

# Annual Report

## International economic development

### **Sub-prime crisis detracts from the overall positive development**

2007 was again characterised by strong growth in the world economy. Global economic performance improved for the fourth time in succession by around 5%. While growth in the industrial countries slowed down slightly, in the emerging markets it remained as strong as ever. As a result of the worldwide boom the oil price rose to new record levels. After still being quoted at the beginning of 2007 at around 55 USD per barrel for North Sea Brent oil, by year-end it had increased to around 95 USD per barrel. While the global economy was hardly affected by the strong increase in energy prices, there was a noticeable rise in inflation rates over the year. This was due to exceptionally sharp increases in the price of food.

A shadow was cast over the generally positive picture of the world economy by the sub-prime crisis in the US mortgage market which from summer onwards led to significant distortions in the international financial markets. The trigger was an increase in defaults by borrowers with a weak credit rating who found themselves under increasing pressure from higher interest charges and falling property prices. With increasing securitisation, international credit trading had seen very rapid expansion in recent years, as a result of which the risks in the US sub-prime market were passed on to financial institutions all over the world. As it was not clear how much had to be written off, there was a crisis of confidence in the banking system that made the refinancing of institutions considerably more difficult. The liquidity shortages prompted a strong increase in interbank money market rates. Central banks throughout the world were forced to provide liquidity to the banks on a massive scale in order to prevent a collapse in the financial system. The effects of the crisis on economic growth were hardly felt in 2007. The outlook for 2008, however, is clearly clouded by the greater uncertainty about the real economic consequences of the financial crisis.

### **Economic development in the USA**

There was a noticeable slowdown in the pace of the US economy in 2007. Economic growth fell to 2.2% after reaching 2.9% in the previous year. An obvious slump in investment in house building had a dampening effect while commercial construction continued to show positive development. The most important pillar of the US economy still remains private households, whose consumption expenditure remained relatively unaffected by the property market crisis. This was helped by the fact that over the whole year there was a renewed positive trend in the labour market and household incomes increased. Over the year, however, the consumer mood became distinctly gloomier. There was a noticeable rise in the inflation rate in the latter half of the year that was caused primarily by significantly higher food and energy prices. While the overall inflation rate rose to over 4% towards the end of the year, the core rate remained at just over 2%.

In the latter half of 2007 the sub-prime crisis caused the US central bank to change its monetary policy. In view of the turbulence in the financial markets and the resulting risks to the US economy, the Fed cut its base rate by 50 basis points in September. Two

more smaller moves then reduced the Fed funds target rate to 4.25%. Capital market yields had continued to rise strongly in the period to mid-year, but then fell significantly in the latter half of the year due to the sub-prime crisis. Yields on 10-year treasury bonds dropped from 5.3% in mid-June to 4.1% at year-end.

The Japanese economy lost momentum in 2007. The gross domestic product only grew by 1.9%, after 2.4% in the previous year. Despite slower economic growth there were positive developments in the labour market. Wage increases, however, remained low, so private consumption was able to increase but not build up strong momentum. In spite of the robust economic situation the Japanese economy did not succeed in finally shaking off deflation. The inflation rate did increase towards the year-end to 0.6% but over the year as a whole prices just stagnated. While the Japanese central bank continued to move towards monetary normalisation by increasing its base rate in February to 0.5%, in view of the US sub-prime crisis it refrained from any further interest rises. Capital market yields rose to just under 2% in the period to mid-year, but by December they had dropped back to around 1.5%. The yen strengthened significantly against the US dollar.

... in Asia

The driver of growth in Asia was once again China, whose economy grew by just under 12%. Gross capital investment continued to be the most important driving force, while private consumption lagged behind the growth in other areas. Since then the Chinese economy has been showing clear signs of overheating. Therefore economic policy has taken steps to curb the economy's rapid growth, especially as inflation performance is also threatening to go off course.

The other Asian economies also experienced strong economic expansion in 2007. India grew by around 9%, South Korea by just under 5% and the Philippines by approximately 7%. Overall the emerging markets in Asia showed themselves to be relatively resistant to the international turbulence in the financial markets that had come into play in the latter half of the year.

In Europe economic growth in 2007 continued with somewhat less momentum. The Eurozone economy grew by 2.6%. The German economy was almost able to maintain its pace of growth despite a sizeable tax increase. As in the previous year, Germany's economy received considerable support from investments and exports. Private consumption, which had made a tentative recovery in 2006, slumped again as a result of the VAT increase and did not move beyond stagnation over the year as a whole. The gross domestic product in Germany grew in real terms by around 2.5%. Economic growth in France and Italy was weaker at just under 2%. Significantly higher growth rates – just below 4% – were recorded in the Netherlands and Spain. Luxembourg again recorded the highest growth rate in Euroland, at around 5.5%.

... in Europe

The British economy continued to expand strongly again in 2007, by a good 3%, though economic growth slowly fell in the second half of the year. After Britain's inflation rate rose to 3.1% in spring, the Bank of England increased the base rate to 5.75% in the period to mid-year. Against the background of the financial market crisis and signs of a weakening economy, however, it started to change its monetary policy as early as December and cut interest rates again by 25 basis points.

In view of the robust economic growth seen in the Eurozone the European Central Bank (ECB) continued to move towards higher interest rates in the first half of 2007. By June the tender rate had been increased in two stages to 4.0%. A further interest rate rise that

ECB puts higher interest  
rates on hold

had been expected to take place in September was abandoned because of the financial crisis. Against the background of an inflation rate that increased to just over 3% towards the end of the year, the ECB has kept up its strong rhetoric but refrained from more increases in interest rates. Changes in capital market yields were again shaped by what was happening in the USA. After the yield on 10-year federal bonds had increased in the period to mid-2007 to just over 4.6%, by the end of the year it had fallen to around 4.3%. At the same time the bond markets were exceptionally volatile. The decline in yields in Euroland was much less pronounced than in the USA, so that at year-end Euroland bonds had a positive yield spread against US treasury bonds for the first time since 2004.

**Diverging performance of  
shares**

Stock market performance was also strongly influenced by the sub-prime crisis in 2007. After the first concerns about a crisis in the US mortgage market emerged in February/March, global markets slumped, but were able to make a good recovery by summer. Due to the financial crisis and looming fears of recession the second half of the year then saw volatile movements with very significant international variation. While the DAX managed a rise of 22.3% over the whole year, there were much smaller increases in the Eurostoxx 50 (+6.5%) and Dow Jones (+6.4%). The Japanese stock market was particularly weak, with the Nikkei falling over the year by 11.1%.

**Euro still flying high**

In 2007 the EU currency again continued to strengthen against the US dollar. The exchange rate rose from 1.32 USD/EUR at the beginning of the year to 1.46 at the end of the year. The Euro hence strengthened by just under 11%. The principal reasons for this were the different directions taken by the central banks with regard to monetary policy. While the Fed showed an increasing tendency to cut interest rates in the course of 2007, the ECB remained inclined to increase rates. The Euro also rose strongly against the British pound, while its gains against the Japanese yen and the Swiss franc were more moderate.

# Management report

## **Business Development in 2007 and Outlook**

Norddeutsche Landesbank Luxembourg S.A. is showing a profit, including profit carried forward, of EUR 47.5 million (previous year: EUR 45.0 million) for 2007.

Within the framework of its Group strategy, the Bank will also be utilising opportunities presented in the financial centre of Luxembourg and the reputation of the Bank among international business and trade partners and will gradually continue to develop its business areas.

Mr Dirk Vormberge left the service of the bank on 1.02.2008. Responsibility for the Financial Markets division at NORD/LB Luxembourg has been taken over by Mr Uwe Rossmannek, who had already been invited to join the Management of NORD/LB Luxembourg in November 2007 and is also the NORD/LB Group's Global Head of Capital Markets.

There were no further occurrences which merited reporting after the balance sheet date.

As a full subsidiary included in the consolidated accounts of Norddeutsche Landesbank Girozentrale, Hanover, Norddeutsche Landesbank Luxembourg S.A. is one of the banks and financial institutes for which the parent company submitted a letter of comfort in its Annual Report.

**Ownership**

## **Business Divisions**

Responsibilities of the Trading division of the Bank include liquidity management within the scope of refinancing reported business transactions and for the purpose of fulfilling minimum reserve requirements as well as own-account trading. Risk items in terms of trading mainly focus on interest-rate rises on euro and US dollar markets and on other currencies with a high degree of market liquidity. The bank also undertakes minor currency risks.

**Trading**

Refinancing in lending business is mainly of a short-term nature. In transactions covering more than a year the risk of changes in interest rates is generally hedged with derivatives. The most significant refinancing sources are deposits from banks and institutional investors, commercial papers issued (ECP and USCP) and open market deals on the money market transacted with the European Central Bank and the Swiss National Bank. Repurchase transactions in securities are also undertaken with other banks. The Bank utilises its EMTN program for long-term refinancing. Under this program benchmark bonds and private placements amounting to more than EUR 2.3 billion in the current euro exchange rate had been issued on the balance sheet date.

Business transactions reflected in the balance sheet mainly comprise transactions with commercial papers, call money and term deposits as well as securities and open-market credits with international issuers.

