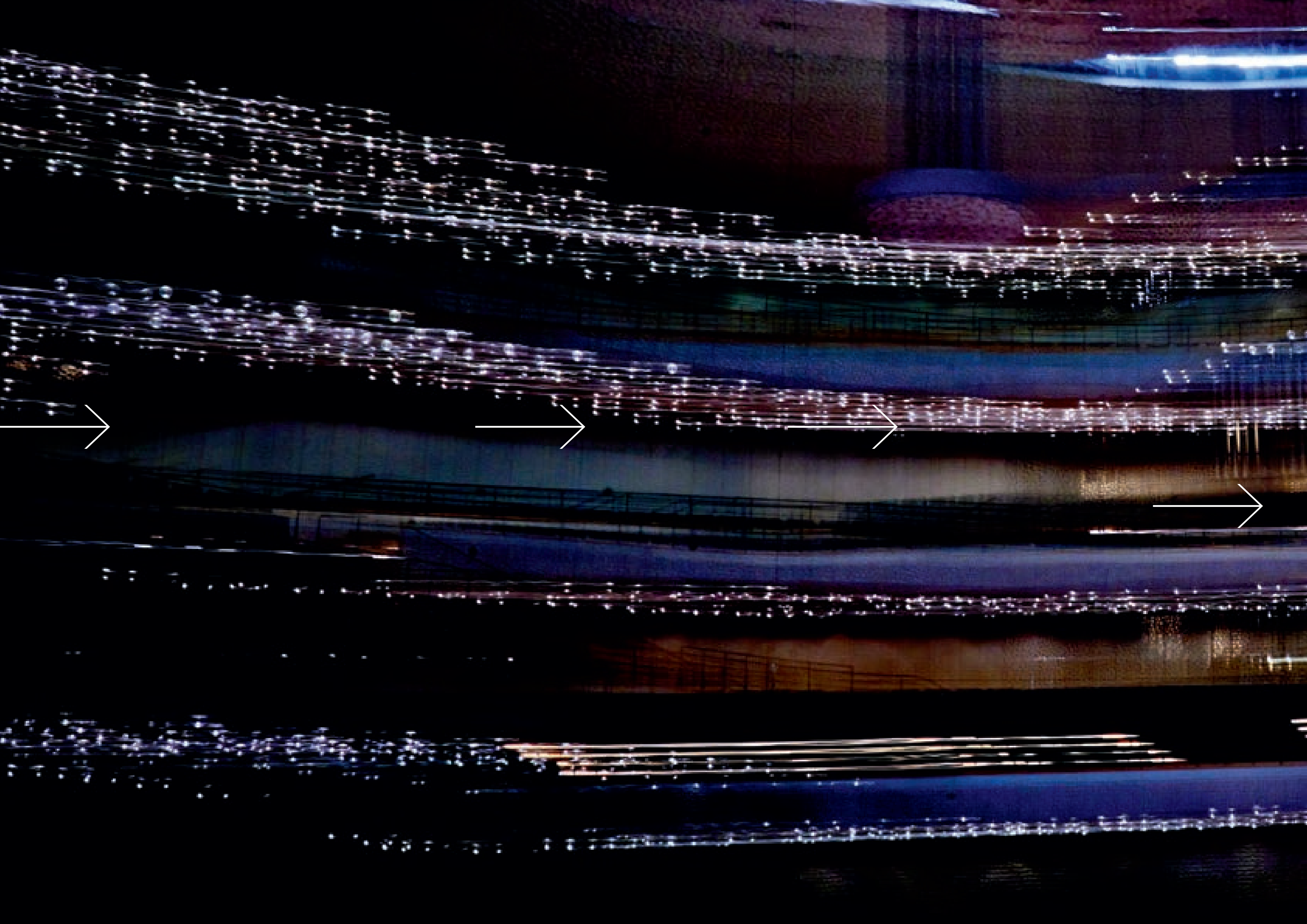
MOMENTUM!

