Report of the Board of Directors 2010

NORDIC INVESTMENT BANK

Report of the Board of Directors

In 2010, the international financial markets and the global economy showed signs of improvements. In addition, the economies in the Nordic-Baltic region started to recover. Towards the end of the year uncertainty in the financial markets increased again due to higher sovereign risk, particularly in Europe.

In June, NIB's Board of Governors decided to increase the Bank's capital base to EUR 6,142 million. A larger capital base adds to the Bank's lending capacity, which had become constrained after high disbursements in 2007–2009. Additional capital allows NIB to continue its lending operations at more or less the same pace as in the last few years. It is expected that the demand for long-term financing will remain high in the coming years. The decision of the Board of Governors to increase the Bank's capital base by EUR 2 billion entered into force as of 16 February 2011 after all member countries had completed their national procedures. The Board of Directors proposes resuming the payment of dividends in the future.

The demand persisted during the year and loans approved by the Board of Directors reached EUR 2,310 million whereas agreed loans reached EUR 1,763 million. At the same time, among the Bank's customers there was an improvement in the liquidity situation while investment activity remained low. This was reflected in disbursements, which were at EUR 1,274 million. The decrease was also attributable to high lending activity during the previous years, which had consumed the inventory of agreed loans as the Bank had to hold back on new approvals.

NIB's operational results for 2010 in terms of core earnings* amounted to EUR 217 million, up from EUR 192 million during the same period in 2009. Positive value adjustments on financial instruments accounted for EUR 27 million. Impairments to the loan book amounted to EUR 38 million in 2010. NIB's profit amounted to EUR 211 million.

Strategic focus

With the increased capital NIB is better equipped to assist the Nordic and Baltic countries in supporting competitiveness and protecting the environment. In the context of the decision, increasing attention was given to high mandate compliance and the need to focus the Bank's activities in order for the Bank to provide a high added value. In concrete terms, high mandate compliance is most likely when financing projects in the Bank's focus sectors: energy; environment; transport, logistics and communications; and innovation. Similarly, a more explicit strong mandate contribution will be required of new projects.

Several steps were taken during the year to increase NIB's ability to meet the requirements for high mandate compliance.

A business strategy for energy sector lending was established. The objective of the strategy is to ensure that energy projects financed by NIB provide high mandate fulfilment for the Bank while taking into account member country energy priorities and ensuring good risk quality. Within the energy sector, the emphasis will be on renewable energy forms, energy efficiency, increased integration and security of supply.

Within the environmental field, the Board of Directors decided to extend by EUR 1 billion the CLEERE lending facility, which supports actions to combat and adapt to climate change. All in all, EUR 1.6 billion out of EUR 2 billion framework was allocated by the end of 2010. The Baltic Sea Environment Financing Facility (BASE) has a framework of EUR 500 million, out of which EUR 138 million was allocated by the end of 2010. Five projects were approved and six tentatively approved under the Baltic Sea Trust Fund managed jointly by NIB and NEFCO.

As regards transport, logistics and communications, the work has proceeded in relation to setting up a secretariat for Northern Dimension Partnership on Transport and Logistics (NDPTL) to be hosted by NIB. The Agreement on the NDPTL secretariat was signed by all the eleven states involved and the Bank. The secretariat should start functioning in early 2011.

The Board of Directors decided in 2009 that NIB will further sharpen its geographical focus by intensifying its cooperation with a limited number of non-member countries which offer the highest potential in terms of project participant interest and mandate fulfilment. In line with this decision, more detailed country strategies were developed for NIB's operations in the neighbouring Baltic Sea region, including Poland, Russia and Ukraine, and in some of the major emerging economies, such as Brazil, China and India. A framework agreement (FA) was signed with Belarus which will enable NIB to finance environmental projects in that country.

The revised Host Country Agreement (HCA) was signed by the parties in October and the Finnish parliament approved it in December.

The Chairmanship of the Board rotates among the member countries every two years. Madis Üürike ended his two-year term on 1 June 2010, when Jesper Olesen took over the Chairmanship.