The Bank pursues an active portfolio strategy with the objective of investing in the historically less volatile banking and financials/financial institutions sector. The strategy only allows the purchase of securities with an investment grade rating and whose issuers are domiciled in OECD countries. The selection of securities focuses in regional terms

on Europe. The market-wide increase in credit spread had an effect on portfolio valuation, though only one company was downgraded to sub-investment grade (BB+). An assumption of permanent impairment has not been made for any of the securities in the current portfolio.

Trading in off-balance sheet business is mainly conducted in interest rate swaps, currency swaps and futures, with the Bank not entering into any appreciable risks pertaining to complex derivative products.

**Private Banking**

The Private Banking division offers customers who are interested in investing internationally a comprehensive consulting service. In addition to a traditional consulting service aligned towards the needs of individual customers (in terms of type of investment, risk preferences and time frame), various asset management concepts may also be utilised. Within the framework of asset management, investors may choose between “personal asset management”, tailor-made to suit customers’ preferences, and “fund asset management”, which involves customers participating in the strategies of the best fund managers worldwide by investing in the Nordlux Pro 30, Pro 60 and Pro 100 funds.

Customer relationships are always based on close, fair cooperation and on a strong focus on customer satisfaction.

**Credits**

The lending business of the Bank is always conducted in close cooperation with other Group units or associated units. In this case the Bank is available to borrowers operating on an international basis who have a first-class credit rating, both bilaterally and within the scope of syndicated loan agreements for all of the standard Euromarket lending business activities. Loans in foreign currencies account for around 41% of all of the loans taken up. There is a strong regional focus on Europe and on other OECD countries (approx. 95%).

On the balance sheet date the Bank shows a credit volume (comprising loan drawdowns, guarantees and open commitments) of EUR 12.5 billion (reduction of 5% in comparison to figures for the previous year). Loan drawdowns amount to EUR 9.0 billion and open commitments to EUR 2.9 billion (reduction of 12% in comparison to figures for the previous year).

The risk strategy of the Bank remains unchanged, with the focus being on a first-class credit rating for borrowers and for trading counterparties. Towards the end of the financial year a value adjustment of EUR 6.4 million was made to a customer liability.

**Subsidiaries**

The Bank is the 100% shareholder of SKANDIFINANZ BANK AG, Zurich, and NORD/LB COVERED FINANCE BANK S.A., Luxembourg. Further information on the Swiss institution and mortgage bond bank subsidiary can be found in the Notes to the Accounts 2007 (“Participating interests and shares in affiliated companies”).

**Schedule of Assets and Financial Data**

The balance sheet total has been reduced by EUR 0.5 billion (-2.0%) to EUR 22.6 billion.

Assets have changed mainly to the extent that loans to credit institutions have been reduced by EUR 0.2 billion (-2.8%), that the volume of security portfolios has been raised by EUR 0.6 billion (+9.4%) and the debt instruments of public authorities for refinancing at the Central Bank have decreased by EUR 1.0 billion. (-85%).

Items shown under liabilities in the balance sheet, on the other hand, have changed considerably. Decreasing liabilities to customers, by EUR 2.7 billion (-60%) offset the increase in liabilities to credit institutions, by EUR 3.2 billion (+30%). Securitised liabilities are EUR 1.2 billion (-18%) lower than those for the previous year.

Within the scope of the appropriation of earnings for 2006, EUR 45.0 million was allocated to reserves.

Attributable equity capital in accordance with Luxembourg regulations amounted to EUR 891.8 million on 31 December 2007. At the end of the year under report the solvency ratio was 10.71%, which means that it far exceeded the regulatory requirement of 8%. The core capital ratio was 7.86% on 31 December 2007.

## Equity Capital

### Earnings

At the end of the year the figure in respect of net interest income and net commission income was EUR 73.5 million (previous year EUR 62.9 million), and was therefore clearly above the level of the previous year.

Net income from financial and investment banking transactions amounted to EUR 2.6 million in the year under report, in comparison to EUR 11.9 million for the previous year. Net income from financial and investment banking transactions for the previous years included sales and premature repayments from Brady bonds. In the spring of 2006 the last Brady bond positions held by the Bank were sold.

General administrative expenses of EUR 20.2 million are approximately EUR 2.3 million above those of the previous year, which is largely due to project activities and increased staff numbers.

The balance of other operating income and expenses amounted to EUR 13.6 million at the end of the year (previous year EUR 7.6 million) as a result of the reversal of accruals.

The Bank adequately took into account all of the discernible risks and made a value adjustment of EUR 6.4 million during the financial year.

Operating income before risk loss provisions and taxes calculated on the basis of commercial criteria increased by around 8.7% to EUR 86.1 million in comparison to that of the previous year (EUR 79.2 million).

## Other Operating Results

## Risk Loss Provisions

## Operating Income

### Risk Report

The Bank has implemented risk management arrangements that correspond to the objectives of its risk strategy. This includes an organisational structure that constantly ensures there is regular teamwork between all the divisions involved in the risk control process. In addition efficient risk procedures with clearly defined duties and responsibilities, supported by appropriate IT infrastructure and qualified staff, guarantee that everything runs smoothly. An effective internal control and monitoring system ensures that there is proper compliance. The objective is to improve the risk management arrangements and adapt them to current requirements on an ongoing basis.

The Bank's business policy is deliberately conservative in nature. As a result the Bank prioritises the responsible handling of risks. In line with the business model and the applicable business strategy, the Management has set out the risk strategy for the whole bank. The risk strategy covers all the main types of risk. The Bank's risk capital is allocated to

the types of risk that are typical for the Bank on the basis of the risk-bearing capacity model that has been implemented. The risk strategy is reviewed at least once a year and adapted where necessary. It is distributed to and discussed with the Board of Directors.

The Bank differentiates between the following types of risk:

- market price risks (interest and credit spread risks together with currency and volatility risks)
- liquidity risks (refinancing and market liquidity risks)
- credit risks (mainly shown as borrower's default risks and country risks)
- operational risks (including legal risks)

The types of risk are subject to various requirements in terms of management and controlling. Detailed descriptions of the risk management system for various risk categories as well as quantitative information on financial instruments are contained in the Notes.

The directives of the Bank relating to its business policy and its risk strategy are stipulated by the Board of Directors of the Bank or by the Management. Setting up specific committees to consolidate and monitor risk-related decisions provides support to the Management in its decision-making. Overall bank management is carried out within the framework of a risk strategy which is aligned towards business requirements and is defined by the risk strategy committee. Risk strategies specified by the

- liquidity and disposition committee
- credit risk committee
- committee for operational and other risks

form the basis of the specific organisation of the risk control process.

The core element of the risk strategy is the risk-bearing capacity model (RBC model), on the basis of which the willingness to accept risk is established. In the RBC model credit risks, participating interest risks, market price risks, liquidity risks and operational risks are combined to result in the risk potential of the Bank on a quarterly basis and then compared with the risk capital available. The volume of risk capital involved is defined in three stages, to be utilised successively to cover unforeseen losses which may result in the event of an (unforeseen) occurrence of risk.

The RBC model serves to further improve risk-oriented corporate management and ensures that requirements pertaining to the Internal Capital Adequacy Assessment Process (ICAAP) within Basel II and MaRisk are fulfilled. Besides providing the required proof that the institute has adequate capital, the model also serves as a monitoring instrument for verifying consistency between the risk strategy employed and specific business activities carried out. The calculation of risk-bearing capacity is also a fixed item on the agenda of the meeting of the Board of Directors which is held on a regular basis.

The market liquidity disruption caused by the sub-prime crisis confirms the requirement for rigorous liquidity management. All the essential information in this respect is provided by the bank's liquidity control instruments, described in more detail in the Notes, that have also proved themselves in a turbulent market environment. Recent findings arising from the crisis were used to further improve the instruments and refinancing policy.

At no time were there any shortages of cash. The liquidity provision was guaranteed at all times.

The Board of Directors of the Bank thanks all the employees for their commitment and their contribution to the satisfactory operating result.

It is proposed that the General Meeting approves the annual financial statements and the appropriation of profits for the 2007 financial year.

