

Geschäftsbericht
Annual Report
2006

Norddeutsche Landesbank Luxembourg S.A.

Mitglieder des Verwaltungsrates

Members of the Board of Directors

Dr. Hannes Rehm, Vorsitzender / Chairman
Vorsitzender des Vorstandes / Chairman of the Board of Directors
Norddeutsche Landesbank Girozentrale

Dr. Gunter Dunkel
Mitglied des Vorstandes / Member of the Board of Directors
Norddeutsche Landesbank Girozentrale

Hans Hartmann
Administrateur-Délégué / Managing Director/CEO
Norddeutsche Landesbank Luxembourg S.A.
(ab 01.02.2006)

Walter Kleine
Vorsitzender des Vorstandes / Chairman of the Board of Directors
Sparkasse Hannover

Jürgen Kösters
Mitglied des Vorstandes / Member of the Board of Directors
Norddeutsche Landesbank Girozentrale

Jochen Petermann
Administrateur-Délégué / Managing Director/CEO
Norddeutsche Landesbank Luxembourg S.A.
(bis 15.03.2006)

Dr. Hans Vieregge
Mitglied des Vorstandes / Member of the Board of Directors
Norddeutsche Landesbank Girozentrale
(bis 31.12.2006)

Dirk Vormberge
Administrateur-Directeur / Managing Director
Norddeutsche Landesbank Luxembourg S.A.

Administrateur-Délégué Hans Hartmann (ab 01.02.2006)	Management
Administrateur-Délégué Jochen Petermann (bis 15.03.2006)	
Administrateur-Directeur Dirk Vormberge	
Directeur Christian Veit (ab 01.08.2006)	
Financial Markets Thorsten Schmidt	Organization chart
Private Banking Jürgen Kühn	
Loans Franz-Josef Glauben	
Settlements Karsten Lehn	
Accounting Silvia Peters (ab 01.12.2006)	
Controlling Roman Lux	
Information Technology Romain Wantz	
Organization & Project Management Oliver Scharr	
Security & Administration Jos Jemmeng (ab 01.01.2007)	
Human Ressources Christian Ehrismann	
Internal Audit Michael Erbelding	
Legal & Compliance Dr. Ursula Hohenadel	

Annual Report

International economic development

Strong global growth

2006 saw renewed strong growth in the world economy. Global economic growth rose by around 5% and hence exceeded 4% for the fourth year in succession. Due to the world-wide dynamic growth, the oil price rose in the period up to August, up to a new record high of just over 79 US dollars per barrel for North Sea Brent oil. By year-end however, the price had dropped again to around 60 US dollars. As in the previous year, a strong rise in energy prices in the period up to summer hardly affected the global economy due to a considerable rise in exports from the industrial countries to Asia and to the oil-producing countries.

Economic development in the USA

The American economy performed well again in 2006, with GDP growth at 3.3%. In the latter half of the year, however, growth slowed down somewhat. This was mainly due to slowdowns in the processing sector and the real-estate market. Private consumption remained relatively unaffected by a considerable slowdown on the housing market, and the spending rate of private households in real terms rose by 3% in 2006. The price development was strongly affected by oil prices, with inflation falling to just over 2% at the end of the year after peak levels exceeding 4% at mid-year.

A weakening economy was responsible for the unchanged monetary policy of the Fed Reserve in the latter half of 2006, after the bank had raised the funds rate to 5.25% in June. Since the bond market expected the Fed to implement measures to lower interest rates in 2007, yields on more long-term investments dropped markedly. After peaking at 5.25% for 10-year treasury bonds in June, yields had dropped to 4.7% at year-end. This led to an inverse interest-rate structure curve on financial markets in America.

... In Asia

Economic recovery was sustained in Japan, with significant impulses being generated by net exports. Wage increases, however, remained extremely weak so that, despite an improved employment market situation, growth in private consumption was restrained. Economic growth was in general hence only at around 2%. Price trends continued to return to normal and for the first time since 1998 prices rose at an average annual rate. This development prompted the Japanese central bank to end its zero interest-rate policy and to cautiously raise the basic lending rate to 0.25% in July. Capital market yields rose to 2% in the period to mid-year; however, by December they had dropped again to around 1.6%. The Japanese yen continued to weaken against the US dollar.

Economic growth in China, at around 10%, was once again the highest in the world. Consumption is still lagging behind economic development and the current account surplus was thus once again increased, particularly in terms of the USA. An extremely dynamic increase in investments and the resulting risk of the economy becoming overheated prompted the government to introduce measures to curb the rapid economic development. In 2006 the Chinese government hardly took any notice of the upward exchange rate pressure on the yuan, which was only permitted to strengthen by a few percentage points against the US dollar.

The other economies in Asia also benefited from the dynamic growth in China. Economic momentum therefore remained extremely robust there, but it did ease somewhat during the course of the year.

Europe saw strong economic growth in 2006, with the gross domestic product in the Eurozone rising by around 2.7%. The German economy was able to overcome a long period of economic weakness as a result. Unlike in previous years, domestic demand generated considerable impulses. This was facilitated by considerable rises in investments in machinery and equipment as well as strong growth in investment in the construction sector, which increased for the first time since 1999. Private consumption was boosted again after four weak years. The gross domestic product in Germany grew in real terms by around 2.5%. Economic growth in France and Italy was somewhat weaker, and was exceeded by growth in Spain and the Netherlands. Luxembourg recorded the highest growth rate in the Eurozone, at around 6%.