HSH
NORDBANK



OPERATIONAL STRENGTH DEMONSTRATED,

INCOME STATEMENT
in (€ m)

	2017	2016
Net income before restructuring	-238	445
Net income before taxes	-453	121
Net income before taxes	-528	69

CAPITAL RATIOS & LEVERAGE RATIO
(%)

	31.12.2017	31.12.2016
CET1 ratio (phase in)	18,5	14,1
Pro forma-CET capital ration (without guarantee)	15,4	12,6
Capital ratio (in phase)	23,5	18,7
Leverage ratio	7,7	6,9

BALANCE SHEET
in (€ bn)

	31.12.2017	31.12.2016
Equity	4,4	5,0
Total assets	70,4	84,4
Business volume	78,6	93,2

EMPLOYEES
(computed on full-time equivalent basis)

	31.12.2017	31.12.2016
Total	1.926	2.164
Germany	1.838	2.068
Abroad	88	96

Client business strengthened, legacy assets reduced, structures further improved – in 2017, we took major steps to set the course for the future. And created the conditions for a successful privatisation: On **28 February 2018,** the federal state owners of Hamburg and Schleswig Holstein and the four US private equity investors Cerberus Capital Management, J.C.

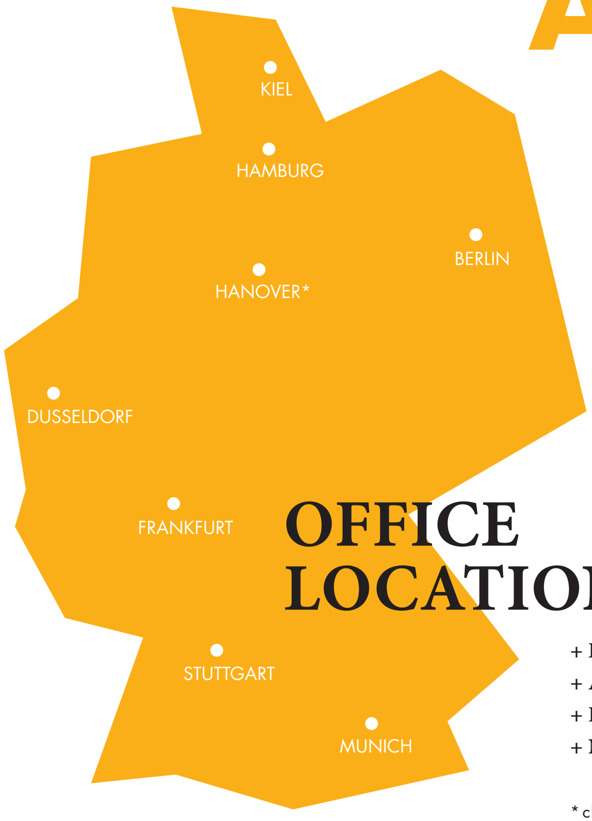
EFFICIENCY RAISED, LEGACY ASSETS REDUCED. BUYERS SECURED.

Flowers, GoldenTree Asset Management and Centaurus Capital as well as Austria's BAWAG-Bank agreed on the **sale of HSH Nordbank.** We have thus bought ourselves an entry ticket for the future. In previous years, we had already been in constant motion and continued to improve. But we know: to succeed as a private bank in the future we need to pick up further steam – and this is what we want to do.

Aside from the privatisation, we generated further significant successes in 2017: Our **new business came to a just over € 8.5 billion,** illustrating our good position on the hotly contested German banking market. We were able to sign business worth € 2.3 billion with new customers. This illustrates the appeal of our offerings. At the same time, we continued to massively reduce our legacy assets. **The path to new horizons has now been cleared.**