**Employees**

Luxembourg, 11 February 2008

The Board of Directors

# Balance sheet as at 31.12.2007

<b>Assets</b> (Amounts shown in EUR)	31.12.2007	31.12.2006
Cash, balances with central banks and post office banks	432,044,407.57	6,070,698.27
Treasury bills and other bills eligible for refinancing with the central bank	172,404,000.00	1,162,190,500.00
a) Treasury bills and similar securities	172,404,000.00	1,162,190,500.00
b) Other bills eligible for refinancing with the central bank	0.00	0.00
Loans and advances to credit institutions	8,493,231,548.24	8,740,447,970.03
a) Repayable on demand	556,572,990.28	277,616,169.25
b) Other loans and advances	7,936,658,557.96	8,462,831,800.78
Loans and advances to customers	5,602,593,323.69	5,585,869,098.49
Bonds and other fixed-income transferable securities	6,620,930,179.81	6,234,629,881.37
a) Issued by public bodies	53,507,510.67	57,169,487.83
b) Issued by other borrowers	6,567,422,669.14	6,177,460,393.54
Shares and other variable yield-securities	201,070,800.00	0.00
Shares in affiliated undertakings	73,194,141.56	73,194,141.56
Of which: undertakings accounted for under the equity method	0.00	0.00
Intangible assets	1,781,309.89	1,162,418.14
Tangible assets	9,080,084.80	9,504,859.46
Other assets	8,814,810.11	2,286,579.94
Prepayments and accrued income	987,122,245.65	1,251,053,639.82
<b>Total Assets</b>	<b>22,602,266,851.32</b>	<b>23,066,409,787.08</b>

<b>Liabilities</b> (Amounts shown in EUR)	31.12.2007	31.12.2006
<b>Amounts owed to credit institutions</b>	<b>13,709,232,739.68</b>	<b>10,506,877,417.67</b>
a) Repayable on demand	589,435,837.21	458,505,980.05
b) With agreed maturity dates or periods of notice	13,119,796,902.47	10,048,371,437.62
<b>Amounts owed to customers</b>	<b>1,826,653,900.74</b>	<b>4,542,656,967.52</b>
a) Savings deposits	0.00	0.00
b) Other debts	1,826,653,900.74	4,542,656,967.52
ba) Repayable on demand	227,770,212.05	637,868,716.88
bb) With agreed maturity dates or periods of notice	1,598,883,688.69	3,904,788,250.64
<b>Debts evidenced by certificates</b>	<b>5,103,432,303.16</b>	<b>6,258,127,263.65</b>
a) Debt securities in issue	2,299,394,810.91	2,367,224,262.76
b) Other	2,804,037,492.25	3,890,903,000.89
<b>Other liabilities</b>	<b>17,755,798.46</b>	<b>17,644,507.79</b>
<b>Accruals and deferred income</b>	<b>979,871,291.87</b>	<b>785,848,866.02</b>
<b>Provisions for liabilities and charges</b>	<b>24,649,731.44</b>	<b>51,703,598.57</b>
a) Provisions for pensions and similar obligations	0.00	0.00
b) Provisions for taxation	12,707,662.46	15,805,172.52
c) Other provisions	11,942,068.98	35,898,426.05
<b>Subordinated liabilities</b>	<b>237,171,085.97</b>	<b>247,171,056.62</b>
<b>Fund for general banking risks</b>	<b>30,000,000.00</b>	<b>30,000,000.00</b>
<b>Subscribed capital</b>	<b>205,000,000.00</b>	<b>205,000,000.00</b>
<b>Reserves</b>	<b>421,000,000.00</b>	<b>376,000,000.00</b>
<b>Profit brought forward</b>	<b>380,109.24</b>	<b>380,109.24</b>
<b>Profit for the financial year</b>	<b>47,119,890.76</b>	<b>45,000,000.00</b>
a) Profit for the financial year	47,119,890.76	45,000,000.00
b) Prepaid dividends	0.00	0.00
<b>Total Liabilities</b>	<b>22,602,266,851.32</b>	<b>23,066,409,787.08</b>

<b>Off balance sheet items</b> (Amounts shown in EUR)	31.12.2007	31.12.2006
<b>Contingent liabilities</b>	<b>638,454,824.34</b>	<b>710,151,588.65</b>
of which: - Acceptances and guaranties by endorsement	0.00	0.00
- Guarantees and assets pledged as collateral security	638,454,824.34	710,151,588.65
<b>Credit risks</b>	<b>3,226,745,052.25</b>	<b>3,346,204,284.60</b>
of which: Commitments arising out of repurchase transactions	0.00	0.00
<b>Fiduciary transactions</b>	<b>10,834,706.91</b>	<b>117,352,990.04</b>

# Profit and Loss account

for the fiscal year 2007

(Amounts shown in EUR)	2007	2006
<b>Interest receivable and similar income</b>	<b>1,823,997,325.79</b>	<b>1,962,141,194.52</b>
Of which: that are arising from fixed-income securities	333,318,937.14	266,925,535.11
<b>Interest payable and similar charges</b>	<b>-1,768,281,368.77</b>	<b>-1,914,415,027.21</b>
<b>Income from securities</b>	<b>4,583,278.41</b>	<b>1,244,632.52</b>
a) Income from shares and other variable-yield securities	3,253,732.27	0.00
b) Income from participating interests	0.00	0.00
Of which: affiliated undertakings	0.00	0.00
c) Income from shares in affiliated undertakings	1,329,546.14	1,244,632.52
Of which: affiliated undertakings	0.00	0.00
<b>Commission receivable</b>	<b>20,512,241.32</b>	<b>19,069,613.05</b>
<b>Commission payable</b>	<b>-2,691,150.59</b>	<b>-3,893,622.08</b>
<b>Net profit or net loss on financial operations</b>	<b>2,550,325.73</b>	<b>11,883,115.37</b>
<b>Other operating income</b>	<b>15,734,281.83</b>	<b>9,536,740.85</b>
<b>General administrative expense</b>	<b>-20,219,533.63</b>	<b>-17,910,826.82</b>
a) Staff costs	-11,278,149.70	-10,581,213.98
Of which: wages and salaries	-9,609,389.40	-9,134,535.31
social security costs	-1,360,641.26	-1,216,912.03
relating to pensions	-558,777.37	-489,225.48
b) Other administrative expenses	-8,941,383.93	-7,329,612.84
<b>Value adjustments in respect of tangible and intangible assets</b>	<b>-993,139.36</b>	<b>-1,198,460.54</b>
<b>Other operating charges</b>	<b>-2,106,850.34</b>	<b>-1,976,135.85</b>
<b>Net loss from depreciation and value adjustments in respect of adjustments, loans and advances and provisions for contingent liabilities and for credit risks (previous year: net income)</b>	<b>-6,377,512.36</b>	<b>85,301.66</b>
<b>Net loss from value adjustments in respect of securities held as financial fixed assets, participating interests and shares in affiliated undertakings</b>	<b>-919,799.70</b>	<b>-7,332,670.66</b>
<b>Tax on profit on ordinary activities</b>	<b>-18,650,407.72</b>	<b>-12,217,120.00</b>
<b>Profit on ordinary activities after tax</b>	<b>47,137,690.61</b>	<b>45,016,734.81</b>
<b>Other taxes not shown under the preceding items</b>	<b>-17,799.85</b>	<b>-16,734.81</b>
<b>Profit for the financial year</b>	<b>47,119,890.76</b>	<b>45,000,000.00</b>

<b>Appropriation of profit</b> (Amounts shown in EUR)	2007	2006
Profit for the financial year	47,119,890.76	45,000,000.00
Profit carried forward	380,109.24	380,109.24
<b>TOTAL</b>	<b>47,500,000.00</b>	<b>45,380,109.24</b>
Dividend payment	0.00	0.00
Transfer to legal reserves	0.00	0.00
Transfer to the other reserves	47,500,000.00	45,000,000.00
Profit carried forward	0.00	380,109.24

# Notes to the Accounts 2007

## A. General

The Bank was founded on 11 September 1972 as a public limited company under Luxembourg law. The company was incorporated for an unlimited duration. Euroloans and Eurodeposits, money market, foreign exchange and securities and private banking are the main areas of business activity of the Bank.

The Bank is a member of the NORD/LB Group and is included in the consolidated accounts. Norddeutsche Landesbank Girozentrale holds all of the capital of the Bank. The headquarters of the Group is in Hanover. The Group also maintains registered offices in Braunschweig and Magdeburg. The consolidated accounts are available at all of the offices.

An accounting period is equivalent to a calendar year. The Bank reports in euros.

The subscribed capital of the company amounted to EUR 205 million at 31 December 2007 and comprises 820,000 registered no-par value shares.

## B. Valuation and Accounting Principles

The annual financial statements are prepared in accordance with statutory regulations and in compliance with the generally accepted accounting principles for the banking sector of the Grand Duchy of Luxembourg. On preparing the annual financial statements the following principles were in particular observed:

- going concern
- continuity
- accrual accounting of expenses and income
- caution
- individual valuation of assets and liabilities
- balance sheet consistency.

The Bank applies the following accounting principles and methods:

<b>Currency conversion</b>	The Bank applies a multi-currency accounting system. Assets and liabilities in foreign currencies are carried in the currency in which the transaction is originated. Expenses and income are accounted for in the balance sheet currency after daily conversion at the respective exchange rates.
<b>Spot exchange transactions and balance sheet items</b>	Assets and liabilities in foreign currencies are converted into the balance sheet currency at the average rate of exchange of the European Central Bank on the balance sheet date.
<b>Futures transactions</b>	Outstanding futures transactions in foreign currencies are valued at the forward exchange rate for the residual term on the balance sheet date.
<b>Currency gains and losses</b>	Currency gains and losses resulting from spot transactions hedged with forward transactions and forward transactions hedged with spot transactions are offset by means of including them under deferred expenses and accrued income or deferred income and accrued expenses. Differences between the spot rate and the futures rate (swap premiums) are reported pro rata temporis in recognition of profit or loss.  Currency gains and losses resulting from unhedged spot transactions are reported in the income statement.