Key figures

(in EUR million)	2010	2009	2008
Net interest income	234	219	212
Profit/loss on financial operations	39	178	-387
Loan impairments	38	43	79
Core earnings*	217	192	189
Profit/loss	211	324	-281
Equity	2,262	2,050	1,730
Total assets	24,898	22,423	22,620
Solvency ratio (equity/total assets %)	9.1%	9.1%	7.6%

*Core earnings consist of the profit before adjustments to hedge accounting, realised and unrealised gains/losses of the trading portfolio, credit losses and reversals thereof.

Activities

Demand continued to persist for NIB loans in 2010, a fact reflected in the total amount of new loans approved by the Board (EUR 2,310 million). The Bank signed 39 loan agreements during the year for a total of EUR 1,763 million, compared to EUR 1,417 million during the same period in 2009.

The disbursement of loans decreased to EUR 1,274 million, compared to EUR 1,954 million during the same period in 2009. This was partly due to the improved liquidity situation in the economy in combination with low investment activity. NIB was also somewhat restrained in granting and signing of new loans during 2007–2009, as these were rapidly turned into disbursements and NIB had a capital constraint.

In line with the efforts to achieve high mandate compliance, two thirds of the Bank's lending was allocated into its focus sectors: energy; environment; transport, logistics and communications; and innovation.

In 2010, environment-related lending accounted for 28% of agreed loans. The Bank participated in a number of projects for new wind, hydropower and biomass plants. Energy efficiency projects, including energy conservation in buildings, were also targeted.

In the other parts of the energy sector, investments aimed at securing the generation and transmission capacity, as well as improving the distribution systems were prioritised by the Bank. Lending was directed to smart metering and electricity distribution investments. Energy investments accounted for 22% of the loans agreed during the year.

Transport, logistics and communication accounts for 12% of agreed loans.
Loans were allocated for sustainable rail transport, including commuter rail, as well as airport development.

The innovation sector accounted for 6% of agreed loans focusing on research and development.

Small projects were targeted through intermediary banks and regional IFIs (17% of agreed loans). Other sectors accounted for 15%.

In total, 73% of the lending was targeted inside the membership area.

NIB continued to closely monitor the Bank's loan portfolio in order to identify and mitigate possible problems among existing borrowers. A temporary work-out unit dealt with loans which were watch-listed or subject to work-out.

NIB fulfilled its funding plan for 2010 by borrowing total funding of EUR 4.1 billion and maintained its position as a leading Nordic benchmark issuer. During the year, the Bank undertook two USD benchmarks. In January, NIB issued a successful 3-year USD 1 billion benchmark, which was the tightest 3-year primary benchmark transaction of 2010 among the supranational institutions. In May, NIB issued a 5-year primary USD benchmark, which was upsized to USD 1.25 billion due to strong demand. In total, 65 transactions were carried out in 11 different currencies, with USD being the most important currency, representing nearly 60% of last year's new funding.

The funding costs turned out to be lower compared to last year and NIB's funding cost is considered to be very competitive. In the financial market, the price development of NIB's bonds followed the supranational institutions situated in Washington. During the first months of the year, NIB's bonds outperformed the bonds of both sovereign and supranational institutions which are located in or have exposure to Southern Europe. In the latter part of 2010, the financial markets normalised and NIB's bonds again traded in line with the European peer group.

During the year, the overall liquidity was at a record high level for a number of reasons: large payment obligations at the beginning of 2011, a large amount of received cash collateral from swap counterparties and a delay in loan disbursements. At the end of the year, operational net liquidity stood at EUR 4,213.2 million.

It is the Bank's target to ensure a sufficient level of liquidity to be able to continue disbursing new loans and fulfil all payment obligations for one year forward, without necessitating additional funding.

