NORD/LB’s credit 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 risk types 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 concentrations 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 investments is also subject to a Supervisory Board resolution as is approval for loans to executives.

The Credit Risk Control Department is responsible for the methods for measuring credit risks and for credit risk control instruments. The independent division which was previously called Credit Risk Control was merged with the Risk Control Division on 1 August 2010.

The Credit Risk Control 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 risk lies.

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 manage 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 by quantifying the credit risk potential in 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 extended borrower entities. The latter defines a loss-at-default 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 heavy 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

The NORD/LB's Credit Risk Control department draws up among other things a Credit Portfolio Report which shows and analyses all the significant structural features and parameters required for controlling the credit portfolio of the NORD/LB Group. The Credit Portfolio Report complements the Risk-Bearing Capacity report and includes in-depth analyses and stress scenarios relating to the credit portfolio. It is submitted to the Managing Board on a quarterly basis and is further specified by the Credit Portfolio Report of NORD/LB and Industry Portfolio Reports for individual sub-segments.

The Managing Board of NORD/LB also receives further regular reports and reports as and when required on the credit portfolio of the NORD/LB Group and NORD/LB, e.g. on risk concentrations with borrower entities and country and industry concentrations.

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 and a report to identify and monitor risk concentrations at the level of borrower entities (large exposure management).

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 para. 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.

Table 5: Credit exposures by industry

Industry (in € million)*)	Credits, commitments and other non-derivative off balance sheet assets		Securities		Derivative financial instruments	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Financing institutes/insurance companies	77 383	64 795	42 170	45 436	7 352	7 479
Service industries/other	62 646	67 943	18 543	18 028	2 166	2 057
Transport/communications	30 564	29 144	680	543	714	517
Manufacturing	6 859	7 757	792	753	608	577
Energy, water and mining	8 570	8 199	1 148	1 001	418	420
Trade, maintenance and repairs	3 590	3 616	57	58	234	86
Agriculture, forestry and fishing	1 555	1 584	27	25	6	8
Construction	2 991	3 122	55	61	85	70
Total	**194 157**	**186 160**	**63 472**	**65 906**	**11 584**	**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	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Euro countries	159 460	150 828	52 651	54 894	7 687	7 336
Other Western Europe	13 057	9 212	2 801	3 543	2 023	2 025
Eastern Europe	1 930	3 247	858	899	53	87
North America	9 808	10 938	3 819	3 225	1 455	1 387
Latin America	1 460	1 365	387	530	8	19
Middle East/Africa	944	1 031	195	238	–	–
Asia	4 671	3 732	1 934	1 875	358	335
Others	2 826	5 806	827	701	–	24
Total	**194 157**	**186 160**	**63 472**	**65 906**	**11 584**	**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	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
> 0 years to ≤ 1 year	51 604	41 795	11 817	13 391	1 297	1 056
> 1 year ≤ 5 years	41 329	40 699	31 178	26 561	6 255	5 464
> 5 years, no term	101 223	103 666	20 477	25 954	4 032	4 692
Total	**194 157**	**186 160**	**63 472**	**65 906**	**11 584**	**11 213**

*) Total differences are rounding differences.

5.1.3 Loan Loss Provisions

Exposures are reviewed 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. A review 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 as well as when establishing the reason for default (and issuing a default rating). Indications for a valuation 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.

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 loan loss provisions in accordance with the German Commercial Code at this point.

For acute counterparty risks relating to lending business reported in the balance sheet, the NORD/LB Group makes specific valuation allowances and lumpsum specific loan loss provisions. 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 valuation allowances are established by establishing lumpsum loan loss provisions. Risks relating to off-balance-sheet transactions (guarantees, endorsement liabilities and loan commitments) are accounted for by a loan loss provision for off-balance-sheet transactions.

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

In accordance with § 327 para. 2 nos. 5 and 6 of the Solvency Regulation, Tables 8 to 10 show non-performing loans and loans in default excluding investment exposures and securitisation transactions by industry and region respectively, and the development of loan loss provisions in the reporting period. In the classification by industry, retail business is also reported. The lumpsum specific loan loss provisions are included in the specific valuation allowances. NORD/LB Luxembourg and NORD/LB CFB have been included with general loan loss provisions in accordance with IFRSs. Lumpsum loan loss provisions and general loan loss provisions, direct write-offs and receipts for written-off loans are reported as a total amount and are not broken down by industry or region.

In order to distinguish between non-performing and loans in default, the three default rating classes 16 to 18 are used taking into account the default criteria in accordance with § 125 of the Solvency Regulation. Rating 16 covers the default reasons of default greater than 90 days and unlikely repayment. Rating 17 covers the default reasons of restructuring/rescheduling of debts / capital reconstruction and impairment/write-down. Under rating 18 the default reasons of rating-induced cancellation/repayment (only when the StandardRating rating method is used), complete write-off/abandonment, factoring with significant rating-induced loss and insolvency (request) are found.

For rated CRSA and IRBA positions, all the non-performing exposures are equivalent to rating grades 17 and 18. All remaining loans in default are included in rating 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 loans in default not requiring a write-down, a cautious assumption is made in that the loans in rating categories 16 to 18 and corresponding CRSA positions for which no specific valuation allowances were made are all considered to be in default. Exposure values are stated.

Table 9 also includes for the regions the changes in specific valuation allowances, lumpsum specific loan loss provisions, general loan loss provisions, loan loss provisions for off-balance-sheet transactions, direct write-offs and receipts for written-off loans. This reporting goes beyond the requirement of § 327 para. 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.