CONTENTS

WE'RE THERE FOR ENTREPRENEURS. AND THERE. AND TH



OFFICE LOCATIONS

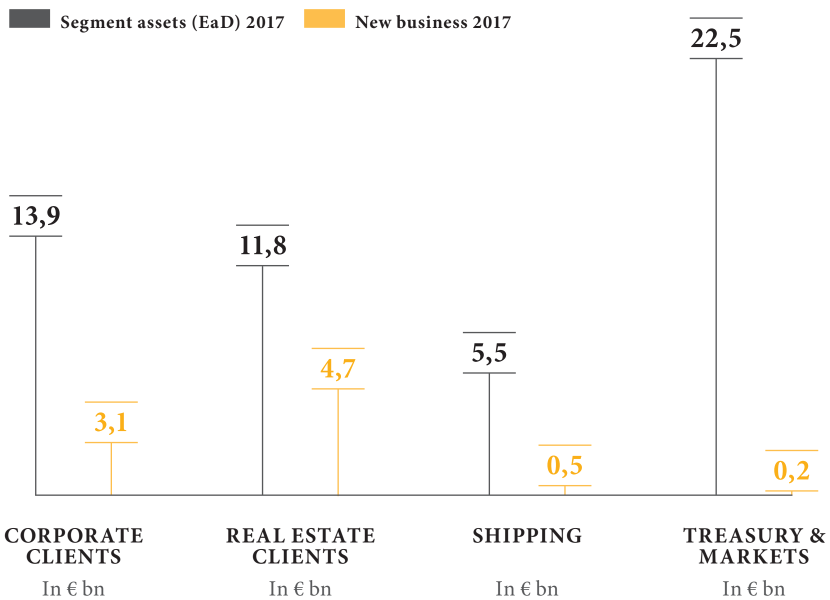
+ LUXEMBOURG
+ ATHENS
+ HONG KONG, SINGAPORE
+ NEW YORK*

* closed since the end of 2017

HSH Nordbank is the bank for entrepreneurs. We are where our clients need us. Of course, that is our home region of Northern Germany, but it extends far beyond: in the west, in the east, in the south and in the centre of the Federal Republic we have offices that ensure direct contact with our clients. At selected locations we also operate outside Germany. But no matter where we are: we not only offer tailored financing solutions for traditional SMEs but also command a leading role in commercial real estate financing in Germany. We are in the premier league when it comes to assisting renewable energy projects in Europe, and infrastructure projects also play an important role for us. And it goes without saying that we retain our links to shipping. But our focus is shifting increasingly to the maritime growth markets of Greece and Asia – where our colleagues are, of course, also on the ground.

ERE. AND OF COURSE THERE TOO.

HSH NORDBANK'S FOUNDATIONS.



A NEW ERA WITHOUT LEGACY ASSETS

FUTURE ASSURED

The hard and focused work particularly in our operating business has paid off – and has assured the Bank's prospects.

NEW CLIENTS CONVINCED

In this challenging market, 120 clients opted for HSH Nordbank for the first time. We signed about € 2.3 billion worth of new business with these clients alone – that illustrates the appeal of our offerings.

A NEW ERA USHERED IN

The Bank is at the beginning of a multi-year transformation. We do not shy away from change because this will be part of our everyday life in future.

LEGACY ASSETS SHARPLY REDUCED

We established the conditions for privatisation by having reduced our legacy assets by more than half. In the wake of the change of ownership, we shall dispose large part of non-performing loans from the past.

LADIES AND GENTLEMEN,

In 2017, we established the conditions for the successful privatisation of HSH Nordbank, thereby laying the foundations for a successful future. Over the past few years we have been busy with intensive preparations for the change in owners demanded by the European Commission in the wake of the state aid proceedings. We have now taken a very decisive step forward: On 28 February 2018, the federal states of Hamburg and Schleswig-Holstein, the four US private equity investors Cerberus Capital Management, J.C. Flowers, GoldenTree Asset Management and Centaurus Capital, and the Austrian bank BAWAG agreed on the sale of HSH Nordbank. We would like to express our thanks to the federal states of Hamburg and Schleswig-Holstein as they managed this complicated sale process with commitment, calm and circumspection.

However, the two federal state parliaments, the regulatory authorities and the European Commission must still give the change of ownership their final approval. The arrangements must also be put in place for a seamless transition from the

OUR REWARD FOR THE HARD W

deposit guarantee system of the Savings Banks Finance Group to that of the Federal Association of German Banks. As we are breaking new ground here, we have called upon experts on the guarantee systems and we are supporting them to the best of our ability.

We are now working on closing the deal, which is planned for the second or third quarter of 2018, when the change in owners is due to be completed. The first privatisation of a landesbank in Germany will then have been concluded – a historic event. It represents a huge opportunity for us, and the start of a great transformation over many years into a client-focused, efficient and lastingly successful bank.