Valuation losses resulting from unhedged forward transactions are offset against previously accrued valuation gains. A provision is established for any remaining valuation losses.

Currency valuation gains and losses from foreign currency interest cash flow (including interest hedging) are shown in net interest income.

These are always valued individually at market price on the basis of general commercial valuation rules and in consideration of the realisation and imparity principle. The results of individual transaction valuations are offset per product and currency upon observation of the regulations of the Luxembourg bank supervisory authorities provided that gains are accrued prior to the occurrence of losses to be offset. The imparity principle is taken into account in that an earnings balance remains unappropriated, while a negative balance will result in the creation of a provision.

In deviation of this principle and to the extent permitted, valuation units are created for the purpose of hedging balance sheet items and expenses and income and for own-account trading. Transactions in securities and derivatives concluded within the framework of overall bank management are regulated in terms of profit and risk in a combined portfolio covering all products and currencies.

Fixed assets other than financial assets are valued at cost. The cost of fixed assets with a limited useful life is reduced by depreciation calculated to ensure that the value of assets is depreciated on a scheduled basis over the period of the useful life of the assets. Assets of minor value are fully reported as expenditure in the year of acquisition.

The Bank depreciates immaterial assets, in particular software programs purchased, at a rate of 25% per annum.

Apart from plots of land, tangible assets are always depreciated on a pro rata basis in accordance with their presumed useful life as follows:

20.00% - 33.33%	IT hardware (IT equipment, PCs and printers)
25.00%	Other technical equipment and machines
10.00% - 25.00%	Operating and office equipment and the fleet of vehicles
10.00%	Safes
6.67% - 20.00%	Plant facilities - buildings
2.00% - 2.78%	Buildings

Financial assets are participating interests, shares in affiliated companies, debt securities and other fixed-interest securities and the debt instruments of public authorities which serve the purpose of permanently supporting the business activities of the Bank and which appear under financial assets by an express decision of the Management.

Securities held as financial assets are always reported at cost or at the lower market value. Values are adjusted in order to report them at the lower value to be attributed to the securities at the balance sheet date, even if it is probable that impairment will not be permanent. The Bank utilises the option to maintain the value of securities. Securities linked to interest rate swaps in valuation units are valued at cost. As from the year under report, securities used for equity investment or subject to special refinancing are also valued at cost.

Premiums and discounts resulting from the acquisition of debt securities and other fixed-interest securities or from the acquisition of debt instruments issued by public authorities are always amortised on a pro rata basis.

Securities which do not serve the purpose of permanently supporting the business activities of the Bank represent current assets.

#### **Valuation of other derivative instruments (IRS, FX swaps, futures, FRAs and options)**

#### **Fixed assets other than financial assets**

#### **Intangible assets**

#### **Tangible assets**

#### **Financial assets**

#### **Valuation of securities**

#### **Premiums and discounts**

#### **Marketable securities**

Marketable securities (trading portfolio and liquidity portfolio) are valued at cost (measured in accordance with the average cost principle) or at the lower market values. Values are adjusted in order to report them at the lower value to be attributed to the securities at the balance sheet date, even if it is probable that impairment will not be permanent.

**Option to maintain the value of securities**

The Bank principally waives the option entitlement to write-ups (on the basis of temporary positive price developments) that it could apply for carrying amounts which had been impaired by depreciation in previous accounting periods. At the end of the year reserves amount to EUR 2.1 million (previous year EUR 2.0 million).

**Loans and advances**

Loans and advances are reported at cost. It is the policy of the Bank to create value adjustments for doubtful debts, depending on the circumstances. The volume of these value adjustments is specified by the organs responsible. Allowances for loan losses are deducted from the respective asset items. Premiums and discounts are always amortised on a pro rata basis. Value adjustments amounting to EUR 6.4 million were made in the financial year.

**Liabilities**

Liabilities are shown in the amounts repayable. Premiums are amortised pro rata over the term of liabilities. Discounts are entered as interest payable on a pro rata basis.

**Tax group**

The Bank and NORD/LB COVERED FINANCE BANK S.A. form a tax group in accordance with Article 164bis of the Luxembourg income tax law. Tax consolidation is applicable for corporation tax and business tax purposes. The Bank acts as the controlling company.

**Imputation of capital gains tax**

As in previous years, the Bank has taken up the option to impute capital gains tax for the year. Imputation was previously, until 2001, carried out for corporation tax payable in accordance with article 174bis LIR. As of 1 January 2002, after the overruling of article 174bis LIR, capital gains tax may be imputed on itself under certain conditions (§ 8a VstG, German capital gains tax law). The Bank has allocated the five-fold amount of imputed capital gains tax to available reserves upon observation of the five-year commitment period within the scope of the appropriation of earnings.

## C. Detailed notes

**Cash, balances with central banks**

The bank has deposits with the Luxembourg central bank to support the minimum reserve amounting to EUR 430.7 million.

**Debt securities and other fixed-interest securities and debt instruments of public authorities**

In 2008 securities amounting to EUR 1,629.6 million will mature.

Debt securities and other fixed-interest securities and the debt instruments of public authorities are to be allocated to financial assets to the amount of EUR 6,757.9 million and EUR 35.5 million is to be allocated to current assets.

**Participating interests and shares in affiliated companies**

As at 1 January 2002 the Bank took over SKANDIFINANZ AG, Zurich, which until this date had been a full subsidiary of Norddeutsche Landesbank Girozentrale, Hanover. SKANDIFINANZ AG, Zurich, was authorised with a banking licence by the Swiss bank supervisory authorities (EBK) in their meeting of 25 June 2002. The company has since conducted its business activities as SKANDIFINANZ/BANK AG.

SKANDIFINANZ/BANK AG, Zurich, conducts forfeiting and export financing transactions as well as private banking business.

The equity of the company amounts to CHF 52.3 million (incl. funds for general banking risks). In 2007, with a balance sheet total of CHF 944.7 million (previous year CHF 651.7 million), the profit for the year amounted to CHF 5,381 thousand (previous year CHF 2,015 thousand).

On 9 May 2006 the Bank founded the mortgage bond bank NORD/LB COVERED FINANCE BANK S.A., in accordance with the governing law of the Grand Duchy of Luxembourg. NORD/LB COVERED FINANCE BANK S.A. is a full subsidiary.

The share capital of the company amounts to EUR 50 million and comprises 500,000 no-par value shares. The balance sheet total at the end of 2007 amounts to EUR 3,089.4 million, the profit for the year 2007 amounts to EUR 3,288 thousand while in the previous year, which was characterised by investments in setting up the Bank, a deficit of EUR -288 thousand was carried forward to the accounting year 2007.

(Amounts shown in kEUR)

	Listed securities	Unlisted securities	Total
	Amounts	Amounts	Amounts
Debt instruments of public authorities	172,404	-	172,404
Debt securities and other fixed-interest securities	5,969,255	651,675	6,620,930
Shares and other variable-yield securities	-	201,071	201,071
Participating interests	-	-	-
Shares in affiliated companies	-	73,194	73,194
<b>Total</b>	<b>6,141,659</b>	<b>925,940</b>	<b>7,067,599</b>

#### Listed and unlisted securities

(Amounts shown in kEUR)

	Carrying amount	Market value	Difference
Debt instruments of public authorities	92,356	91,266	-1,090
Debt securities and other fixed-interest securities	1,045,432	1,025,720	-19,712
<b>Total</b>	<b>1,137,788</b>	<b>1,116,986</b>	<b>-20,802</b>
Of which: hedged with asset swaps	678,230	665,670	-12,560

#### Financial assets reported at an amount in excess of fair value without taking up the option of making an allowance for loan losses

The carrying amount was not reduced since all of the securities in question are hedged with a micro hedge (asset swaps), i.e. the lower market values of the securities are compensated for by positive valuation results from the asset swaps, or the securities are used for equity investment or are subject to special refinancing. It is assumed that there is no permanent impairment with regard to these securities.

Statement of fixed assets  
2007

## FIXED ASSETS

(Amounts shown in kEUR)

Development of fixed assets	Gross value	Additions	Disposals	Foreign exchange adjustment +/-	Gross value	Value adjustments/ accumulated depreciation	Additions for the financial year	Net value
	01.01.2007				31.12.2007	31.12.2007		31.12.2007
Debt instruments of public authorities	1,089,871	80,365	996,202	-	174,034	1,630	-	172,404
Debt securities and other fixed-interest securities	5,028,362	4,455,609	2,832,688	-15,548	6,635,735	50,265	-	6,585,470
Participating interests	-	-	-	-	-	-	-	-
Shares in affiliated companies	73,194	-	-	-	73,194	-	-	73,194
Intangible assets	11,531	872	-	-	12,403	10,622	-	1,781
Land and buildings	14,193	40	-	-	14,233	6,214	-	8,019
Operating and office equipment	10,735	283	34	-	10,984	9,923	-	1,061
<b>Total</b>	<b>6,227,886</b>	<b>4,537,169</b>	<b>3,828,925</b>	<b>-15,548</b>	<b>6,920,581</b>	<b>78,653</b>	<b>-</b>	<b>6,841,928</b>

Land and buildings are used for operating purposes.