Table 8: Non-performing loans and loans in default by industry

Industry (in € million)	Non-performing loans and loans in default (requiring a write-down)*)	Specific valuation allowances*)	Lumpsum/general loan loss provisions	Loan loss provisions for off-balance-sheet transactions*)	Changes in specific valuation allowances	Changes in lumpsum/general loan loss provisions	Changes in loan loss provisions for off-balance-sheet transactions	Direct write-offs	Receipts for written-off loans	Loans in default (not requiring a write-down)*)
Financing institutes / insurance companies	477	169		57	69		– 8			27
Service industries / other	1 498	414		55	– 74		15			454
Transport / communications	853	249		7	37		2			1 442
Manufacturing	342	166		38	53		36			75
Energy, water and mining	116	32		9	14		9			13
Trade, maintenance and repairs	63	40		1	– 17		–			16
Agriculture, forestry and fishing	15	9		–	2		– 2			5
Construction	96	66		13	12		13			4
Retail	275	157		5	25		2			79
Total 31 Dec. 2010	**3 736**	**1 301**	**230**	**184**	**121**	**– 16**	**67**	**54**	**13**	**2 116**
Total 31 Dec. 2009	3 112	1 180	247	117	307	18	– 96	95	11	888

*) Total differences are rounding differences.

Table 9: Non-performing loans and loans in defaulted by region

Region (in € million)	Non-performing loans and loans in default (requiring a write-down)*)	Specific valuation allowances*)	Lumpsum/general loan loss provisions	Loan loss provisions for off-balance-sheet transactions	Changes in specific valuation allowances	Changes in lumpsum/general loan loss provisions	Changes in loan loss provisions for off-balance-sheet transactions*)	Direct write-offs	Receipts for written-off loans	Loans in default (not requiring a write-down)*)
Euro countries	2 397	998		94	190		76			1 593
Other Western Europe	601	188		4	65		1			195
Eastern Europe	13	2		1	1		1			2
North America	492	95		5	– 9		– 2			269
Latin America	208	1		48	–		– 13			–
Middle East/Africa	–	–		–	–		–			–
Asia	26	10		–	7		–			–
Others	–	8		32	– 133		5			58
Total 31 Dec. 2010	**3 736**	**1 301**	**230**	**184**	**121**	**– 16**	**67**	**54**	**13**	**2 116**
Total 31 Dec. 2009	3 112	1 180	247	117	307	18	– 96	95	11	888

*) Total differences are rounding differences.

Table 10: Development of loan loss provisions

Method of loan loss 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 valuation allowance	1 180	597	306	180	10	1 301
Lumpsum/general loan loss provisions	247	7	24	–	–	230
Loan loss provisions for off-balance-sheet transactions	117	99	34	4	7	184

*) 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 14 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 classification 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 with private customers were still shown in the CRSA in 2010, so that savings bank customer scoring based on an automatic scoring procedure were not yet employed in regulatory terms.

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 (Sparkassen Rating und Risikosysteme (SR) GmbH) and the Landesbanks (Rating Service Unit (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 Credit Risk Control 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 basically uses the same rating method as NORD/LB. 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 banking 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 management 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 para. 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 banking book. This currently does not apply in the NORD/LB Group. A separate presentation of items in accordance with § 335 para. 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.

With the average probabilities of default a slight improvement has been noticed compared to the previous year. The average PD (not including default) has improved from 1.0 per cent to 0.9 per cent, while the average risk weight (not including default) has improved from 48.7 per cent to 46.2 per cent.

Table 11: Aggregate credit volume by PD grades (not including retail)

Portfolio	EAD € million *)	Ø PD in %	Ø RW in %
		0% ≤ PD ≤ 0.5 %	
Central governments	10 128	0.0	7.0
Banks	50 188	0.1	16.8
Corporates	45 326	0.2	35.4
Investments	–	–	–
Total 31 Dec. 2010	**105 642**	**0.1**	**23.8**
Total 31 Dec. 2009	104 587	0.1	26.6
		0.5% < PD ≤ 5%	
Central governments	291	1.7	114.3
Banks	1 372	0.9	88.8
Corporates	25 719	1.6	97.4
Investments	–	–	–
Total 31 Dec. 2010	**27 383**	**1.6**	**97.1**
Total 31 Dec. 2009	27 645	1.5	96.8
		5% < PD < 100 %	
Central governments	20	6.7	218.6
Banks	24	10.5	207.1
Corporates	6 321	12.2	197.6
Investments	–	–	–
Total 31 Dec. 2010	**6 366**	**12.2**	**197.7**
Total 31 Dec. 2009	6 438	12.6	201.6
		Total (not including)	
Central governments	**10 440**	**0.1**	**10.4**
Banks	**51 584**	**0.1**	**18.8**
Corporates	**77 366**	**1.6**	**69.2**
Investments	**–**	**–**	**–**
Total 31 Dec. 2010	**139 390**	**0.9**	**46.2**
Total 31 Dec. 2009	138 670	1.0	48.7
		Default	
Central governments	–	–	–
Banks	105	100.0	0.0
Corporates	4 737	100.0	0.0
Investments	–	–	–
Total 31 Dec. 2010	**4 842**	**100.0**	**0.0**
Total 31 Dec. 2009	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 two previous reporting periods in accordance with § 335 para. 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 banking 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 fallen by € 77 million. This fall is in particular the result of the impending economic recovery, and as a consequence the ratings of the NORD/LB Group's borrowers as well.

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

Table 12: Expected and actual losses in lending business

	1 Jan. 2010 – 31 Dec. 2010		1 Jan. 2009 – 31 Dec. 2009		1 Jan. 2008 – 31 Dec. 2008	
Portfolio (in € million)	Expected loss (EL)*)	Actual loss	Expected loss (EL)	Actual loss	Expected loss (EL)	Actual loss
Central governments	3		10		–	
Banks	60		83		99	
Corporates	2 188		1 633		1 026	
Investments	1		–		–	
Total	**2 251**	**119**	**1 726**	**196**	**1 125**	**132**

*) Total differences are rounding differences.