The sale of HSH Nordbank has already impacted on the results for the 2017 financial year, which we therefore closed with a loss of € 528 million after taxes. The main reason for this was the sale of a portfolio of non-performing loans totalling € 6.3 billion to an entity of our new owners. As a result, we had to make unforeseen loan loss provisions of € 1.1 billion for 2017. Due to this portfolio transaction, which is a precondition for our successful privatisation, the Bank has hardly any non-performing exposures left on its books. Because we have been freed from these encumbrances of the past, the quality of our portfolio has improved to an outstanding level when compared with the European competition. Our prospects are thus very good.

In operational terms, we once again demonstrated our strength in day-to-day business with a 2017 pre-tax profit of € 732 million in the Core Bank. This figure, which also benefits from the realisation of reserves, is just under ten percent above the previous year's result. In terms of new business, we almost matched the good 2016 result with a figure of € 8.5 billion despite the burdens from the privatisation process – our sincerest thanks go to our clients for their loyalty.

Over the past year, we have lent approximately € 2.3 billion to around 120 new clients, which demonstrates the good quality of our offerings. Our common equity Tier 1 ratio without the guarantee is above 15 percent, which is a very solid value. At the same time, we have cut the volume in the Non-Core Bank by more than half, from € 21.4 billion to € 9.8 billion. Once the portfolio transaction comprising € 6.3 billion has been closed, all non-performing exposures from the Non-Core Bank will disappear. These results, which are genuinely satisfactory overall, are the outcome of a strong performance by all our colleagues, and we would like to express our thanks to them for this.

We are now forming the new bank, which will have its basis in our current areas of business. The disappearance of the EU restrictions opens fresh opportunities, and we will take advantage of them on a selective basis. For example, we will carefully extend our business with commercial real estate financing to some international markets. We will broaden our radius slightly more when it comes to financing infrastructure projects and renewable energies, in which we already have business outside Germany. There are also fresh opportunities in the capital markets business; we are strengthening our office in Singapore. And of course, we will continue to count on our proven sector-focused SME business in Germany, despite the fierce predatory competition. In particular, we will take care to provide even better assistance through services in the areas of domestic and international transactions, corporate finance and hedging products – thus improving our non-interest-related result. In short, there is sufficient potential and we will make use of it. At the same time, we are reducing the complexity of our internal processes visibly. In this way, we are becoming an agile bank that offers its clients precisely what suits them.

In 2017, we were on the move. We will keep up the momentum in 2018 – change is becoming our everyday fare. Thinking outside of the box is more desirable than ever, as is creativity. This is the only way for us to prevail in a market that is undergoing dynamic change.

YOURS SINCERELY

YOUR MANAGEMENT BOARD

f. l. t. r.: Torsten Temp (Management Board member for Markets), Stefan Ermisch (Chief Executive Officer), Oliver Gatzke (Chief Financial Officer), Ulrik Lackschewitz (Chief Risk Officer)

ORK: THE TICKET TO THE FUTURE.

Stefan Ermisch,
Chief Executive Officer

WE ARE DOING PIONEERING WORK WITH OUR PRIV

NOW IT'S A MATT

„A HUGE TRANSFORMATION PROCESS EXTENDING OVER SEVERAL YEARS LIES AHEAD OF US“

What is your assessment of the past year?

Stefan Ermisch: 2017 was another year of change, characterised by preparations for the privatisation. We worked hard towards this aim, and our colleagues did excellent work in the process. On 28 February 2018 we were ready: the federal states of Hamburg and Schleswig-Holstein and the four US private equity investors Cerberus Capital Management, J.C. Flowers, GoldenTree Asset Management and Centaurus Capital as well as Austria's BAWAG agreed on the sale of HSH Nordbank. This means the first successful privatisation of a landesbank in Germany – a historical event. And a huge opportunity for us. We stand at the outset of an exciting journey. However, the two federal state parliaments, the regulatory authorities as well as the European Commission must still give their final approval to the change of ownership. A seamless transition from the guarantee system of the Savings Banks Finance Group to the Federal Association of German Banks has also yet to be managed. As we are breaking new ground here, experts on the guarantee systems are called upon and we are, of course, supporting them to the best of our ability.

ATISATION.

ER OF BOLDLY TAKING ADVANTAGE

HSH Nordbank closed out the year with a loss of 528 million euros after taxes. Why is that?