After declining slightly in the previous year, the British economy generated strong growth again in 2006, with the gross domestic product growing by around 2.9%. The inflation rate, significant for the Bank of England, also increased markedly; the annual average was 2.3% and at the end of the year a relatively high rate of 2.7% was reported. Since the target inflation rate of the British central bank is 2%, the Bank of England raised the base rate by 50 basis points in two steps, to 5%.

2006 saw a clear levelling off of the interest rate curve. One reason for this was the interest-rate policy of the European Central Bank, which had raised the tender rate to 3.5% by December. Since the economic upswing gained in momentum, the Central Bank decided to return to a neutral course of action. At the same time capital market yields remained on a relatively low level in 2006. Accompanied by considerable fluctuations, yields only rose from 3.3% at the beginning of the year to just over 4% at year-end, despite a more cautious monetary policy and a strong economic upswing. The American bond market continued to have a considerable influence and the spread was reduced to around 70 basic points.

In 2006 the financial markets focused on shares. A weak phase during the first six months was overcome long-term, so that at the end of the year high to very high growth rates were reported on the most significant markets. The most important reasons for this development were good business figures, the fact that there was no risk of inflation and positive developments in earnings. The DAX grew strongest, by 22%, followed by the Dow Jones, at 16.3% and the Eurostoxx 50 at 15.1%. The Japanese Nikkei on the other hand did not perform quite as well, with growth at 6.9%, not least as a result of slower economic growth.

The EU currency was able to reinforce and hold its position against the US dollar during the course of 2006. The exchange rate rose from 1.18 USD/EUR at the beginning of the year to 1.32 USD/EUR at the end of the year. The euro hence strengthened by just under 12%. The main reasons for this development were varying expectations concerning monetary policies in the USA and in Euroland. Whereas the cycle of rising interest rates was brought to a halt in June 2006 in the USA and expectations concerning falling interest rates in 2007 gradually gained in significance, the ECB will be raising its base rates again at the beginning of 2007. The euro also showed itself to be strengthening against the Japanese yen and the Swiss franc.

... In Europe

**ECB raises interest rates,
capital market yields
relatively low**

**Equity markets perform
extremely well**

**Euro strengthens its
position**

Management report

Business Development in 2006 and Outlook

Norddeutsche Landesbank Luxembourg S.A. is showing a profit of EUR 45 million (previous year: EUR 65.4 million) for 2006.

On 9 May 2006, within the scope of an investment in kind and in accordance with the governing law of the Grand Duchy of Luxembourg, the Bank founded a mortgage bond bank, NORD/LB COVERED FINANCE BANK S.A.

NORD/LB COVERED FINANCE BANK S.A. will be functioning as a competence centre of the NORD/LB Group for business transactions with public authorities and companies located in OECD and European Economic Area countries and will thus complement the activities of Norddeutsche Landesbank Girozentrale in this division in Germany.

NORD/LB COVERED FINANCE BANK S.A. is a full subsidiary and is included in the consolidated accounts of Norddeutsche Landesbank Girozentrale, Hanover through the sub-consolidated accounts of Norddeutsche Landesbank Luxembourg S.A.

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.

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

Ownership

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.

Business Divisions

Trading

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 risks on euro and US dollar markets and on other currencies with a high degree of market liquidity. The bank also undertakes minor currency risks.

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 2.4 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 securities portfolio mainly comprises securities issued by public issuers and by banks with an external rating of A-/A3 or higher.

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.

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.

Private Banking

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

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 50% of all of the loans taken up. There is a strong regional focus on Europe and on other OECD countries (approx. 90%).

Credits

On the balance sheet date the Bank shows a credit volume (comprising loan drawdowns, guarantees and open commitments) of EUR 13.2 billion (reduction of 6% in comparison to figures for the previous year). Loan drawdowns amount to EUR 9.2 billion and open commitments to EUR 3.3 billion.

The risk strategy of the Bank remains unchanged, with the focus being on a first-class credit rating for borrowers and for trading counterparties.

Schedule of Assets and Financial Data

The balance sheet total has been raised by EUR 0.3 billion (+ 1.3%) to EUR 23.1 billion.

Assets have changed mainly to the extent that loans to customers have been reduced by EUR 1.3 billion (-18.8%), that the volume of security portfolios has been raised by EUR 0.2 billion. (+3.3%) and the debt instruments of public authorities for refinancing at the Central Bank have increased by EUR 0.9 billion (+300%).

Items shown under liabilities in the balance sheet have also changed only marginally. Decreasing liabilities to banks, by EUR 0.1 billion (-1%), offset the same increase in liabilities to customers (+ 2.3%). Securitised liabilities, at EUR 6.2 billion, remain unchanged in comparison to those of the previous year.

Equity Capital

Within the scope of the appropriation of earnings for 2005, EUR 52.5 million was allocated to reserves and earnings of EUR 0.4 million were carried forward to the new accounting year. An existing subordinated loan amounting to EUR 70 million was recalled as at 30 June 2006.