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 Investors Service Ltd. and FitchRatings 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 Investors Service Ltd. and FitchRatings 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 para. 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 para. 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 paras. 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 participating interests (investment funds that have not been rendered transparent).

The heavy fall in exposure values for simple risk weights is attributable to the introduction of the aircraft rating, as these exposures are now assess with the new rating method.

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

Risk weight (in %)	Volume of exposure values (in € million)					
	CRSA Before credit risk mitigation		IRBA After credit risk mitigation		IRBA (special financing and investments)	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
0	92 810	88 714	96 124	94 154	4	10
10	246	98	246	98	–	–
20	4 135	3 945	3 510	3 484	–	–
35	760	802	2 244	1 356	–	–
50	1 145	568	993	650	17	68
70	–	–	8	–	257	883
75	4 425	4 721	2 836	4 082	–	–
90	–	–	–	–	23	138
100	13 406	13 205	8 411	9 253	–	–
115	–	–	–	–	2	157
150	239	139	213	119	–	–
190	–	–	–	–	–	–
250	–	–	–	–	21	149
290	–	–	–	–	–	–
350	–	–	–	–	–	–
370	–	–	–	–	17	24
1250	–	–	–	–	–	–
Capital deduction	–	–	–	–	–	–

5.1.6 Derivative Counterparty 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. Future contracts are also concluded for fixed interest rate securities. Stock derivative agreements are mainly concluded as stock options and equity swaps. Credit derivatives are also used.

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 para. 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 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 loan loss 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 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 risk positions before and after netting and collateral in accordance with § 326 para. 2 no.1 of the Solvency Regulation. The term "positive replacement cost" means the current potential replacement cost in accordance with §19 of the Solvency Regulation. This is equivalent to the current positive fair value.

Table 14: Positive replacement costs

(in € million)	Positive replacement cost before netting and collateral	Netting options	Eligible collateral	Positive replacement cost after netting and collateral
Interest rate-based contracts	8 335			
Currency-based contracts	1 723			
Equity/index-based contracts	74			
Credit derivatives	5			
Commodity-based contracts	120			
Other contracts	–			
Total 31 Dec. 2010	**10 257**	**6 025**	**1 208**	**3 024**
Total 31 Dec. 2009	9 726	6 139	591	2 996

The counterparty default risk to be allowed for in accordance with §326 para. 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

Counterparty default risk position (in € million)	Original exposure method	Current exposure method	Standard method	Internal model
Total 31 Dec. 2010	**–**	**6 577**	**–**	**–**
Total 31 Dec. 2009	–	6 104	–	–

Table 16 shows hedge transactions with credit derivatives in accordance with §326 para. 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

	Nominal value of hedge transactions	
(in € million)	31 Dec. 2010	31 Dec. 2009
Credit derivatives (assignees)	370	88

Table 17 shows a breakdown of the nominal value of credit derivatives in acquisitions and sales in accordance with §326 para. 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.

Table 17: Credit derivatives – purpose

Nominal value (in € million)	Used in the bank's own credit portfolio				Brokerage activities	
	Purchased		Sold			
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Credit Default Swaps	1 555	1 774	7 553	7 754	–	–
Total Return Swaps	–	–	670	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 collaterals the cost-benefit relationship of the collateralisation is considered.

The collaterals are assessed both at the time the loan is granted and during the subsequent ongoing (normally at least half-yearly) 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 collateral 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. Guarantees, credit securities similar to sureties, assignments of receivables and other rights, chattle mortgages, property, receivables and other rights and collateral assignment of chattel are accepted as collaterals. Other collaterals 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, 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 Association of German Public Sector Banks (Bundesverband Öffentlicher Banken Deutschlands) is used to support the ongoing monitoring of real estate values. This method is recognised as a statistical method in accordance with § 20a para. 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.

In the category other IRBA physical collateral, ships (NORD/LB and Bremer Landesbank), aircraft, engines, assigned or pledged life insurance policies (only NORD/LB) and wind energy plants (only Bremer Landesbank) are used to ease equity requirements.

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 eligibility of engines for consideration is ascertained in a two-stage process. The compliance with minimum requirements for the consideration of engines as other IRBA physical collateral required by the Solvency Regulation is, like ships and aircraft, ensured by the business policy documented in the organisational guidelines and the contract templates used. These requirements concern in particular the determination of the object, the degree of cover and the right of inspection. Engines were included for the first time as at 30 November 2010.

Under the amendments to the Solvency Regulation which came into effect on 31 December 2010, banks will in future also have the opportunity to include life insurance policies, though not as was previously the case only as guarantees, but, depending on the method used to measure the credit risk, as other physical collateral (IRBA) or as guarantees (CRSA). NORD/LB includes endowment insurance policies and private annuity insurance policies which are eligible for consideration whose 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, the significant operator rights relating to location and rights resulting from supply contracts are normally assigned to it.

The guarantees considered in credit risk mitigation techniques are predominantly sureties and guarantees. The carrying amounts are based on the credit rating of the guarantor. The same rating rules apply as for all other borrowers. 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. 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.

Tables 18 and 19 contain in accordance with § 336 para. 2 of the Solvency Regulation an overview of collateralised CRSA and IRBA exposure values for each exposure class. With derivatives netting agreements are considered. Investments only need to be disclosed as a separate portfolio when the PD / LGD approach is used for investment exposures in the banking book. This currently does not apply in the NORD/LB Group.