Stefan Ermisch: The loss is primarily because we sold non-performing exposures (NPEs) from the Non-Core Bank totalling 6.3 billion euros to a vehicle from among the investors. We had to set aside unscheduled loan loss provisions for this. In return, the Bank will be freed from virtually all legacy assets that have been weighing us down massively for years. This liberation is a crucial step for a successful privatisation. The quality of our portfolio thereby improves in one go to a very good level by European standards – our NPE ratio falls below two percent.

How did the operating business perform last year?

Stefan Ermisch: Profit before tax in the Core Bank comes to 732 million euros, which is just under ten percent above the previous year's figure. We are also benefiting from the leveraging of hidden reserves, which helps us to bear the burden of the past. In new business, we almost reached the good pre-year level with a figure of 8.5 billion euros, and 2.3 billion euros alone were extended to around 120 new clients, something I find particularly gratifying. On top of this, at over 15 percent, our CET 1 capital ratio is very solid – also when compared with the competition. All told, we have achieved remarkable structural successes. The result is generally satisfactory.

To what extent has the privatisation affected new business?

Stefan Ermisch: There were more than a few who doubted that the Bank could be sold and who made their views known. This led to disquiet and did not make doing business any easier. Given these underlying conditions, our team put up a good show; new business really is respectable.

Is the Bank prepared for the switch to the private bank side?

Stefan Ermisch: One step at a time. In recent years, we have done everything to ensure that the privatisation is successful thanks to our good performance and an improvement in our structures. But this alone is certainly not enough, we cannot afford to relax and lean back. A huge transformation process extending over several years lies ahead of us. We are developing from a landesbank with state owners to a bank with private shareholders. The difference could hardly be more pronounced. For us, change will form part of our everyday life more than ever before.

NG ADVANTAGE OF OUR GOOD PROSPECTS:
SHARPENING OUR

Stefan Ermisch,
Chief Executive Officer

IMAGE, GAINING MORE CLIENTS –

What does this mean specifically?
Stefan Ermisch: In future, we will have to be much more efficient in our work, as illustrated in the following four goals. First, a modest return on equity of at least eight percent. Second, an adequate cost/income ratio of 40 percent when compared with other commercial banks. Third, a sustainable CET1 ratio of 15 percent as our yardstick of security. Fourth, an NPE ratio of less than two percent, which represents the quality of our portfolio.

Are these the challenging goals of the new owners?
Stefan Ermisch: They are by no means overstated. We must set them as a challenge for ourselves because we want to be competitive. Incidentally, the European Commission also has very clear ideas about the future profitability of our Bank, just as it does about the profitability of other financial institutions. It grants its approval to privatisation only if proof of a bank's viability has been provided – the above performance indicators play a key role here. The Commission wants a strong, commercially successful bank with a stable market presence. Which is exactly what the management team wants.

How will the Bank's business model change?
Stefan Ermisch: We will continue to be a commercial bank with loans as an anchor product but with a new name. Our current business areas constitute the structure of the new bank. At the same time, we will widen our horizons while maintaining a sense of proportion. We will be able to do this because after the transaction is closed, which is expected to take place in the second or third quarter, the restrictions from the EU state aid proceedings will no longer apply.

What might an expansion of activities look like?
Stefan Ermisch: Looking forward, we will be able to extend our real estate business cautiously to a number of international markets. We will strengthen our presence in Singapore, Asia's growth centre, and new opportunities are opening up in the capital markets business. We already have operations outside Germany when it comes to financing infrastructure projects and renewable energies, and here we intend to expand our radius slightly. Despite the predatory competition, we will carefully intensify our clearly sector-focused presence in the German SME segment, selling more services and thereby improving our non-interest-related income.

Will structural and personnel changes be necessary?
Stefan Ermisch: We are faced with the task of transforming a former public-sector bank whose total assets once came to around 200 billion euros into a private bank with target total assets of less than 60 billion euros. Years ago, we agreed a necessary capacity reduction to fewer than 1,600 full-time equivalent positions by mid-2019 with our social partners. With the success of the privatisation, all issues relating to the Non-Core Bank will no longer apply, as the latter will cease to exist. We will face the new tasks presented by the future.