**Other assets**

Other assets mainly comprise the following:

- Tax refunds	kEUR	5,457
- Claims for dividends SKANDIFINANZ/BANK AG	kEUR	1,330
- Other items	kEUR	2,028

**Loans and liabilities relating to affiliated companies in which an equity investment exists, and subordinated assets**

(Amounts shown in kEUR)

	Affiliated companies	Companies in which an equity investment exists	Subordinated receivables from affiliated companies
	Amounts	Amounts	Amounts
<b>Loans</b>			
Loans to banks	4,155,118	-	27,172
Loans to customers	69,998	-	-
Debt securities and other fixed-income securities	253,345	-	-
<b>Liabilities</b>			
Liabilities to banks	4,884,100	-	-
Liabilities to customers	3,340	-	-
Subordinated liabilities	237,171	-	-

**Assets and liabilities in foreign currencies**

The current value of assets and liabilities in foreign currencies is EUR 6,408.3 million and EUR 11,887.0 million respectively.

On the balance sheet date repurchase transactions in securities had been accounted for at respective costs of EUR 4,095.4 million (repurchase seller) and EUR 1,684.3 million (repurchase buyer).

Accumulated deferred premiums from debt securities and other fixed-interest securities and the debt instruments of public authorities reported in financial assets amount to EUR 2.6 million at the balance sheet date.

- Liabilities from silent partnership holdings	kEUR	15,889
- Preferential liabilities	kEUR	1,845
- Liabilities - costs	kEUR	21
- Redemption liabilities - checks	kEUR	1

The fully paid-in share capital amounts to EUR 205 million and comprises 820,000 registered no-par value shares.

Earnings for the accounting period amount to EUR 47.1 million and will be allocated to the free reserves, together with the profit brought forward (EUR 0.4 million), subsequent to adoption of the annual financial statements.

In accordance with Article 72 of the law dated 10 August 1915, 5% of the annual profit is to be allocated to the legal reserve, until the reserve is equivalent to 10% of the subscribed capital. The legal reserve may not be paid out.

The Bank reports subordinated borrowed funds amounting to EUR 237.2 million at the balance sheet date. These loans resulted in expenses to the amount of EUR 21.1 million in the accounting period.

The following is an overview of the subordinated loans of the Bank.

Type of loan	Amount	Term in years	Interest rates in %	Due date
Other loans	USD 60.0 m. <sup>1)</sup>	15	5.045*	08.06.2016
Other loans	USD 65.0 m. <sup>2)</sup>	15	5.27*	31.12.2017
Silent participations	EUR 76.7 m.	10	4.775**	30.06.2008
Silent participations	EUR 12.8 m.	10	4.79**	30.06.2008
Silent participations	EUR 12.8 m.	10	3.89**	02.03.2009
Silent participations	EUR 50.0 m.	10	5.25**	27.09.2010

\* On a roll-over basis at EURIBOR or LIBOR rates (interest rates applicable at the balance sheet date)

\*\* Plus earnings-related remuneration

1) Equivalent to EUR 40.8 m. at the balance sheet date 2) Equivalent to EUR 44.2 m. at the balance sheet date

Under Luxembourg regulations silent participations are included in tier 1 supplementary capital. They were acquired from the parent company.

The Bank is a member of the Association pour la Garantie des Dépôts in Luxembourg (deposit guarantee association, abbreviated AGDL). The corporate object of the AGDL was originally to establish a system to mutually secure customers' deposits of the AGDL member institutes.

Since 2001 the AGDL has also been securing the assets of customers held in custody. Thus both deposits and depot assets are each secured to the amount of EUR 20,000. In the event of default the annual payment obligation for each member of the AGDL is limited to 5% of equity.

## Repurchase transactions

## Accumulated deferred premiums

## Other liabilities

## Subscribed capital

## Profits for the financial year

## Legal reserve

## Subordinated loans

## Deposit guarantee and investor compensation scheme

**Assets pledged as collateral**

The Bank has pledged assets to the nominal amount of EUR 30.0 million as collateral for participation in the clearing system of Clearstream Banking Luxembourg S.A.

In addition a nominal EUR 5.0 million has been pledged as collateral at the parent company for margin services relating to commission business transactions in options.

**Contingent liabilities**

The following contingent liabilities are reported: (Amounts shown in kEUR)

Type	31.12.2007 Amount
Guaranteed credits	638,455
of which to affiliated companies	-
Guarantees for services provided by third parties	-

**Credit risks**

The following credit risks are reported: (Amounts shown in kEUR)

Type	31.12.2007 Amount
- Forward purchases of assets	339,917
- Forward sales of assets	-
- Firm loan commitments	2,886,828

**Outstanding forward transactions and derivative financial instruments**

Type (Nominal volume in EUR m.) as at 31.12.2007	Hedging	Trading	Total
Exchange rate related transactions			
- Forward exchange contracts (swaps, outright)	6,822	-	6,822
- Interest Rate Currency Swaps	964	-	964
- Options	-	-	-
- Other exchange rate related transactions	-	-	-
Interest rate related transactions			
- Interest Rate Swaps	13,944	40,878	54,822
- Future or Forward Rate Agreements	-	-	-
- Interest rate futures	-	-	-
- Options	-	-	-
- Other interest rate related transactions	-	-	-
Total	21,730	40,878	62,608

Appendix D shows primary and derivative financial instruments classified according to residual terms. There are no significant concentrations of risk associated with primary financial instruments or for derivatives.

**Management and representation services**

The Bank mainly provides the following management and representation services for third parties:

- Asset management
- Custody and administration of securities
- Renting out safes
- Agency activities
- Insourcing data processing centre
- Effecting transactions (SLA's) for affiliated companies

	EUR m
Income from debtor warrants	2.8
Income from the release of tax provisions	3.8
Other income - accounting for services	1.4
Other income / Other income from the release of provisions	7.7
<b>Total</b>	<b>15.7</b>

**Other operating income**

	EUR m
Interest expenses not relating to the period	0.3
Handling fees (accounting for group – internal cost allocations)	0.7
Other expenses	1.1
<b>Total</b>	<b>2.1</b>

**Other operating expenses**

The Bank generates its earnings almost solely on markets in OECD countries (primarily Europe and North America).

**Classification of income according to geographical markets**

The following shows the average number of Bank employees in the accounting period.

**Average number of employees**

Group	Number
Management	3.0
Senior staff	12.8
Employees	92.3
Contract staff	0.5
<b>Total</b>	<b>108.6</b>

(Amounts shown in kEUR)

	Remuneration, allowances	Pension obligations	Credits
Extended management*	2,495*	218	60
Board of Administration	60*	-	-
	2,555*	218	60

**Emoluments, pension obligations and loans to executive bodies of the Bank**

\* Refers to 15.8 persons on an annual average (Management and senior staff)

(Amounts shown in kEUR)

Annual statutory audit	360.0
Other audit services	30.0
<b>Total</b>	<b>390.0</b>

**Auditors' fees (net / excl. VAT)**

**D. Further details concerning maturities/credit risks of financial instruments**

(Amounts shown in kEUR)

**Primary financial instruments**  
non-trading instruments  
(current assets)

The values of the primary and derivative financial instruments in the financial asset portfolio have been calculated on the basis of the nominal amount less value adjustments. For derivative financial instruments in the trading portfolio we have shown the current replacement costs in addition to the nominal amounts. These replacement costs have been calculated on the basis of market prices. They show the potential additional expenses or decreased income which would occur in the event of the default of the counterparty, because of the necessary replacement transactions (see tables, item D).

	Repayable on demand	≤ 3 months	> 3 months ≤ 1 year	> 1 year ≤ 5 years	> 5 years	Total	Total last year
<b>Classes of instruments (financial assets)</b>							
Cash, balances with central banks	432,044	-	-	-	-	432,044	6,071
Treasury bills	-	25,000	30,039	46,000	71,365	172,404	1,162,191
Loans and advances to credit institutions	556,573	3,197,499	1,846,050	2,464,556	428,554	8,493,232	8,740,448
Loans and advances to customers	27,464	704,434	833,142	1,842,995	2,194,558	5,602,593	5,585,869
Debt securities and other fixed-income securities	-	122,133	1,452,394	3,298,415	1,747,988	6,620,930	6,234,630
Shares and other variable-yield securities	201,071	-	-	-	-	201,071	-
Other assets	-	-	-	-	-	1,079,993	1,337,201
<b>Total</b>	<b>1,217,152</b>	<b>4,049,066</b>	<b>4,161,625</b>	<b>7,651,966</b>	<b>4,442,465</b>	<b>22,602,267</b>	<b>23,066,410</b>
<b>Classes of instruments (financial liabilities)</b>							
Amounts owed to credit institutions	589,436	8,414,136	828,308	1,798,309	2,079,044	13,709,233	10,506,877
Amounts owed to customers	227,770	1,550,085	46,448	2,351	-	1,826,654	4,542,657
Debts evidenced by certificates	55,947	2,675,814	72,276	1,229,792	1,069,603	5,103,432	6,258,127
Other liabilities	-	-	-	-	-	1,962,948	1,758,749
<b>Total</b>	<b>873,153</b>	<b>12,640,035</b>	<b>947,032</b>	<b>3,030,452</b>	<b>3,148,647</b>	<b>22,602,267</b>	<b>23,066,410</b>
<b>Common off-balance liabilities</b>							
Contingent liabilities arising out of guarantees and assets pledged as collateral security	-	155,683	31,278	240,474	211,020	638,455	710,152
Commitments arising out of forward purchases of assets	-	339,917	-	-	-	339,917	54,125
Firm loan commitment	-	344,589	338,944	1,786,731	416,564	2,886,828	3,292,079
<b>Total</b>	<b>-</b>	<b>840,189</b>	<b>370,222</b>	<b>2,027,205</b>	<b>627,584</b>	<b>3,865,200</b>	<b>4,056,356</b>