The exposure values reported are collateralised by eligible financial collateral in accordance with § 154 para. 1 clause 1 no. 1 of the Solvency Regulation after the application of value fluctuation factors, guarantees in accordance with § 154 para. 1 clause 1 no. 2 of the Solvency Regulation and life insurance policies in accordance with § 170 of the Solvency Regulation and other IRBA collateral in accordance with § 154 para. 1 clause 1 no. 3 of the Solvency Regulation.

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”.

Financial collateral has been technically extended since the previous reporting date. Within the scope of this extension, financial collateral relating to repo transactions are now reported separately. As at the previous reporting date financial collateral was considered, however its reporting involved reducing the respective measurement base, so this type of collateral was not reported separately.

Table 18: Aggregate amount of collateralised CRSA exposure values (not including securitisations)

(in € million)	Financial collateral		Guarantees		Mortage liens	
Exposure class	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Central governments	408	–	1 078	950	–	–
Regional governments and local authorities	–	–	2 327	1 558	–	–
Other public-sector entities	–	–	265	68	–	–
Multilateral development banks	–	–	31	20	–	–
International organisations	–	–	–	–	–	–
Banks	4 685	771	1 318	1 409	–	–
Covered bonds issued by banks	–	–	42	42	–	–
Corporates	1 562	1 138	3 231	3 029	–	–
Retail	1	1	–	–	–	–
Exposures secured by real estate	–	–	–	–	606	612
Investment certificates	–	–	–	–	–	–
Investments	–	–	–	–	–	–
Other exposures	–	–	–	–	–	–
Overdue exposures	–	–	2	–	26	20
Total	**6 656**	**1 910**	**8 294**	**7 076**	**632**	**633**

Table 19: Aggregate amount of collateralised IRBA exposure values (not including securitisations)

(in € million)	Financial collateral		Guarantees		Other IRBA collateral	
Exposure class	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Central governments	–	–	673	197	31	33
Banks	14 703	11 536	1 346	1 174	38	65
Corporates	626	536	3 047	3 152	20 964	16 425
Retail	–	–	–	–	–	–
Investments	–	–	–	–	–	–
Total	**15 329**	**12 072**	**5 066**	**4 523**	**21 033**	**16 523**

5.1.7.3 Netting Agreements

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

Netting agreements are always multilateral. 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 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 control credit risks in NORD/LB. 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 or sponsor). NORD/LB also conducts securitisation activities as an arranger of structured transactions in the interest of customers.

Both synthetic securitisations using various hedging instruments and true sale transactions are available for risk control. As a sponsor, NORD/LB makes liquidity facilities available in order to improve the credit quality of the institute's own asset-backed-commercial-paper (ABCP)-conduit-programme. NORD/LB uses, among other approaches, a rating system in accordance with the Solvency Regulation's Internal Assessment Approach for its securitisation transactions.

In the period under review no institute receivables were securitised by the NORD/LB Group. NORD/LB pursues a conservative exposure strategy in its role as investor and sponsor. Securitisation positions held by the NORD/LB Group mainly comprise tranches with a low risk weighting and generally declined in the period under review.

Bremer Landesbank last appeared as an investor within the scope of securitisation transactions in 2004 and no longer has a portfolio as at 31 December 2010 due to early repayment. Deutsche Hypo has only appeared as an investor in securitisation transactions on a small scale, most recently in 2007. Deutsche Hypo's securitisation portfolios are measured using the ratings-based approach for securitisations, while Bremer Landesbank's are also measured using the supervisory formula approach. 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 Methods 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. This method was applied until 30 June 2010. As at the reporting date NORD/LB did not have any unrated CRSA securitisation exposures in the 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.

In general short and long-term external ratings from Standard & Poor´s, Moody´s Investors Service Ltd. and FitchRatings are 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 § 253 para. 5 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 20 and 21. Loan amounts are unweighted exposure values. Please note that the NORD/LB Group does not maintain any securitisation exposures in connection with revolving counterparty risk positions or act as a servicer in the case of securitised loans so no information is provided on securitised non-performing loans or loans in default or on losses realised in the current period in accordance with § 334 para. 2 no. 2 of the Solvency Regulation. In the period under review no institute loans were securitised by the NORD/LB Group.

Table 20: Aggregate amount of securitised loans

Portfolio (in € million)	Securitised loans 31 Dec. 2010	Securitised loans 31 Dec. 2009
True sale securitisations Commercial real estate	235	235
Synthetic securitisations –	–	–
Total	**235**	**235**

Table 21: Securitisation transactions in the reporting period

Portfolio (in € million)	Securitised loans: True sale		Securitised loans: Synthetic		Profits/losses from true sale transactions (in € million)	
	1 Jan.–31 Dec. 2010	1 Jan.–31 Dec. 2009	1.1.–31 Dec. 2010	1 Jan.–31 Dec. 2009	1 Jan.–31 Dec. 2010	1 Jan.–31 Dec. 2009
–	–	–	–	–	–	–
–	–	–	–	–	–	–
–	–	–	–	–	–	–
Total	**–**	**–**	**–**	**–**	**–**	**–**

In accordance with § 334 para. 2 nos. 3 and 4 of the Solvency Regulation, securitisation activities of the significant companies of 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 22 and 23. Compared to the previous reporting date the exposure values due to repayments have fallen.

Table 23 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 100 per cent. The reason for this is in particular the rating migrations due to the change in method used by the leading rating agencies, which have also resulted in a corresponding increase in capital requirements.