Attributable equity capital in accordance with Luxembourg regulations amounted to EUR 857.4 on 31 December 2006. At the end of the year under report the solvency ratio was 11.46%, which means that it far exceeded the regulatory requirement of 8%. The core capital ratio was 10.19% on 31 December 2006.

Earnings

At the end of the year, the figure in respect of net interest income and net commission income was EUR 62.9 million (previous year: EUR 64.8 million), thus more or less at the level of the previous year.

Net income from financial and investment banking transactions amounted to EUR 11.9 million in the year under report, in comparison to EUR 34.8 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 stock of bonds held by the Bank was sold.

General administrative expenses of EUR 17.9 million, are approximately EUR 0.5 million below those of the previous year and comprise set-up costs and costs for the commencement of operations at NORD/LB COVERED FINANCE BANK S.A. as a special item.

Other Operating Results

The balance of other operating income and expenses amounted to EUR 7.6 million at the end of the year (previous year: EUR -0.1 million) as a result of the reversal of accruals.

Risk Loss Provisions

The Bank adequately took into account all of the discernible risks. In addition lump-sum provisions have been created to the extent permitted by tax legislation.

Operating Income

Operating income before risk loss provisions and taxes calculated on the basis of commercial criteria fell by around 4.1% to EUR 79.2 million in comparison to that of the previous year (EUR 82.6 million).

Risk Report

The Bank controls risks with the help of a framework comprising risk principles, organisational structures and processes closely aligned to the activities of the Bank divisions. The risk management system of the Bank is regularly improved in accordance with commercial and regulatory criteria and is based on standard concepts which apply throughout the NORD/LB Group. Individual risk categories such as

- market price risks (in particular the risk of changes in interest rates)
- liquidity risks
- credit risks (mainly shown as borrower's default risks and country risks)
- operational risks (including legal risks)

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.

Risk management at the Bank is geared towards the earnings-related exploitation of business potential within the scope of the risk-bearing capacity of the Bank. The new risk-bearing capacity model applied throughout the Group was used for measuring the risk-bearing capacity of the entire bank for the first time as at 31 December 2006. In this 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 losses which may result in the event of an (unforeseen) occurrence of risk. Quotients resulting from reserves for covering risk and risk potential ("level of risk covering") serve as a yardstick for the risk-bearing capacity of the bank.

The new 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 of the Bank which is held twice a year.

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 2006 financial year.

Luxembourg, 12 February 2007

The Board of Directors

Employees

Balance sheet as at December 31, 2006

Assets (Amounts shown in EUR)	31.12.2006	31.12.2005
Cash, balances with central banks and post office banks	6,070,698.27	65,299,455.56
Treasury bills and other bills eligible for refinancing with the central bank	1,162,190,500.00	276,085,000.00
a) Treasury bills and similar securities	1,162,190,500.00	276,085,000.00
b) Other bills eligible for refinancing with the central bank	0.00	0.00
Loans and advances to credit institutions	8,740,447,970.03	8,852,263,731.58
a) Repayable on demand	277,616,169.25	165,626,183.79
b) Other loans and advances	8,462,831,800.78	8,686,637,547.79
Loans and advances to customers	5,585,869,098.49	6,901,698,075.40
Bonds and other fixed-income transferable securities	6,234,629,881.37	5,976,879,158.80
a) Issued by public bodies	57,169,487.83	530,353,068.72
b) Issued by other borrowers	6,177,460,393.54	5,446,526,090.08
Shares in affiliated undertakings	73,194,141.56	21,474,259.01
Of which: undertakings accounted for under the equity method	0.00	0.00
Intangible assets	1,162,418.14	696,598.13
Tangible assets	9,504,859.46	9,961,506.31
Other assets	2,286,579.94	916,500.39
Prepayments and accrued income	1,251,053,639.82	672,933,913.59
Total Assets	23,066,409,787.08	22,778,208,198.77

Liabilities (Amounts shown in EUR)	31.12.2006	31.12.2005
Amounts owed to credit institutions	10,506,877,417.67	10,627,516,974.21
a) Repayable on demand	458,505,980.05	49,642,409.86
b) With agreed maturity dates or periods of notice	10,048,371,437.62	10,577,874,564.35
Amounts owed to customers	4,542,656,967.52	4,381,484,137.50
a) Savings deposits	0.00	0.00
b) Other debts	4,542,656,967.52	4,381,484,137.50
ba) Repayable on demand	637,868,716.88	60,136,122.96
bb) With agreed maturity dates or periods of notice	3,904,788,250.64	4,321,348,014.54
Debts evidenced by certificates	6,258,127,263.65	6,242,192,772.18
a) Debt securities in issue	2,367,224,262.76	2,453,472,951.21
b) Other	3,890,903,000.89	3,788,719,820.97
Other liabilities	17,644,507.79	18,827,709.40
Accruals and deferred income	785,848,866.02	504,433,486.03
Provisions for liabilities and charges	51,703,598.57	51,655,491.84
a) Provisions for pensions and similar obligations	0.00	0.00
b) Provisions for taxation	15,805,172.52	20,755,360.84
c) Other provisions	35,898,426.05	30,900,131.00
Subordinated liabilities	247,171,056.62	328,217,518.37
Fund for general banking risks	30,000,000.00	30,000,000.00
Subscribed capital	205,000,000.00	205,000,000.00
Reserves	376,000,000.00	323,500,000.00
Profit brought forward	380,109.24	0.00
Profit for the financial year	45,000,000.00	65,380,109.24
a) Profit for the financial year	45,000,000.00	65,380,109.24
b) Prepaid dividends	0.00	0.00
Total Liabilities	23,066,409,787.08	22,778,208,198.77