The calculation for measuring the credit risk arising from financial items (solvency) breaks down as follows:

Weighting	Amount
0%	2,578,993
10%	1,236,081
20%	15,084,361
100%	<u>3,704,202</u>
	<b>22,603,637</b>

**Derivative Instruments**  
**non-trading instruments**

(Amounts shown in kEUR)	≤ 3 months		> 3 months ≤ 1 year		> 1 year ≤ 5 years		> 5 years		Total	Total last year
OTC transactions	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Nominal amount
<b>Classes of instruments (financial assets)</b>										
Operations linked to Interest rates										
Interest rate swaps	4,242,570	16,235	1,201,813	9,868	711,470	15,334	439,707	13,351	6,595,560	6,409,315
Operations linked to currency exchange rate										
Forward currency transactions	3,125,009	49,212	49,373	916	-	-	-	-	3,174,382	8,548,927
Interest rate currency swaps	-	-	24,525	1,113	19,379	1,443	152,207	7,670	196,111	404,476
<b>Subtotal</b>	<b>7,367,579</b>	<b>65,447</b>	<b>1,275,711</b>	<b>11,897</b>	<b>730,849</b>	<b>16,777</b>	<b>591,914</b>	<b>21,021</b>	<b>9,966,053</b>	<b>15,362,718</b>
<b>Classes of instruments (financial liabilities)</b>										
Operations linked to Interest rates										
Interest rate swaps	2,358,081	6,057	2,294,780	10,115	1,837,181	51,534	858,278	65,673	7,348,320	9,355,350
Operations linked to currency exchange rate										
Forward currency transactions	3,563,403	44,768	84,649	1,150	-	-	-	-	3,648,052	5,932,728
Interest rate currency swaps	299,734	5,628	-	-	117,258	35,092	350,998	67,139	767,990	349,533
<b>Subtotal</b>	<b>6,221,218</b>	<b>56,453</b>	<b>2,379,429</b>	<b>11,265</b>	<b>1,954,439</b>	<b>86,626</b>	<b>1,209,276</b>	<b>132,812</b>	<b>11,764,362</b>	<b>15,637,611</b>
<b>Total</b>	<b>13,588,797</b>	<b>121,900</b>	<b>3,655,140</b>	<b>23,162</b>	<b>2,685,288</b>	<b>103,403</b>	<b>1,801,190</b>	<b>153,833</b>	<b>21,730,415</b>	<b>31,000,329</b>

Current replacement costs of financial assets (liabilities) are calculated using market prices. These represent the potential additional expenditure (income) or lower income (expenditure) that would arise in the event of the default of the counterparty, as a result of the necessary replacement transactions.

### Derivative trading Instruments

(Amounts shown in kEUR)	≤ 3 months		> 3 months ≤ 1 year		> 1 year ≤ 5 years		> 5 years		Total		Total last year	
	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs
<b>Stock market</b>												
<b>Classes of instruments (financial assets)</b>												
Operations linked to Interest rates												
Futures												
Interest Futures	-	-	-	-	-	-	-	-	-	-	911,465	3,445
<b>Subtotal</b>	-	-	-	-	-	-	-	-	-	-	<b>911,465</b>	<b>3,445</b>
<b>OTC transactions</b>												
<b>Classes of instruments (financial assets)</b>												
Operations linked to Interest rates												
Interest rate swaps	4,901,398	196,990	13,441,468	282,250	1,453,590	79,499	121,264	4,919	19,917,720	563,658	15,573,273	285,690
Forward rate agreements	-	-	-	-	-	-	-	-	-	-	759,301	3,232
Operations linked to currency exchange rate												
Forward currency transactions	-	-	-	-	-	-	-	-	-	-	281,427	12,305
<b>Subtotal</b>	<b>4,901,398</b>	<b>196,990</b>	<b>13,441,468</b>	<b>282,250</b>	<b>1,453,590</b>	<b>79,499</b>	<b>121,264</b>	<b>4,919</b>	<b>19,917,720</b>	<b>563,658</b>	<b>16,614,001</b>	<b>301,227</b>
<b>OTC transactions</b>												
<b>Classes of instruments (financial liabilities)</b>												
Operations linked to Interest rates												
Interest rate swaps	4,901,398	189,420	14,502,099	279,688	1,435,401	76,175	121,264	5,055	20,960,162	550,338	14,693,622	287,013
Forward rate agreements	-	-	-	-	-	-	-	-	-	-	759,301	1,871
Operations linked to currency exchange rate												
Forward currency transactions	-	-	-	-	-	-	-	-	-	-	5,300,000	253,168
<b>Subtotal</b>	<b>4,901,398</b>	<b>189,420</b>	<b>14,502,099</b>	<b>279,688</b>	<b>1,435,401</b>	<b>76,175</b>	<b>121,264</b>	<b>5,055</b>	<b>20,960,162</b>	<b>550,338</b>	<b>20,752,923</b>	<b>542,052</b>
<b>Total</b>	<b>9,802,796</b>	<b>386,410</b>	<b>27,943,567</b>	<b>561,938</b>	<b>2,888,991</b>	<b>155,674</b>	<b>242,528</b>	<b>9,974</b>	<b>40,877,882</b>	<b>1,113,996</b>	<b>38,278,389</b>	<b>846,724</b>

Current replacement costs of financial assets (liabilities) are calculated using market prices. These represent the potential additional expenditure (income) or lower income (expenditure) that would arise in the event of the default of the counterparty, as a result of the necessary replacement transactions.

**Credit Risk on OTC-  
derivative instruments**  
(use of market risk  
method)

(Amounts shown in kEUR)	Nominal amount *	Nominal amount last year	Current replacement costs **	Potential future replacement costs **	Overall replacement costs provisions	Collateral	Net risk exposure	Net risk exposure after counterparty weighting
<b>Counterparty solvency</b> (based on external valuations)								
<b>OECD credit institutions</b>	62,542,495	69,204,017	677,796	165,823	843,619	-	843,619	168,724
of which credit institutions from GB	40,133,608		433,981	37,732				
of which credit institutions from DE	7,197,204		32,312	75,494				
of which credit institutions from DK	5,759,329		85,773	16,661				
of which credit institutions from FR	3,465,648		44,065	3,120				
of which credit institutions from US	3,276,688		56,051	1,052				
of which credit institutions from CH	1,259,323		3,296	12,533				
of which credit institutions from LU	417,686		9,830	14,044				
of which credit institutions from FI	373,741		11,684	341				
from the rest of Europe	307,107		804	2,976				
of which credit institutions from NL	216,301		-	1,870				
of which credit institutions from CA	135,860		-	-				
<b>Customers</b>	65,802	74,701	1,004	512	1,516	-	1,516	303
of which private customers from NL	27,418		437	137				
of which private customers from DE	25,340		298	253				
of which private customers from MU	7,294		163	73				
of which private customers from LU	3,653		73	37				
of which private customers from US	1,813		32	9				
of which private customers from FR	238		-	2				
of which private customers from ZA	46		1	1				
<b>Total</b>	<b>62,608,297</b>		<b>678,800</b>	<b>166,335</b>	<b>845,135</b>	<b>-</b>	<b>845,135</b>	<b>169,027</b>

\* before netting    \*\* after netting

## E: Supplements to the Risk Report

### Definition and method

Each open position in products, whose value depends on current market parameters (interest rates, exchange rates, volatility or similar) entails the risk that changes in these market parameters could lead to an impairment of the position. The potential losses from changes in the market parameters are hereafter called market price risk.

Depending on the varying market parameters, the Bank currently differentiates between three kinds of market price risk: interest rate risk, currency risk and volatility risk. The interest rate risk consists of the components general interest rate risk and specific interest rate risk (credit spread risk).

### Market price risks

### **Interest rate risk**

A general interest rate risk always exists when the value of a position or portfolio is influenced by changes in one or more interest rates or by changes in complete interest rate curves and changes in interest rates or interest rate curves could lead to an impairment of the position.

For the general interest rate risk, the relevant valuation interest rates are determined in each case by the currency and the term of the instrument as well as by the market segment to which the instrument relates. The principal trading currencies of NORD/LB Luxembourg are the euro, the US dollar, the yen, the British pound and the Swiss franc.

The objective is to undertake maturity transformations and to participate in general market trends within the framework of the risk limits.