Lending

(In EUR million unless otherwise specified)	2010	2009	2008
Energy	**383**	**253**	**-**
Environment	**498**	**415**	**-**
Transport, logistics and communication	**216**	**327**	**-**
Innovation	**102**	**139**	**-**
Financial intermediaries	308	144	-
Others	257	140	-
Loans agreed, total	**1,763**	**1,417**	**2,707**
Member countries	1,284	1,201	2,027
Non-member countries	479	216	680
Number of loan agreements, total	**39**	**40**	**53**
Member countries	28	33	40
Non-member countries	11	7	13
Loans outstanding and guarantees	**13,780**	**13,775**	**13,079**
Member countries	11,019	10,901	10,160
Non-member countries	2,761	2,874	2,920
Repayments and prepayments	**1,807**	**1,343**	**1,467**

New method of collecting statistics for focus sectors was used for 2009-10. The statistics based on agreed loans includes loan programs which will be allocated to focus sectors only after the amounts have been disbursed. The focus sector share for disbursed loans was 78% in 2010.

Financial activities

(In EUR million)	2010	2009	2008
New debt issues	4,120	4,137	4,681
Debts evidenced by certificates at year-end	19,944	17,998	17,549
Number of borrowing transactions	65	71	59
Number of borrowing currencies	11	10	13

Financial results

NIB's net interest income amounted to EUR 234 million, which corresponds to an increase of EUR 15 million compared to 2009. The administrative expenses for the period amounted to EUR 31 million. NIB's underlying business for 2010 in terms of core earnings* continues its increase to EUR 217 million, compared to EUR 192 million for the corresponding period in 2009.

NIB's profit normalised to EUR 211 million, of which net profit on financial operations accounted for EUR 39 million. Valuation profits on financial instruments amounted to EUR 27 million compared with the extraordinarily high figure of the previous year (EUR 137 million). Impairments to the loan book amounted to EUR 38 million in 2010 (EUR 43 million in 2009).

The Bank's total assets at the end of the period was EUR 25 billion, up from EUR 22 billion at the end of 2009. The outstanding loan stock was EUR 14 billion.

Risk management

Overall, the quality of the Bank's portfolios remained high in 2010, despite the continued weakness of the economy and the problems encountered by some counterparties. The share of the weakest risk classes decreased slightly from year-end 2009. The credit quality of the treasury portfolio improved during the year. Portfolios were well-balanced in both their geographical and sectoral distribution, as well as in their degree of concentration regarding exposure to individual counterparties.

The Bank continued to emphasise follow-up measures on its customers and counterparties during 2010.

Outlook

NIB expects the economic recovery in the member countries to continue. Due to central bank operations, liquidity will be ample in the financial markets. However, the supply of long-term financing remains constrained partly due to expected new regulatory requirements. The volatility in the financial market, related to increased sovereign risks, is also likely to continue.

In these circumstances, NIB will direct its efforts to projects which have high mandate compliance. The Bank's focus sectors have large potential in this respect, but they are still suffering from low investment activity in the aftermath of the financial crisis. NIB also expects to continue to have good access to funding in the financial markets.

**Core earnings consist of the profit before adjustments to hedge accounting, realised and unrealised gains/losses of the trading portfolio, credit losses and reversals thereof.*

Proposal by the Board of Directors to the Board of Governors

The Board of Directors' proposal with regard to the financial results for the year 2010 takes into account the need to keep the Bank's ratio of equity to total assets at a secure level, which is a prerequisite for maintaining the Bank's high creditworthiness.

In accordance with section 11 of the Statutes of the Bank, the profit for 2010
of EUR 210,832,171.72 is to be allocated as follows:
- EUR 210,832,171.72 is transferred to the General Credit Risk Fund as a part of equity;
- no transfer is made to the Special Credit Risk Fund for Project Investment Loans;
- no transfer is made to the Statutory Reserve. The Statutory Reserve amounts to
EUR 683,045,630.31 or 16.5% of the Bank's authorised capital stock as of 31 December 2010 and 11.1% of the Bank's authorised capital stock after the capital increase which took effect on 16 February 2011; and
- no dividends be made available to the Bank's member countries.

Read more in the statement of comprehensive income, statement of financial position, changes in equity and cash flow statement, as well as in the notes to the financial statements.

Helsinki, 3 March 2011

Jesper Olesen

Rolandas Kriščiūnas

Madis Üürike

Kristina Sarjo

Þorsteinn Þorsteinsson

Edmunds Krastiņš

Heidi Heggenes

Erik Åsbrink

Johnny Åkerholm
President and CEO