What does this mean?
Stefan Ermisch: We are seeking to become an agile and excellent commercial bank of medium-sized nature. We will discuss the necessary personnel adjustments with our social partners at the appropriate time. Generally speaking, it is about further streamlining the back-office structures that are still too complex and that partly date from the old days, and about strengthening sales in a meaningful way. We will increase our speed, become more agile and work more independently of rigid hierarchies. What this also means is a change in our management structure. We need more creativity; more diversity. Our aim is to create a new bank that is successful with its private shareholders. I see great potential in the new bank.

CLIENTS – BEING SUCCESSFUL.

MILESTONES: THE PATH TO PRIVATISATION

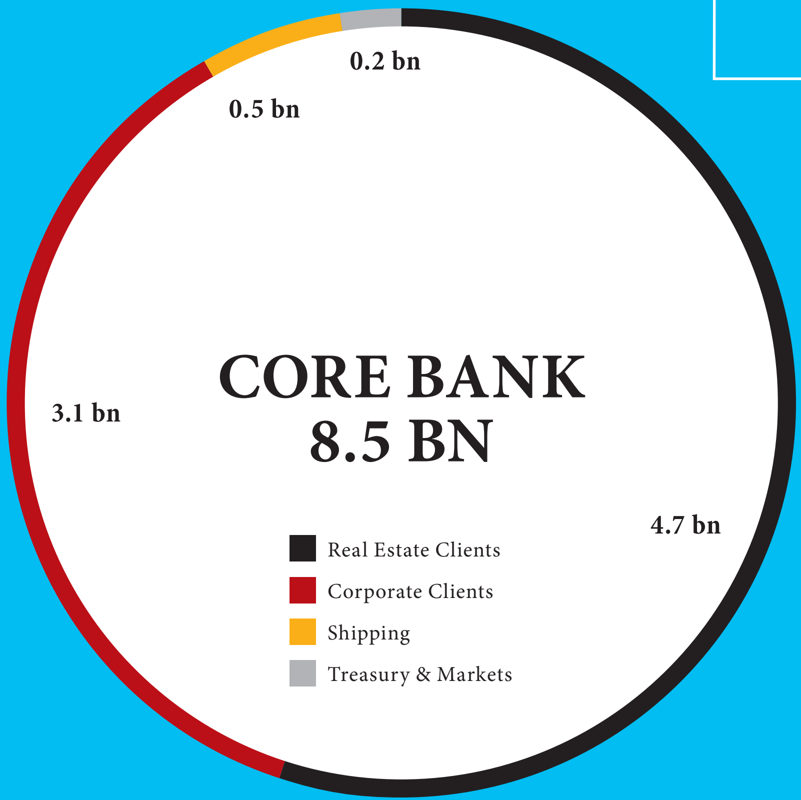
2008	2009	2011	2012
Insolvency Lehman Brothers	Federal state guarantee over EUR 10 billion	Reduction of the federal state guarantee to EUR 7 billion	Aggravation of the global shipping crisis
Worldwide financial and economic crisis	Start of the 1st EU state aid proceedings	Conclusion of the 1st EU state aid proceedings	
	Launch of comprehensive restructuring measures and realignment of the Bank		

Today

2013	2014	2015	2016	2017	2018	beyond 2018
Re-increase of the state guarantee to EUR 10 billion	ECB stress test passed	Agreement in principle with the EU in the 2nd state aid proceedings	Conclusion of the 2nd EU state aid proceedings	Official start of the selling process	Purchase agreement signed on 28 February	A sustainable and profitable, business model accepted by the EU
Start of the 2nd EU state aid proceedings		Decision to privatise HSH Nordbank by February 2018	Portfolio reallocation and clear separation of HSH into Core Bank and Non-Core Bank	Sale Market portfolio	Expected to close	New business opportunities
				Submission of binding bids. Subsequently: negotiations between owners and bidders	Change of owners completed and new name for the Bank	Disappearance of EU restrictions