Off balance sheet items (Amounts shown in EUR)	31.12.2006	31.12.2005
Contingent liabilities	710,151,588.65	339,411,781.11
of which: – Acceptances and guaranties by endorsement	0.00	0.00
– Guarantees and assets pledged as collateral security	710,151,588.65	339,411,781.11
Commitments	3,346,204,284.60	3,183,342,345.89
Forward purchases of assets	54,124,989.98	0.00
Firm loan commitments	3,292,079,294.62	3,183,342,345.89
Fiduciary transactions	117,352,990.04	0.00

Profit and Loss account

for the fiscal year 2006

(Amounts shown in EUR)	2006	2005
Interest receivable and similar income	1,962,141,194.52	1,671,854,818.25
Of which: that are arising from fixed-income securities	266,925,535.11	217,653,237.50
Interest payable and similar charges	-1,914,415,027.21	-1,619,321,350.40
Income from securities	1,244,632.52	257,218.19
a) Income from shares and other variable-yield securities	0.00	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	1,244,632.52	257,218.19
Of which: affiliated undertakings	0.00	0.00
Commission receivable	19,069,613.05	16,165,121.84
Commission payable	-3,893,622.08	-3,873,564.07
Net profit or net loss on financial operations	11,883,115.37	34,838,405.35
Other operating income	9,536,740.85	3,840,024.28
General administrative expense	-17,910,826.82	-17,375,570.10
a) Staff costs	-10,581,213.98	-10,059,529.51
Of which: wages and salaries	-9,134,535.31	-8,520,271.42
social security costs	-1,216,912.03	-1,364,017.68
relating to pensions	-489,225.48	-646,323.01
b) Other administrative expenses	-7,329,612.84	-7,316,040.59
Value adjustments in respect of tangible and intangible assets	-1,198,460.54	-2,864,929.13
Other operating charges	-1,976,135.85	-3,959,189.42
Net income from the value readjustments in respect of adjustments, loans and advances and provisions for contingent liabilities and for commitments	85,301.66	9,602,631.64
Net loss from value adjustments in respect of securities held as financial fixed assets, participating interests and shares in affiliated undertakings	-7,332,670.66	-7,421,482.39
Tax on profit on ordinary activities	-12,217,120.00	-16,345,120.00
Profit on ordinary activities after tax	45,016,734.81	65,397,014.04
Other taxes not shown under the preceding items	-16,734.81	-16,904.80
Profit for the financial year	45,000,000.00	65,380,109.24

Appropriation of profit (Amounts shown in EUR)	2006	2005
Profit for the financial year	45,000,000.00	65,380,109.24
Profit carried forward	380,109.24	0.00
Total	45,380,109.24	65,380,109.24
Dividend payment	0.00	12,500,000.00
Transfer to legal reserves	0.00	0.00
Transfer to the other reserves	45,000,000.00	52,500,000.00
Profit carried forward	380,109.24	380,109.24

Notes to the Accounts 2006

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 trading 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 2006 and comprises 820,000 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. The accounting policy and valuation methods are determined by the Group. 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:

Currency conversion

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.

Spot exchange transactions and balance sheet items

Assets and liabilities in foreign currencies are converted into the balance sheet currency at the average rate of exchange (Reuters European Central Bank page “ECB37”) on the balance sheet date.

Futures transactions

Outstanding futures transactions in foreign currencies are valued at the forward exchange rate for the residual term on the balance sheet date.

Currency gains and losses

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 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 for the purpose of better operational transparency.

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 amortises 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.

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.

Premiums 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.

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.

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

Marketable securities

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 million (previous year EUR 19 million).

Loans

Loans 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.

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.

Overall lump-sum provisions

Overall lump-sum provisions are created to the extent permitted by tax legislation. The proportion of overall lump-sum provisions relating to balance-sheet assets is deducted from the asset side. A provision is established for the proportion relating to off-balance sheet items.

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

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

In 2007 securities amounting to EUR 2,608.6 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 6,110.7 million and EUR 1,291 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 2006, with a balance sheet total of CHF 651.7 million (previous year CHF 546.1 million), the profit for the year amounted to CHF 2,015 million (previous year CHF 449 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 2006 amounts to EUR 961.1 million. The assets and earnings situation for the accounting period ended was characterised by investments undertaken in setting up the Bank. The deficit of EUR -0.288 million is carried forward to the new accounting year.