Table 22: Aggregate amount of retained or purchased securitisation exposures

Securitisation exposures (in € million)	Retained/purchased securitisation exposures (in € million)			
	Exposure values CRSA		Exposure values IRBA	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
On-balance-sheet items				
Receivables	634	746	2 184	3 077
Investments in ABS transactions	–	–	278	354
Aggregated on-balance-sheet items	**634**	**746**	**2 462**	**3 431**
Off-balance-sheet items				
Measures to improve credit quality	296	511	1 679	2 327
Derivatives	–	–	–	–
Aggregated off-balance-sheet items	**296**	**511**	**1 679**	**2 327**

Table 23: Capital requirements for retained or purchased securitisation exposures by risk weight bands

Risk-weight bands	Retained/purchased securitisation exposures (in € million)					
	Exposure values *)		Capital requirement CRSA		Capital requirement IRBA	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
≤ 10 %	1 282	2 401	–	–	8	12
> 10 % ≤ 20 %	1 810	2 435	13	16	11	16
> 20 % ≤ 50 %	767	893	2	2	21	19
> 50 % ≤ 100 %	384	608	3	10	20	26
> 100 % ≤ 650 %	616	463	1	1	111	96
> 650 % < 1 250 %	22	76	–	12	12	35
1250 %/capital detuction	189	140	10	30	179	110
Total	**5 071**	**7 015**	**29**	**71**	**362**	**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 credit institutes and financial companies.

Group interests are maintained in relation to participating interests 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, intermediate and annual reports and 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 at the level of the NORD/LB Group:

- Significant investments, which make a significant contribution to general risk at Group level.
- Investments which are not significant for risk reporting.

The allocation to these categories is regularly reviewed by NORD/LB's Risk Control Division using quantitative criteria. In the period under review, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo and NORD/LB CFB were identified as significant investments for risk reporting.

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 risk type. Risks resulting from other investments 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 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 model used calculates contributions made by individual investments towards unexpected loss at portfolio level, which together add up to an unexpected loss for the full portfolio. The parameters for the model are set in accordance with the standard parameters of Basel II.

Investments dealt with in the capital deduction directly reduce the risk capital available in the amount of its carrying amounts.

In addition to optimising the investment portfolio, the continued development of investment risk management was a priority in the past year. The bank has started to modify its materiality concept for investment management and to subject existing risk factors to different considerations.

In addition to this, processes were reviewed on a cross-divisional basis, a new reporting system was developed, the working instruction for investments completely revised and a central investment application was implemented which includes information for the controlling and monitoring of Group-wide investments. At the time of the implementation of the application in the spring of the year under review, structural and procedural adjustments resulted in the centralisation of data management in the Finance Division.

Under the new materiality concept investments are assigned to different categories, with strategic, financial and risk-oriented aspects being considered. The different categories entail the differentiated control and monitoring of the respective investments.

5.2.1.2 Investment Risk Management Structure and Organisation

Risks resulting from investments at various levels in the Group are managed 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.

To control all material strategic and strategy-supporting investments the Erweiterter Konzernvorstand and the Konzernsteuerungskreise are being used. For the purpose of evidence all smaller investments are concentrated centrally in 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 participating interests the NORD/LB Group has, on the basis of a critical review of the investment portfolio, disposed of a range of participating interests since 2005. This strategy was continued in 2010.

5.2.1.4 Investment Risk Reporting

Current income (earnings and depreciation) and the risks of all investments are regularly evaluated and reported to the NORD/LB Managing Board together with other significant key data within the scope of modified reporting.

5.2.2 Quantitative Information on Investment Risk

In accordance with § 332 Nos. 2a and b of the Solvency Regulation, Table 24 contains an overview of the carrying amounts of investment exposures in the banking 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 lower fair value in the event of a permanent loss of value, whereby the fair value is calculated based on the present value of the shareholders' future net earnings associated with the ownership of the company.

With regard to Table 24, 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.

In the period under review the investment motives were recategorised. For the sake of clarity, four investment groups are reported in Table 24. Yield investments are made to achieve an optimum yield taking into account risk-bearing capacity; they also include private equity investments and typically silent participations. Investments to support the operational business concern investments in product suppliers, in outsourced or third-party service providers and credit-substituting investments. Regional or structural investments are made to serve the bank's respective responsibilities as a Landesbank. Investments that cannot be allocated to any of the above-mentioned groups are consolidated in the group of other investments.

Due to the recategorisation of investment motives and as a result the limited comparability, the previous year's values are not reported in Table 24. Overall, the carrying amount of investments fell to € 1 055 million (31 December 2009: € 1 277 million).

Table 24: Carrying amounts of investment exposures

Group of investment exposures (in € million)	Carrying amount	Fair value	Market value
Yield investments			
listed	25	25	25
not listed but included in a sufficiently diversified investment portfolio	782	825	
other investment exposures	–	–	
Investments to support the operational business			
listed	–	–	–
not listed but included in a sufficiently diversified investment portfolio	137	162	
other investment exposures	11	11	
Regional or structural investments			
listed	3	3	3
not listed but included in a sufficiently diversified investment portfolio	10	19	
other investment exposures	–	–	
Other investments			
listed	–	–	–
not listed but included in a sufficiently diversified investment portfolio	70	78	
other investment exposures	17	17	

In accordance with § 332 nos. 2c and d of the Solvency Regulation, Table 24 contains an overview of the realised and unrealised gains or losses in the banking 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 loss from sales was recorded in the previous period, in the current period a profit has been realised. There are also latent revaluation gains as at the reporting date.

Table 25: Realised and unrealised gains/losses from investment exposures

	Realised gain/loss from sale/liquidation		Latent revaluation gains/losses			
			Total		of which included in supplementary capital	
(in € million)	1 Jan.– 31 Dec. 2010	1 Jan.– 31 Dec. 2009	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
Total	**2**	**– 21**	**84**	**– 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.

Trading activities focus on interest rate risk. Here the NORD/LB Group aims, within the scope of set limits, to achieve earnings from term transformation or credit spreads 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 banking book. The NORD/LB Group generally aims to use the credit spread to maturity. The credit investment books which are currently frozen are managed by the central Credit Investments Working Committee.