NEW BUSINESS

in € bn, EaD



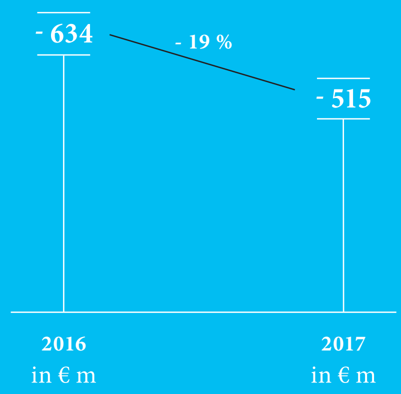
STRONG CLIENT BASE IN NEW BUSINESS

6.2 BN EURO
EXISTING CLIENTS

2.3 BN EURO
NEW CLIENTS

OUR PATH TO PRIVATIS

COSTS
UNDER CONTROL



ENERGY & UTILITIES
• TOP 5 EUROPEAN FINANCIERS
• 1.1 BN NEW BUSINESS EURO*

*EaD

REAL ESTATE CLIENTS
LOAN PORTFOLIO: 11.8 BN EURO*

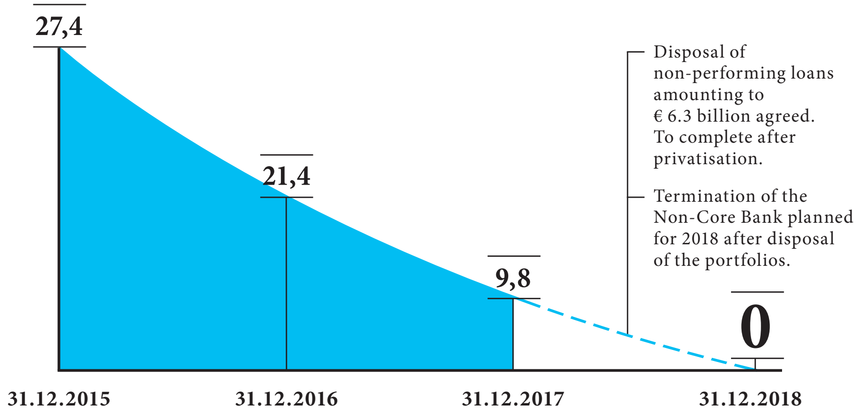
*EaD

ATION: BECOMING LEANER, MORE EFFECTIVE AND STRONGER.

C

REDUCING THE PORFOLIO OF THE NON-CORE BANK

in € bn, EaD



CLEAR PRINCIPLES, HIGH PACE, TOUGH CUTBACKS: WE MORE
THE AMOUNT OF OUR NON-PERF

"EXTREMELY RAPID WIND-DOWN OF LEGACY ASSETS SUCCESSFUL"

Non-performing loans – many of them from shipping – have been a burden on the Bank for many years. How did the wind-down progress in 2017?
Ulrik Lackschewitz: Very well! Within the space of twelve months we have cut the volume of non-performing exposures (NPEs) within the Bank in half: from 14.6 billion euros at the end of 2016 to 7.5 billion euros at end 2017. We have thus been able to scale down our legacy assets very quickly. This reduction has made a crucial contribution to our successful privatisation. The volume of the entire Non-Core bank – which in addition to non-performing exposures has always included non-strategic portfolios – has been reduced by more than half within the space of a year: from 21.4 billion euros to 9.8 billion euros.

Why was the wind-down so fast?
Ulrik Lackschewitz: There are several reasons for this. The rather positive shipping market – many non-performing exposures are in shipping – together with a slightly weaker US dollar, but also our own restructuring successes in restoring exposures to health, so they no longer form part of the NPE portfolio. All these factors have a role to play. But almost as importantly: we have changed our approach.

What do you mean?
Ulrik Lackschewitz: We set ourselves even clearer principles during restructuring and recovery and were willing – to an even greater extent than previously – to accept tough cutbacks. At the same time, we were always guided by what is best for the Bank and the guarantors.

Can you be more specific?
Ulrik Lackschewitz: If we recover or restructure a non-performing exposure, it must be restored to health for good, because we do not simply want to shift the problem to sometime in the future. In 2017, there was a slight uptrend involving container ships and general cargo carriers. Because we do not know how long this trend will last, we took advantage of the window of opportunity to reduce our NPE portfolio as extensively as possible – we definitely did not want to miss the chance to exit our portfolio. But it is very important for me to stress: the rapid wind-down was only made possible by the fact that our entire organisation worked together extremely well. This was an outstanding team effort.