(Amounts shown in Keur)

	Listed securities	Unlisted securities	Total
	Amounts	Amounts	Amounts
Debt instruments of public authorities	1,162,191	–	1,162,191
Debt securities and other fixed-interest securities	4,071,765	2,162,865	6,234,630
Shares and other variable-yield securities	–	–	–
Participating interests	–	–	–
Shares in affiliated companies	–	73,194	73,194
Total	5,233,956	2,236,059	7,470,015

Listed and unlisted securities

(Amounts shown in Keur)

	Carrying amount	Market value	Difference
Debt securities and other fixed-interest securities	186,149	182,707	-3,442

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 (assets swaps), i.e. the lower market values of the securities are compensated for by positive valuation results from the asset swaps.

FIXED ASSETS**Statement of fixed assets 2006**

(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
	01.01.2006				31.12.2006	31.12.2006		31.12.2006
Debt instruments of public authorities	175,955	913,916	–	–	1,089,871	4,544	–	1,085,327
Debt securities and other fixed-interest securities	5,314,131	3,602,903	3,873,080	-15,592	5,028,362	2,966	–	5,025,396
Participating interests	–	–	–	–	–	–	–	–
Shares in affiliated companies	21,474	51,720	–	–	73,194	–	–	73,194
Intangible assets	10,913	801	183	–	11,531	10,368	–	1,163
Land and buildings	14,193	–	–	–	14,193	5,857	–	8,336
Operating and office equipment	10,221	616	102	–	10,735	9,567	–	1,168
Total	5,546,887	4,569,956	3,873,365	-15,592	6,227,886	33,302	0	6,194,584

Land and buildings are used for operating purposes.

Since individual positions are rounded off to EUR thousand for commercial reasons, deviations totalling EUR 1,000 result when compared to the items land and buildings and operating and office equipment on the balance sheet.

Other assets

Other assets mainly comprise the following:

- Claims for dividends	SKANDIFINANZ/BANK AG	Keur	1,245
- Tax refunds		Keur	1,014
- Other items		Keur	28

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 other companies
	Amounts	Amounts	Amounts
Loans			
Loans to banks	1,972,343	-	-
Loans to customers	73,274	-	-
Debt securities and other fixed-income securities	326,020	-	-
Liabilities			
Liabilities to banks	4,094,847	-	-
Liabilities to customers	9,535	-	-
Subordinated liabilities	247,171	-	-

Assets and liabilities in foreign currencies

The current value of assets and liabilities in foreign currencies is EUR 9,515 million and EUR 11,761 million respectively.

Repurchase transactions

On the balance sheet date repurchase transactions in securities had been accounted for at respective costs of EUR 2,581.6 million (repurchase seller) and EUR 166.8 million (repurchase buyer).

Accumulated deferred premiums

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 2.4 million at the balance sheet date.

Other liabilities

- Liabilities from silent partnership holdings	Keur	14,396
- Preferential liabilities	Keur	3,067
- Liabilities - costs	Keur	93
- Redemption liabilities - checks	Keur	89

Subscribed capital

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

Profit for the financial year

Earnings for the accounting period amount to EUR 45 million and will be allocated to the free reserves subsequent to adoption of the annual financial statements.

Legal reserve

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.

Subordinated loans

The Bank reports subordinated borrowed funds amounting to EUR 247.2 million at the balance sheet date. These loans resulted in expenses to the amount of EUR 24.3 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 ¹⁾	15	5.54*	08.06.2016
Other loans	USD 65.0 ²⁾	15	5.81163*	31.12.2017
Silent participations	EUR 76.7	10	5.77**	11.06.2007
Silent participations	EUR 12.8	10	4.79**	30.06.2008
Silent participations	EUR 12.8	10	3.89**	02.03.2009
Silent participations	EUR 50.0	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 45.6 m. at the balance sheet date 2) Equivalent to EUR 49.4 m. at the balance sheet date

The Bank prematurely cancelled a subordinated loan amounting to EUR 70 m. in the 2006 accounting period.

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. Provisions have been created by the Bank to the extent permitted by tax legislation.

The Bank has pledged assets to the nominal amount of EUR 30 million as collateral for participation in the clearing system of Clearstream Banking Luxembourg S.A.

In addition a nominal EUR 3.5 million has been pledged as collateral at the parent company for margin services relating to commission business transactions in options.

Deposit guarantee and investor compensation scheme

Assets pledged as collateral

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

Contingent liabilities

Type	31.12.2006 Amount
Guaranteed credits	710,152
of which to affiliated companies	–
Guarantees for services provided by third parties	–

The following commitments are reported: (Amounts shown in Keur)

Loan commitments/ Credit risks

Type	31.12.2006 Amount
– Forward purchases of assets	54,125
– Forward sales of assets	–
– Firm loan commitments	3,292,079

Outstanding forward transactions and derivative financial instruments	Type (Nominal volume in EUR m.) as at 31.12.2006	Hedging	Trading	Total
	Exchange rate related transactions			
	– Forward exchange contracts (swaps, outright)	14,482	5,581	20,063
	– Interest rate currency swaps	754	–	754
	– Options	–	–	–
	– Other exchange rate related transactions	–	–	–
	Interest rate related transactions			
	– Interest rate swaps	15,765	30,267	46,032
	– Future or forward rate agreements	–	1,519	1,519
	– Interest rate futures	–	911	911
	– Options	–	–	–
	– Other interest rate related transactions	–	–	–
	Total	31,001	38,278	69,279

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.