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 market data from the front-office systems which is quality-assured independent of trading.

For the internal control and monitoring and limiting of market price risks, Value-at-Risk (VaR) methods are generally employed for all significant portfolios.

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 VaR 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 of correlation effects between risk factors and sub-portfolios.

Credit spread risks in the banking 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 VaR model is verified with comprehensive back-testing analyses. This involves a comparison of the daily change in value of the respective portfolio with the VaR of the previous day. A back-testing exception exists if a negative change in value observed exceeds the VaR.

The number of back-testing exceptions rose 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. The increased number was expected after a relatively calm period in the relevant markets was followed due to the Greek crisis by a more turbulent market phase with higher volatilities. The VaR values of the trading areas concerned rose accordingly with an impact on the backtesting mark-up.

In daily stress-test analyses, in addition to the VaR 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 market price risk types relevant for the NORD/LB Group, namely interest rate risk, currency risk, share price risk, fund price risk, volatility risk and credit-spread risk in the banking 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 material 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. Further general stress tests for all risk types are conducted on a quarterly basis within the context of reporting on risk-bearing capacity. The stress test parameters are reviewed on at least an annual basis and adjusted to changes in the market situation as and when required.

5.3.1.2 Market Price Risk Management Structure and Organisation

The control of market price risks involves all divisions handling items bearing market price risks which also account for profits and losses resulting from changes in market parameters. At NORD/LB this includes the Treasury, Markets and Portfolio Investments divisions. Within the scope of their Global Head function, the trading 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.

Risks are monitored by the Risk Control Division, which in accordance with MaRisk operates independently of divisions responsible for market price risk control in terms of both function and organisation and performs comprehensive monitoring, limiting and reporting activities for NORD/LB (including its foreign branches) and the NORD/LB Group. This also includes calculating amounts eligible for the quarterly SolvV report to the Bundesbank.

The Treasury Division presents the current maturity profile for strategic planning and, if necessary, makes proposals to the planning committee concerning the method of strategic planning in future. This committee, which convenes monthly, is an advisory body of the Financial Markets Board Member and its members include representatives from the Treasury, Markets, Research/Economy, Controlling/Taxes and Risk Control 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 Working Committee the Portfolio Investments Division shows positioning in maturity-congruent refinanced securities and credit derivatives in the banking book and makes proposals for the risk management of the portfolio. The Working Committee 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 served to reduce risk relating to the portfolio. Members of the Credit Investment Working Committee include the Financial Market and Risk Control Board Members 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

For the VaR values limits are set which are derived from the RBC model. Compliance with the limits is monitored both throughout the day and at the end of the day by the Risk Control units. Any losses are immediately added to the loss limits, hence resulting in a reduction in VaR limits in accordance with the principle of self-absorption. Correlation effects between the portfolios are included in calculating VaR and in the delegation of sub-limits. In some areas specific sensitivity limits are added to the VaR limits. Banking 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 Board Member. The Board Members 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 banking 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

Under the amendments to the Solvency Regulation which came into effect on 31 December 2010, § 330 supplemented by para. 3 with additional quantitative requirements for banks with internal models. Firstly, an overview of the VaR-values in the trading book is to be reported, and secondly, the daily VaR is to be compared with the daily changes in the value of the portfolio and significant VaR transgressions are to be disclosed.

VaR data relating to general interest rate risks and general and specific share price risks determined in the internal model is shown in Table 26. The schedule contains the VaR on the balance sheet date, the highest and lowest VaR during the reporting period and the annual average.

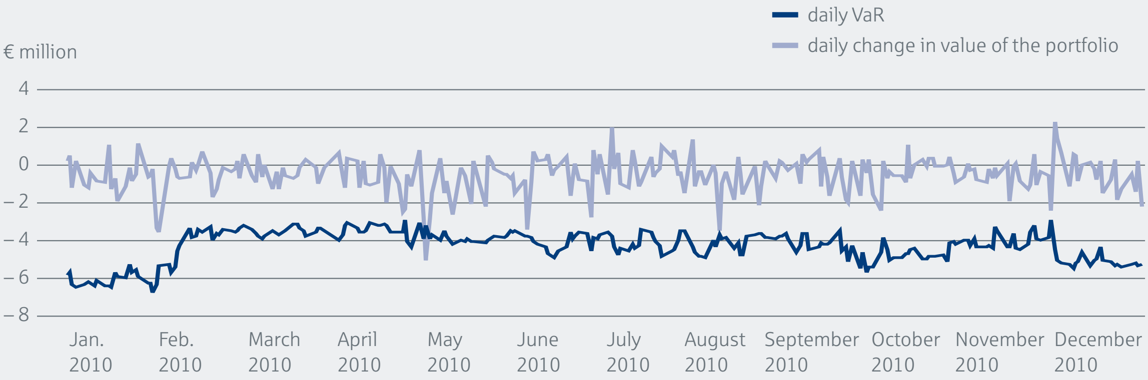
The NORD/LB Group had already voluntarily published the overview of VAR values on the previous two reporting dates, using the regulatory parameters for this purpose (confidence level of 99 per cent, holding period of ten working days). The additional reporting requirements of § 330 of the Solvency Regulation only provide for a holding period of one working day though. The VaR for Table 26 has therefore now been calculated with a confidence level of 99 per cent and a holding period of one trading day. Due to this change in method and the resulting lack of comparability, comparative values for the previous reporting date are not reported.