### **Credit spread risk**

Specific interest rate risks or credit spread risks refer to changes in value that arise when there is a change in the relevant additional interest for the issuer (for securities) or reference borrower (for credit derivatives) concerned that is added to the „risk-free“ interest rate within the framework of the market valuation of the position.

The Bank aims to receive the credit spread until the final maturity of the commitment or to participate in an improvement in the credit rating of the issuer or reference entity. This means striving to achieve maturity matching refinancing of investments as well as a healthy diversification of the portfolios.

### **Currency risk**

There are always currency risks when the value of a position or portfolio is influenced by changes in exchange rates and the change in exchange rates can lead to an impairment of the position. Therefore, as well as the classical currency transactions and their derivatives, foreign currency loans and securities not listed in euros are exposed above all to currency risks.

In general, the Bank distinguishes between three categories of trading currencies: principal trading currencies, opportunistic currencies and hedging currencies. Positions are constantly entered in principal trading currencies, while they are only periodically held in opportunistic currencies. No active positions are taken in hedging currencies. Transactions undertaken with customers are settled immediately.

### **Volatility risk**

For options the price is established by the volatility of the valuation and the price of the underlying asset. These valuation volatilities are subject to own market fluctuations. Volatility risks always exist when the value of the option position or a portfolio is influenced by changes in these valuation volatilities.

Market price risks are quantified and monitored and net incomes from trading activities are calculated (separately under annual, monthly and daily income) independently of trade in the Controlling organisational unit (OU). The management of the Bank is informed in detail here on a daily basis.

The Bank employs a value-at-risk (VaR) procedure to internally regulate, monitor and limit market price risks. Market price risks are in this case measured in accordance with Group-wide standards with the help of the historical simulation method. Calculations are based on the following parameters:

- A confidence level of 95%
- A holding period of one trading day
- An historical observation period of one year

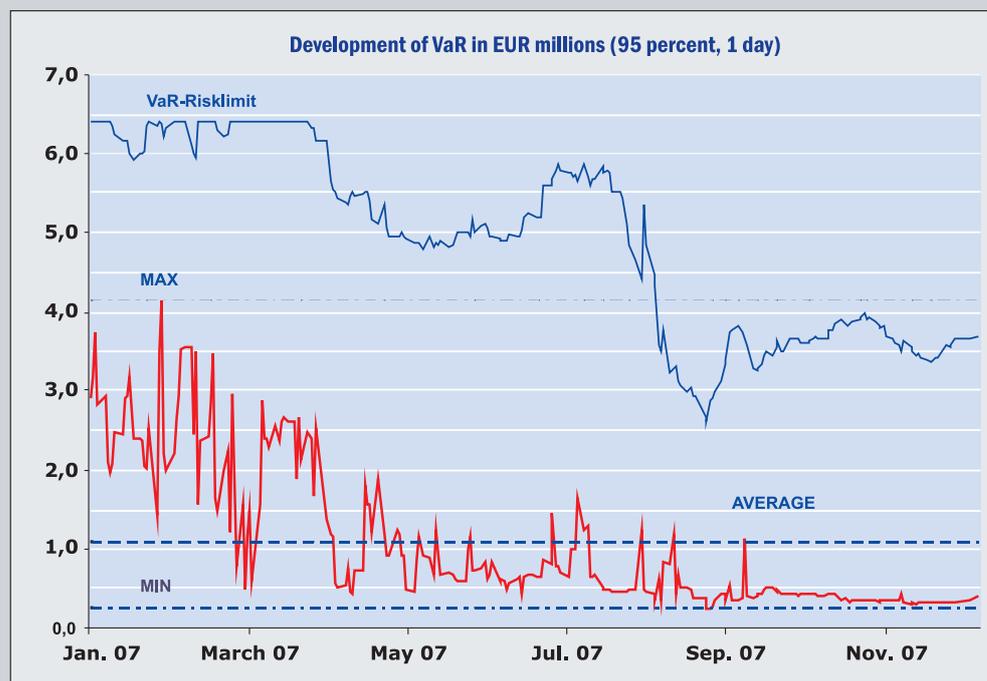
The model implicitly takes into account correlation effects between risk factors, types of risk, currencies and sub-portfolios. For risks that are not yet included in the VaR approach, appropriate add-on values are specified by the Risk Controlling division.

Trade transactions conducted by the organisational unit responsible for these transactions are monitored by means of an allocated loss limit. The limit was stipulated by the Board of Directors of the Bank. On the one hand the limit has been calculated to ensure that there is sufficient scope for trading on national and international markets in order to secure and reinforce market positions. On the other hand the defined limit ensures that the ratio between the risk of losses relating to trade transactions and the equity resources and earnings of the Bank is appropriate. This is regularly examined within the framework of a calculation of the risk-bearing capacity of the Bank.

#### **Development in 2007**

The VaR risk limit is calculated from the so-called self-consuming loss limit, i.e. a cumulative negative trading result leads to a limit reduction. The risk limit may not be exceeded.

The average utilisation of the VaR risk limit over the year was 20.2% (previous year 35.4%); the maximum utilisation level was 64.9% while minimum utilisation was 7.5%.



Back testing analyses are carried out to ensure that the VaR calculated adequately reflects possible changes in the value of the risk items. The back testing method is applied on the basis of a “clean Profit & Loss Statement” (without any distortion due to changes in portfolios having occurred in the meantime).

In a first step, the value-at-risk is determined for the respective reporting date. The second step involves the portfolio (without any distortion of the net income from trading activities as a result of intra-day trading) being newly-valued with the market interest rates applicable on the following day (this implies a one-day holding period of the portfolio). The difference between the two calculations is the actual change in the cash value of the portfolio, which is compared with the value-at-risk calculated.

Since the value-at-risk method does not cover extreme market fluctuations, additional analyses ensure the quality and the reliability of risk quantification. On the basis of extreme scenarios these so-called stress tests measure the magnitude of losses and extreme market fluctuations and also take into particular account the fact that assumptions made in the VaR model in respect of market correlations and/or currencies may no longer be valid. Fourteen different stress tests are calculated every day. In addition to differences in interest rates (parallel differences and misrepresentations) exchange-rate shocks and implied option volatilities are also taken into account. The stress scenario with the highest potential loss is decisive for risk monitoring.

The following risk items of the Bank at year-end show value-at-risk and overnight stress tests separately according to bank book and trading book items:

Portfolio 31.12.2007 (in EUR m.) (Previous year value shown in brackets)	VaR [95%]	Stress test
NORD/LB Luxembourg S.A. entire bank	0.4 (2.8)	5.7 (52.6)
→ Bank book	0.4 (1.8)	5.6 (38.4)
→ Trading book	0.1 (1.3)	1.2 (14.2)

### Definition and method

Malfunctions in the liquidity of individual market segments (e.g. in crises) and unexpected occurrences in the lending and investment lines of business (withdrawal of investments, delayed receipt of payments, etc.) or a worsening of the Bank's own refinancing basis (e.g. as a result of downgrading), may have a negative effect on the earnings of the Bank. The Bank includes all of these potential losses or risks under liquidity risks.

### Refinancing risk

Refinancing risks are the potential trading losses that NORD/LB Luxembourg may experience as a result of the worsening of the Bank's own refinancing conditions. This affects positions in the money market and the capital market. The aim is not to avoid the refinancing risk but to undertake a structured liquidity maturity transformation.

Two different methods are applied for the internal measurement and control of refinancing risks:

- Limiting liquidity cash flows by **volume-based structural limits** in the individual maturity bands. The limit structure and level also stem from the need to be able to implement definite arrangements to control the risk of changes in interest rates and take temporary measures in day-to-day business. In addition there is also the opportunity here to generate income as a result of active liquidity management.
- In addition to a volume-based consideration, the refinancing risk is also analysed on a **cash-equivalent basis**, i.e. the costs which would need to be paid for measures to eliminate current liquidity risks are determined on the inclusion of a risk premium. Risk parameters relating to maturity specified by the Risk Controlling division of NORD/LB GZ are applied when calculating the risk premium.

The liquidity risk is monitored and measured (volume-based and cash equivalent approach) every day by the Controlling OU and is reported to the Treasury OU and to the management. The liquidity situation is discussed in the Liquidity and Disposition Committee of the Bank on at least a monthly basis.

The control system is continually developed in close cooperation with NORD/LB GZ. The Treasury OU is responsible for liquidity control in the Bank. The Bank meets market liquidity risks by conducting its activities solely on liquid markets.

### Liquidity risk

When measuring internal liquidity risk, the cash equivalent refinancing costs at the end of 2007 are calculated at EUR 0.6 million, compared to the unchanged risk premiums for the previous year (previous year EUR 1.3 million). The liquidity ratio for external reporting is determined in accordance with Luxembourg banking supervisory requirements (minimum ratio of 30%). The liquidity ratio was maintained for the entire accounting period and at the end of 2007 it amounted to 42.95% (previous year: 45.8%).

### **Classical liquidity risk**

Classical liquidity risk is the danger that the Bank will no longer be able to meet its short-term payment obligations because of market problems due to external causes or unexpected occurrences in the lending and investment lines of business. The objective is essentially to avoid classical liquidity risk by maintaining sufficient liquid assets. This means favouring investment grade securities that can be cashed in immediately in the event of a crisis.