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

Management and representation services

- 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
Other operating income	
Income from debtor warrants	2.0
Income from the release of tax provisions	5.0
Other income - accounting for services	0.9
Other income / Other income from the release of provisions	1.6
Total	9.5

	EUR m
Other operating expenses	
Interest expenses not relating to the period	0.4
Handling fees (accounting for group – internal cost allocations)	0.6
Deposit guarantee fund	0.5
Other expenses	0.5
Total	2.0

Classification of income according to geographical markets

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

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

Group	Number
Management	2.8
Senior staff	26.8
Employees	65.6
Contract staff	0
Total	98.2

Average number of employees

(Amounts shown in Keur)

	Remuneration, allowances	Pensions obligations	Credits
Extended management*	2,552*	285	99
Board of Directors	63	–	–
	2,615	285	99

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

* Refers to 10.9 persons on an annual average

(Amounts shown in Keur)

Annual statutory audit	305.0
Other audit services	22.0
Total	327.0

**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
Classes of instruments (financial assets)							
Cash, balances with central banks	6,071	-	-	-	-	6,071	65,299
Treasury bills	-	-	-	964,871	197,320	1,162,191	276,085
Loans and advances to credit institutions	277,616	1,569,845	3,575,023	2,898,909	419,055	8,740,448	8,852,264
Loans and advances to customers	4,763	601,974	234,984	1,342,290	3,401,858	5,585,869	6,901,698
Debt securities and other fixed-income securities	10,000	1,242,300	1,351,393	2,506,006	1,124,931	6,234,630	5,976,879
Shares and other variable-yield securities	-	-	-	-	-	-	-
Other assets	-	-	-	-	-	1,337,201	705,983
Total	298,450	3,414,119	5,161,400	7,712,076	5,143,164	23,066,410	22,778,208

Classes of instruments (financial liabilities)

Amounts owed to credit institutions	458,506	5,585,855	599,476	647,026	3,216,014	10,506,877	10,627,517
Amounts owed to customers	637,869	3,821,795	82,918	75	-	4,542,657	4,381,484
Debts evidenced by certificates	-	2,556,975	1,343,928	733,859	1,623,365	6,258,127	6,242,193
Other liabilities	-	-	-	-	-	1,758,749	1,527,014
Total	1,096,375	11,964,625	2,026,322	1,380,960	4,839,379	23,066,410	22,778,208

Common off-balance liabilities

Contingent liabilities arising out of guarantees and assets pledged as collateral security	-	407,579	452	171,324	130,797	710,152	339,412
Commitments arising out of forward purchases of assets	-	-	54,125	-	-	54,125	-
Firm loan commitment	-	110,926	597,833	2,062,131	521,189	3,292,079	3,183,342
Total	-	518,505	652,410	2,233,455	651,986	4,056,356	3,522,754

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

Weighting	Amount
0%	4.524.717
10%	759.997
20%	15.157.688
100%	2.624.008
	<u>23.066.410</u>

Primary trading instruments

	≤ 3 months		> 3 months ≤ 1 year		> 1 year ≤ 5 years		> 5 years		Total		Total last year	
	Book value	Market value	Book value	Market value	Book value	Market value	Book value	Market value	Book value	Market value	Book value	Market value
Classes of instruments (financial assets)												
Debt securities and other fixed-income securities	-	-	-	-	-	-	-	-	-	-	59,946	59,955
Total	-	-	-	-	-	-	-	-	-	-	59,946	59,955

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
	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Nominal amount
OTC transactions										
Classes of instruments (financial assets)										
Operations linked to Interest rates										
Interest rate swaps	2,230,140	15,939	3,167,169	28,490	776,613	12,641	235,393	8,823	6,409,315	15,230,272
Operations linked to currency exchange rate										
Forward currency transactions	6,159,391	144,387	2,389,536	109,347	0	0	0	0	8,548,927	4,460,407
Interest rate currency swaps	327,342	1,014	33,230	2,335	43,904	751	0	0	404,476	43,540
Subtotal	8,716,873	161,340	5,589,935	140,172	820,517	13,392	235,393	8,823	15,362,718	19,734,219
Classes of instruments (financial liabilities)										
Operations linked to Interest rates										
Interest rate swaps	2,401,767	17,865	3,314,410	29,029	2,526,856	88,160	1,112,317	64,567	9,355,350	16,495,474
Operations linked to currency exchange rate										
Forward currency transactions	5,501,299	76,674	431,429	10,345	0	0	0	0	5,932,728	3,965,501
Interest rate currency swaps	5,771	563	8,440	1,110	96,160	24,392	239,162	60,589	349,533	732,984
Subtotal	7,908,837	95,102	3,754,279	40,484	2,623,016	112,552	1,351,479	125,156	15,637,611	21,193,959
Total	16,625,710	256,442	9,344,214	180,656	3,443,533	125,944	1,586,872	133,979	31,000,329	40,928,178