Table 26: 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	**7**	**9**	**3**	**5**

The following diagram shows the VaR values for general interest rate risk and general share price risk calculated daily at the close of business using the internal model with a confidence level of 99 per cent and a holding period of one trading day. In order to make it easier to identify any backtesting exceptions, i.e. negative changes in value in accordance with § 318 para. 1 clause 2 which exceed the previous day's VaR value, the following presentation was chosen: The VaR value is reported as a potential loss with a minus sign, the part for special share price risk in accordance with § 339 para. 14 of the Solvency Regulation is not considered, and the change in value in accordance with § 318 para. 1 clause 2 at the close of business on this date and the VaR value at the close of business of the previous day are assigned to the respective date. This is not the backtesting VaR value for internal control purposes, but the relevant value in terms of regulatory requirements.

Value-at-Risk (99 per cent, 1 day) portfolio change in value in € million



In the period under review one backtesting exception was recorded. This exception occurred on 5 May 2010 during the period of increased market fluctuations due to the Greek crisis which was escalating at this time. The main driver of this exception was the heavy fall in interest rates. Subsequent analyses of processes and models did not identify any need for action. The relevant crisis scenarios for the market movements observed showed much higher losses than the loss actually observed on 5 May 2010. Due to this regulatory backtesting exception there was no need to adjust the crisis scenarios. Overall the reduction in VaR recorded in the year under review was based on the fall in interest rate risk.

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 Banking Book

Interest rate risks in the banking 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. The quarterly calculation of the interest rate shock in the banking 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. Unlimited equity and unlimited investments are not considered in accordance with regulatory requirements.

Table 27 in accordance with § 333 para. 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 interest rate shock reflects the lower risk acceptance level in relation to interest rate risk in the NORD/LB Group.

Table 27: Interest rate risks in the banking book

Currency (in € million)	Change in present value *)			
	Interest rate shock + 130 basis points		Interest rate shock – 190 basis points	
	31 Dec. 2010	31 Dec. 2009	31 Dec. 2010	31 Dec. 2009
EUR	– 263	– 329	448	528
USD	– 11	– 13	17	16
JPY	4	2	– 2	–
GBP	– 2	– 1	1	–
CHF	– 15	– 1	27	5
Other	–	–	–	–
Total	**– 287**	**– 343**	**491**	**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 traditional 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 funding risk. Risks are constrained with suitable limits in both cases.

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

In order to limit market liquidity risk the NORD/LB Group primarily makes trading transactions in markets which have proven themselves to be sufficiently liquid even when they are under pressure. This applies in particular to all transactions in the trading book.

In the Global Group Liquidity Policy the business policies for liquidity risk management in the NORD/LB Group are specified. The individual institutes of the NORD/LB Group also have liquidity control policies which describe the basic strategic guidelines for ensuring a sufficient supply of liquidity. Liquidity control 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 covered bond business, which provides the NORD/LB Group with additional access to the funding market.

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

Calculation of dynamic and static stress scenarios for modelling traditional 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 banking book when calculating market price risks. 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

In addition to the Treasury Division, the global trading divisions Markets and Portfolio Investments and the Risk Control Division are included in the process of liquidity risk control at NORD/LB.

Treasury is responsible controlling items bearing liquidity risks and producing profits and losses resulting from changes in the liquidity situation (in general or specific to NORD/LB).

The Treasury also presents the liquidity maturity balance sheet to the planning committee. It also reports to this committee on refinancing risk and makes recommendations for action concerning 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 traditional liquidity risk and monitors refinancing risk. It also ascertains and monitors regulatory indicators in accordance with German Liquidity Regulation (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. The liquidity progress is also considered by currency.

Traditional liquidity risk is limited by a dynamic stress test scenario. The scenario describes the most likely crisis situation in each case, hence also describing a current market environment which is characterised by economic problems in the periphery countries of the EU and a continuing loss of confidence in financial markets. Analysis is based on liquidity cash flows and covers the coming twelve months on a daily basis. For products without fixed liquidity flows, optional components (e.g. from irrevocable credit commitments), planned new business and refinancing opportunities, assumptions are made in accordance with the market situation which are subject to regular validation.

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 at least six months in the dynamic stress scenario taking into account 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. The scenario for calculating the liquidity buffer resulting from the third MaRisk amendment is currently being developed.

Market liquidity risks are implicitly accounted for by means of classifying securities in the liquidity maturity balance sheet in accordance with their market liquidity. Securities are allocated to one of eight categories (e.g. trading book, cover pool, central bank eligibility) on the basis of a detailed liquidity category concept. The presentation of the liquidity maturity balance sheet 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 maturity balance sheet 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 liquidity maturity balance sheets are also prepared in the most important foreign currencies.

5.4.1.4 Liquidity Risk Reporting

The Risk Control Division reports to the responsible Board Member several times a week, and depending on the amount of the limit used on a daily basis if necessary, on the dynamic stress test scenario for the NORD/LB Group's traditional liquidity risk.

In addition to this the NORD/LB's biggest investors in new business are monitored regularly. The responsible Board Members and Heads of Division are informed of liquidity concentrations in the concentration risk report.

The Managing Board is informed in detail in the monthly report on market and liquidity risks of the NORD/LB Group's liquidity risk situation. Information is also provided on a quarterly basis in the report on risk-bearing capacity.

The monthly refinancing risk reports are prepared in euro and in the most important foreign currencies. The progress reviews upon which the refinancing risk is based are also presented together with the stress tests to the planning committee which meets on a monthly basis.

The liquidity ratios calculated in accordance with the German Liquidity Regulation (LiqV) can be calculated daily and submitted to the Treasury Division for the purpose of regulating liquidity risk. The report in accordance with Liqv for the entire bank and each location is submitted to the Bundesbank, the control divisions and to the Managing Board of NORD/LB.

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 protects itself against operational risks if the costs for the protection are not greater than the costs directly incurred as a result of the risk or if its reputation could be significantly affected.