In order to be able to assess the liquidity situation of the Bank in extreme market situations, three static and one dynamic liquidity stress test scenarios (LST scenarios) have been implemented at Group level as part of the Liquidity Contingency Funding Plan. These scenarios take into account internal Bank problems and problems that are market-related.

The **static LST scenarios** represent standard scenarios in which the following scenarios are simulated:

– **Market-wide liquidity disruption:**

A significant shortage of cash on financial markets in the main trading currencies; central banks are in operation and help on the market.

– **NORD/LB credit event:**

Downgrading the credit rating of NORD/LB with significant effects on liquidity.

– **Market-wide liquidity crisis:**

International financial crisis triggered by individual banks, bank groups, branches or materially significant asset classes, that causes a liquidity crisis in the financial market.

The **dynamic LST scenario** reflects the crisis situation that is most likely in the current environment. The dynamic scenario can be equivalent to a static scenario but in most cases will represent a combination of different static scenarios.

In each of these scenarios the possible changes in lending, deposit and off-balance transactions (in particular credit approvals) are analysed in respect of the liquidity situation of the Bank. The dynamic scenario is reported on a daily basis. The static scenarios are calculated and reported on a monthly basis.

### **Credit risks/Borrower's default risks**

Assessing credit risks in the Bank is carried out in close cooperation with NORD/LB GZ and in accordance with the principles of the parent company. On

examining the borrower's default risk the Bank mainly concentrates on the financial situation of a borrower, taking into account any possible branch-related risks or cluster risks and including requested collateral. On granting credits to business associates with their registered office in countries which are not members of the Euro monetary union, national risk is appraised in addition to the credit rating.

An internal rating classification system in conformity with Basel II requirements is used to regulate borrowers' default risks. The modules employed for stipulating the rating level are split into scorecard and simulation-based processes, which take into account the features of individual borrowers and types of financing.

Within the framework of the credit monitoring process, the individual credit exposures undergo regular monitoring, depending on their volume, creditworthiness and available collateral.

The collateral of each borrower is evaluated and verified at regular intervals, separately from the rating classification. There is also an organisation unit at NORD/LB GZ for the purpose of evaluating real estate. This unit operates independently of the credit divisions.

Customers of savings banks included in the savings bank network at NORD/LB GZ are only granted credits with the guarantee of the agency savings bank.

Credits in the Lombard credit segment are secured with available assets whose current value is measured on the inclusion of a conservative loan reduction. Credits are all monitored individually on a daily basis by the private Banking OU and they are also monitored by the respective credit division every two weeks.

The credit risk controlling division of the Bank monitors the portfolio regularly in order to ensure that the risks remain within acceptable limits. The aim is to identify and record risks in good time in order to be able to initiate counter-measures at an early stage.

On assessing risks, a portfolio is examined in accordance with various aspects such as an assessment of the borrower in terms of credit rating, loan periods and branch and national risks. The results are recorded in the credit risk report of the Bank. In addition a watch list of critical exposures is drawn up and, together with the credit risk report these critical exposures are then dealt with in the quarterly meeting of the credit risk committee.

The credit risks of SKANDIFINANZ BANK AG and NORD/LB COVERED FINANCE BANK S.A. are integrated in the credit risk report of the Bank.

In connection with the introduction of a new Group-wide model for determining the risk-bearing capacity of the Bank, a completely new credit risk model is being implemented by NORD/LB GZ. This model is based on the Gordy model (Basel II). This is to ensure that capital allocation adequately indicates the economic risk situation while at the same time remaining compliant with the regulatory approach. Since 2006 the requirements have been met to enable essential data to be made available

in the data pool intended for this purpose, hence ensuring the uniform, consistent measuring of credit risks for the entire Group. On an individual institute level the new model will in future facilitate a more precise, more risk-adequate control of credit risks.

#### **Borrower's default risk in the case of trade activities**

The Bank deals with other credit risks relating to trade activities with a comprehensive system of limits and controls. For this purpose the Bank has issued limits and has stipulated working guidelines for the Trade division. These limits determine the type and the scope of activities with respective products and with different borrowers. Transactions may at all times only be conducted within the approved limits. The term for money market and currency transactions is also limited. All of the borrower's default risks relating to counterparties and to issuers of the Bank are incorporated in the NORD/LB GZ limit process.

When collateral agreements are concluded, the securing of risk potentials (positive net replacement values) are agreed on in addition to basic agreements within the framework of collateral management.

The development of new ideas for overall bank management and changes in banking supervision mean that improving the methods and procedures in lending business has become a dynamic process. The systems currently in use at the Bank are constantly being tested and are subject to consistent adjustment in order to adequately account for risks.

The Bank has taken into consideration all of the known risks by establishing provisions for loan losses if necessary. There are no significant concentrations of risk.

#### **Operational and other risks**

The Bank understands operational risks to constitute the risk of losses incurred as a result of the inadequacy of internal procedures, employees and technology or their failure or of losses which occur as a result of external influences. The definition includes legal risks and – as consequent and secondary risks – reputation risks.

Operational risks are inherent in all business activities. As a rule these risks are not paid for by the market. If necessary they are reflected in the unit cost when prices are set. The objective is therefore to avoid operational risks. This means that the fundamental idea in the business calculation is to protect oneself from operational risks as far as possible without the cost of the protection exceeding the cost of risks that may occur.

Information on losses incurred as a result of operational risks has been collected since mid-2005. The losses are categorised on the basis of their causes and effects and entered into the IT application "Operational Risk Center" (ORC). Since 2006 the losses incurred have been included in anonymous form in the data consortium "DakOR" initiated by the Association of German Public Centre Banks (VÖB), through which a wider data basis is created and a requirement for the introduction of an advanced measurement approach (AMA) is met. The losses provided by the

consortium are used to finalise the internal VaR model for operational risks that is currently under development and to carry out scenario analysis.

Using the self-assessment method that is undertaken on an annual basis, future elements can be added to information on past losses. Expert assessments are used to provide detailed insights into the risk situation in specialist areas and to derive the measures to be taken where necessary. Results from the loss databank and self-assessment are analysed on a regular basis.

An explicit calculation and allocation of equity for operational risks is being carried out as a result of the implementation of Basel II. The standard approach is being used initially with regard to the equity provision for operational risk. With the methods and procedures that have been introduced to control operational risk, the Bank is already complying with the relevant requirements of Basel II. In the medium-term the Bank is working towards using an AMA, because of the associated positive effects, and is putting the required conditions in place for this.

On the basis of the data that are already available, an operational value-at-risk (OpVaR) was already calculated by 30.09.2007. OpVaR gives a risk measurement that shows which value of unexpected loss from operational risks is not exceeded within a given timescale (holding period) with a given probability.

Earnings risks represent unexpected fluctuations in results which may occur when expenses cannot be reduced to the same extent as declines in earnings. The Bank meets the earnings risk with a comprehensive system of financial indicators and with instruments for cost analysis, with the segmental report and with the annual earnings and expenses projections covering several accounting periods. The Controlling OU draws up segment reports and regular planned/actual comparisons etc. for the purpose of budget control in order to regulate short-term earnings risks.

A special Bank committee also deals with the issue of controlling and regulating operational risks, also in the context of overall Bank management.

Insofar as concrete indications are present, any risks arising will be included in the annual financial statements.

# Independent Auditor's report

To the Board of Directors of  
Norddeutsche Landesbank Luxembourg S.A., Luxembourg

## **Report on the annual accounts**

Following our appointment by the Board of Directors we have audited the accompanying annual accounts of Norddeutsche Landesbank Luxembourg S.A., Luxembourg, which comprise the balance sheet as at December 31, 2007 and the profit and loss account for the year then ended, and a summary of significant accounting policies and other explanatory notes.

## **Board of Directors' responsibility for the annual accounts**

The Board of Directors is responsible for the preparation and fair presentation of these annual accounts in accordance with Luxembourg legal and regulatory requirements relating to the preparation of the annual accounts. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of annual accounts that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

## **Auditor's responsibility**

Our responsibility is to express an opinion on these annual accounts based on our audit. We conducted our audit in accordance with International Standards on Auditing as adopted by the "Institut des Réviseurs d'Entreprises". Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the annual accounts are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the annual accounts. The procedures selected depend on the Auditor's judgment, including the assessment of the risks of material misstatement of the annual accounts, whether due to fraud or error. In making those risk assessments, the Auditor considers internal control relevant to the entity's preparation and fair presentation of the annual accounts in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Board of Directors, as well as evaluating the overall presentation of the annual accounts. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### **Opinion**

In our opinion, these annual accounts give a true and fair view of the financial position of Norddeutsche Landesbank Luxembourg S.A., Luxembourg, as of December 31, 2007 and of the results of its operations for the year then ended in accordance with Luxembourg legal and regulatory requirements relating to the preparation of the annual accounts.

### **Report on other legal and regulatory requirements**

The management report, which is the responsibility of the Board of Directors, is in accordance with the annual accounts.

Luxembourg, February 11, 2008

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