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

	≤ 3 months		> 3 months ≤ 1 year		> 1 year ≤ 5 years		> 5 years		Total	Total last year
Stock market	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Nominal amount	Current replacement costs	Current replacement costs	Current replacement costs
Classes of instruments (financial liabilities)										
Operations linked to Interest rates										
Futures										
Options	-	-	-	-	-	-	-	-	-	-
Interest Futures	911,465	3,445	-	-	-	-	911,465	3,445	-	-
Subtotal	911,465	3,445	-	-	-	-	911,465	3,445	-	-
OTC transactions										
Classes of instruments (financial liabilities)										
Operations linked to Interest rates										
Interest rate swaps	49,999	2,229	5,964,009	35,330	9,369,221	243,505	190,044	4,626	15,573,273	5,532,184
Forward rate agreements	-	-	759,301	3,232	-	-	-	-	759,301	3,232
Operations linked to currency exchange rate	-	-	281,427	12,305	-	-	-	-	281,427	30,938
Forward currency transactions	-	-	281,427	12,305	-	-	-	-	281,427	694
Subtotal	49,999	2,229	7,004,737	50,867	9,369,221	243,505	190,044	4,626	16,614,001	5,563,122
Subtotal	49,999	2,229	7,004,737	50,867	9,369,221	243,505	190,044	4,626	16,614,001	39,231
OTC transactions										
Classes of instruments (financial assets)										
Operations linked to Interest rates										
Interest rate swaps	49,999	2,251	5,084,358	34,420	9,369,221	245,451	190,044	4,891	14,693,622	5,524,985
Forward rate agreements	-	-	759,301	1,871	-	-	-	-	759,301	1,871
Operations linked to currency exchange rate	-	-	-	-	-	-	-	-	-	-
Forward currency transactions	5,000,000	236,850	300,000	16,318	-	-	-	-	5,300,000	31,039
Subtotal	5,049,999	239,101	6,143,659	52,609	9,369,221	245,451	190,044	4,891	20,752,923	5,556,024
Subtotal	5,049,999	239,101	6,143,659	52,609	9,369,221	245,451	190,044	4,891	20,752,923	39,089
Total	6,011,463	241,330	13,148,396	103,476	18,738,442	488,956	380,088	9,517	38,278,389	11,119,146
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.										
Total	6,011,463	241,330	13,148,396	103,476	18,738,442	488,956	380,088	9,517	38,278,389	78,320

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

	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
(Amounts shown in Keur)								
Counterparty solvency (based on external valuations)								
OECD credit institutions	69,204,017	51,900,700	866,407	364,852	1,231,259	0	1,231,259	246,252
of which credit institutions from GB	35,047,830		430,804	154,487				
of which credit institutions from DE	12,446,607		75,366	80,014				
of which credit institutions from FR	6,968,190		93,882	26,473				
of which credit institutions from CH	3,811,065		45,491	38,048				
of which credit institutions from DK	3,239,781		44,231	13,913				
of which credit institutions from US	2,618,936		70,554	15,548				
from the rest of Europe	1,528,712		53,398	14,691				
of which credit institutions from CA	1,245,254		9,969	759				
of which credit institutions from BE	812,149		19,845	5,622				
of which credit institutions from SE	771,507		14,158	7,715				
of which credit institutions from LU	504,335		8,220	5,485				
from outside Europe	209,651		489	2,097				
Zone B Bank	0	0	0	0	0	0	0	0
Customers	74,701	146,623	2,817	594	3,411	0	3,411	1,706
of which private customers from NL	28,823		1,093	144				
of which private customers from DE	23,278		1,306	233				
of which private customers from LU	17,188		326	172				
of which private customers from MU	3,223		56	32				
of which private customers from US	1,867		34	9				
of which private customers from FR	266		0	3				
of which private customers from ZA	56		2	1				
Total	69,278,718		869,224	365,446	1,234,670	0	1,234,670	247,958

E. Supplements to the Risk Report

Definition and method

Market price risks in the Bank are potential negative changes in the value of items which may result from changes in market prices (primarily interest rates and exchanges rates) and from factors which may have an influence on prices (volatilities and correlations).

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:

Market price risks

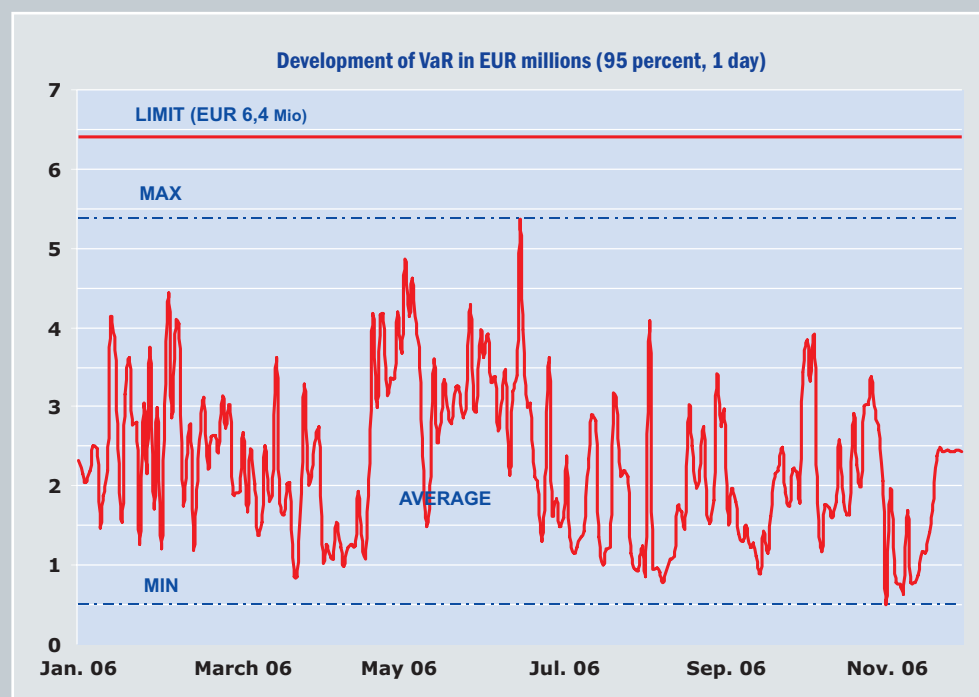
- A confidence level of 95%
- A holding period of one trading day
- An historical observation period of one year