The NORD/LB Group possesses a suitable framework in the form of technical and organisational measures, contractual regulations and working instructions in order to prevent operational risks from occurring as far as possible. This includes contingency planning and appropriate insurance cover. The raising of risk awareness among all employees plays a key role in preventing operational risks in day-to-day business (risk culture).

The management of operational risks is supported by a methodical framework for risk assessment. Escalation processes are defined in order to implement targeted measures promptly.

With continual analysis of loss events, risk indicators and scenarios, causes of risk should be identified and concentrations of risk prevented. The internal control system (ICS) is reviewed regularly in relation to its appropriateness and effectiveness with regard to risk (ICS control cycle). 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 event data base provides the basis for analyses in support of risk management and is an important element of a statistical/mathematical risk model developed by the bank. The significant companies of the NORD/LB Group and the NORD/LB Asset Management Group for risk reporting 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 Association of German Public Sector Banks (VÖB). In return the NORD/LB Group receives the loss events collected by the consortium as a data basis, which is used for the internal model. 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 risk assessment method applied in NORD/LB, Bremer Landesbank, NORD/LB Luxembourg, Deutsche Hypo, NORD/LB CFB and the NORD/LB Asset Management Group, the recording of data concerning past losses is supplemented with future components. Expert appraisals on the impact of specific scenarios provide a detailed insight into the risk situation of the individual bank divisions so that relevant measures can be derived if necessary. The method was completely revised in the year under review and replaces the previous self-assessment method.

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.

The NORD/LB Group has an internal model to measure operational risk which is based on the loss distribution approach. Distribution parameters for loss frequency are calculated based on internal data. The parameterisation of loss values also includes scenario analyses and external data from the DakOR consortium, whereby elements of the extreme value theory are considered. The Value at Risk for the holding period of one year is calculated using the Monte Carlo simulation method. Correlation effects are modelled with the help of a Gaussian copula, in which qualitative and quantitative information is included in the parameters.

Risk indicators in the warning area impact on the models. If anticipated losses are considered in the planning process of the divisions, these are deducted from the model result. The VaR calculated in this way is used as a control variable for operational risks in the risk-bearing capacity model. An allocation process which combines size indicators with risk-sensitive elements is used to distribute the model results to the individual institutes. The model’s parameters are regularly subjected to a comprehensive validation and stress tests.

Mitigation effects due to insurance or other instruments used to transfer risk are currently not considered in the quantification model. The bank considers the use of customary insurance products to be part of active risk control.

The methods and procedures implemented in the NORD/LB Group meet the requirements of § 272 of the Solvency Regulation concerning the use of the standard approach for operational risk. The amount allowable for operational risk was calculated in the year under review using the standard approach in accordance with the Solvency Regulation. The further developments based closely on the requirements of the Solvency Regulation also enable the prompt 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 managing 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 strategic and conceptual responsibilities relating to security and contingency management are combined in the Group Security division. NORD/LB has a security strategy and uniform standards in order to efficiently and sustainably protect the bank from harm and at the same time meet legal and supervisory requirements. Contingency measures ensure appropriate operation in the event of an emergency and a return to normal operations as quickly as possible with consistent business continuation and recovery planning which focus on time-critical activities and processes.

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 coordinate closely with the Risk Control Division of NORD/LB. There is also close coordination with the Risk Control unit of the NORD/LB Asset Management Group. 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

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. The remuneration system comprises a performance-related component which provides incentives and at the same time supports sustainability and risk awareness in work practices.

Criminal actions are countered in close cooperation with the criminal prosecution authorities. It is the responsibility of Fraud Prevention Management, which is located in, the Compliance Department, to continually improve the bank's protection against internal and external acts of fraud and to prevent these as far as possible. An important element of the preventive measures is the generation of staff awareness. As elements of a comprehensive awareness concept, online learning programmes for all staff combined with classroom events, a regular newsletter and information as required with relevant warnings are used. The established whistle-blowing system and online fraud training were also used in the subsidiaries in the year under review.

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 managing operational risks.

The ICS framework implemented for this purpose is based on the framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) 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. NORD/LB's insurance cover was subjected in the year under review to a full analysis with regard to its scope and effectiveness. The resulting optimisation measures will be implemented in 2011.

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. NORD/LB has a process for assessing service providers in terms of their significance for risk aspects 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, risk assessment, risk indicators and internal model 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. All of the results are included in the quarterly RBC reporting.

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.

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.

Schedule of Abbreviations

AAKA	"Allgemeiner Arbeits- und Kreditausschuss" (General Working and Credit Committee at NORD/LB)
ABCP	Asset-Backed-Commercial-Paper
AMA	Advanced Measurement Approach
BaFin	"Bundesanstalt für Finanzdienstleistungsaufsicht" (German Federal Financial Supervisory Authority)
CCF	Credit Conversion Factor
CMS	Collateral Management System
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CPC	Credit-Pricing Calculator
CRM	Credit Risk Management
CRO	Chief Risk Officer
CRSA	Credit Risk Standard Approach
CSSF	Commission de Surveillance du Secteur Financier (Luxembourg Financial Supervisory Authority)
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 Savings Banks Association)
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
ICS	Internal Control System
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
Repo	Repurchase Agreement
RSU	Rating Service Unit GmbH & Co. KG
RBC	Risk-Bearing Capacity
RW	Risk Weight
RWA	Risk-Weighted Assets
SFA	Supervisory Formula Approach
SCM	Special Credit Management
SolvV	German Solvency Regulation
SolvVua ÄndV	Regulation which implements the revised Banking Directive and the revised Capital Adequacy Directive
SPE	Special Purpose Entity
SR	Sparkassen Rating und Risikosysteme GmbH
VaR	Value-at-Risk
VÖB	Bundesverband Öffentlicher Banken Deutschlands (Association of German Public-Sector Banks)

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