The model implicitly takes into account correlation effects between risk factors, types of risk, currencies and sub-portfolios.

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 2006

The market price risk limit may not be exceeded without the prior agreement of the management and the Board of Directors of the Bank. The limit was not exceeded in the 2006 financial year. The average utilisation of the VaR risk limit (entire bank, no equity capital) of the Bank was 35.4% (previous year 62.5%); the maximum utilisation level was 83.8% while minimum utilisation was 7.9%.



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 31.12.2006 (in EUR m)	VaR (95%)	Stress test
NORD/LB Luxembourg S.A. entire bank	2.8	52.6
⇒ Bank book	1.8	38.4
⇒ Trading book	1.3	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.

Various methods are applied for the internal measurement and control of liquidity risks:

- Classical liquidity risk is measured in separate maturity bands which cover the entire maturity range. Liquidity cash flows are limited by volume-based structural limits in the respective maturity bands.

Liquidity risk

- 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 a monthly basis. Market and liquidity risk strategies were specified within the framework of the concept for overall bank management.

The control system is permanently 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.

When measuring internal liquidity risk, the utilisation of the cash value limit (including the cash equivalent liquidity risk of NORD/LB COVERED FINANCE BANK S.A. amounting to EUR 1.2 million) was at 10.6% at the end of 2006. 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 2006 it amounted to 45.8% (previous year: 46.6%).

Liquidity Contingency Funding Plan

The Bank has developed a liquidity contingency plan in order to ensure sufficient liquidity, also in the event of liquidity shortages on the market. This Liquidity Contingency Funding Plan is examined and updated once a year in consideration of findings and experience gained during the year ended.

In order to be able to assess the liquidity situation of the Bank in extreme market situations, five different scenarios for stress situations have been established at Group level within the framework of the liquidity contingency plan. Estimations of inflows and outflows of cash were made for each scenario on the assumption that the situation would remain unchanged on five working days. These scenarios take into account internal Bank problems and problems that are market-related. The scenarios have been classified as follows:

- **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.

- **Market-wide Operational Disruption:**

Problems with one or more payment systems.

- **NORD/LB Credit Event:**

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

– **Market-wide Credit Event:**

International financial crises, for example on the stock exchanges; the banks are not willing to grant credits to customers with a weak credit rating.

– **Single Name Disruption:**

A major bank was downgraded or is undergoing a crisis.

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 scenario calculations are drawn up on a monthly basis.

Letter of Comfort

As a full subsidiary included in the consolidated accounts of NORD/LB GZ, 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.

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.

In 2006 the current credit rating classification system for regulating borrower's default risks was fully replaced by an internal rating classification system to conform to Basel II requirements. 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.

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

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. The Bank is involved in the project and in 2006 it fulfilled requirements necessary 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.

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 and - in consequence - reputation risks. Strategic risks and business risks on the other hand have not been included.

Operational and other risks

Technical and organisational prerequisites for meeting requirements anticipated under Basel II / CAD III were drawn up within the framework of a project to achieve a standard approach. Losses incurred as a result of operational risks are reported to NORD/LB GZ, where they are entered in a loss databank for the entire Group.

In the accounting period, self-assessment was carried out for the first time in order to identify and measure operational risks. The results of this assessment are included in the risk bearing capacity statement which, in addition to operational risks, also shows credit, participating interest, market price and liquidity risks in proportion to the risk capital.

A number of plans and measures are focussed on recognising and controlling operational risks. These operational risks are hence reduced by a contingency manual, a disaster recovery centre, facility, OR and IT security officers, adequate insurance coverage and sets of regulations. Processing instructions incorporated in the organisation manual are regularly adapted to changes in basic conditions and processes.

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 projection 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. This committee for operational and other risks meets twice a year.

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

Report of the independent auditors

To the Board of Directors

Norddeutsche Landesbank Luxembourg S.A., Luxembourg

Report on the annual accounts

Following our appointment by the Board of Directors dated February 16, 2006 we have audited the accompanying annual accounts of Norddeutsche Landesbank Luxembourg S.A., Luxembourg, which comprise the balance sheet as at December 31, 2006, 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, 2006 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, 12 February 2007

PricewaterhouseCoopers S.à r.l.

Réviseurs d'Entreprises

Represented by:

Thomas Schiffler