Ulrik Lackschewitz, Chief Risk Officer

THAN HALVED
ORMING LOANS WITHIN THE SPACE OF TWELVE MONTHS.

NTHS. FREED FROM LEGACY ASSET

What impact does the privatisation have on legacy assets?
Ulrik Lackschewitz: In the course of the change in ownership, we disposed of almost all non-performing exposures from the Non-Core Bank, mostly ship finance, with a volume of 6.3 billion euros to a special-purpose entity set up by the investors. This portfolio transaction is, however, subject to the condition precedent of the privatisation being successfully completed, which will happen once the transaction closes. This is expected to be the case in the second or third quarter. To enable the sale of the 6.3 billion euro portfolio and thus enable the important release from the legacy assets, we had to make additional, non-recurring write-downs totalling 1.1 billion euros. We had already set aside very extensive loan loss provisions of 2.8 billion euros for the portfolio.

So why is the additional write-down so large?
Ulrik Lackschewitz: It corresponds to the difference between the net carrying amount and the purchase price. The portfolio includes highly problematic assets – they are simply of poor quality.

But doesn't the purchase price correspond to the value used by the bank to measure portfolios?
Ulrik Lackschewitz: Unfortunately, it is not quite as simple as that. In some cases it is very difficult to establish the value of such a large portfolio on the tight shipping market. We must not forget one thing: although the shipping markets have recovered from their historic lows, they remain at a very low level.

The federal states' guarantee has been fully utilised in balance-sheet terms. What does this write-down mean for the Group net result?
Ulrik Lackschewitz: We are showing this loan loss provision in our income statement, which was the main reason for our loss of -528 million euros after taxes in 2017. This was a tough but necessary caesura. The portfolio sale means that the Bank has divested almost all its legacy assets. The NPE ratio of the Bank as a whole – which is the only one we will be referring to in the future – will thereafter fall to less than two percent. This is a good figure compared with the competition. Freed from our legacy assets, our prospects are good.

TS, OUR PROSPECTS ARE GOOD.

Ulrik Lackschewitz,
Chief Risk Officer

OUR PROJECTS CONSIST OF CEMENT, GLASS, VISION, MARKET KN

Strong for entrepreneurs
REAL ESTATE CLIENTS

UNDERSTAND It takes expertise and experience to correctly assess the potential of a location or a property.

RECOGNISE As one of the leading banks specialising in real estate, we set up tailored finance in close collaboration with you: from the project idea through to disbursement.

SHAPE Rely on one of the top names: together we will lay foundations you can.

WOOD,
OW LEDGE AND GOOD FIGURES.

HSH Nordbank is among the major finance providers in Germany. Our business partners appreciate our expertise and decades of experience in the real estate sector. We have a sympathetic ear for our clients; we understand their business plans and jointly work out dedicated solutions – from conventional mortgage loans through to complex, structured finance. Thanks to clean processes and short decision-making channels, investors, property developers and building contractors receive transaction security for their plans quickly and reliably – exactly what they need.

When it comes to new business, it is important to us to keep a keen eye on the risks. "In a maturing market, we will take another, closer look: We examined projects amounting to about € 22 billion and ultimately closed € 4.7 billion worth of that business," says Peter Axmann, Head of Real Estate Clients. We simultaneously make sure of a balanced mix in our loan portfolio, which is why it includes residential real estate, offices and retail properties in equal measure.

We are also broadly positioned in regional terms: in addition to our head offices in Hamburg and Kiel, we have branch offices and regional expertise in Berlin, Düsseldorf, Frankfurt, Stuttgart and Munich. Our established clientele furthermore includes well-known international investors, whom we assist in their projects on the sought-after German real estate market.

Peter Axmann,
Head of Real Estate Clients

Fig.: TAS Group of Companies
An der Alster 1, Hamburg

TAS GROUP OF COMPANIES

BRICK UPON BRICK UPON BRICK UPON BRI BR

When the topping-out ceremony for the building shell took place at Überseering 2 in Hamburg's City Nord in spring 2016, Hamburg's former Mayor Olaf Scholz welcomed the guests in person. This is because, with Deutsche Telekom as a tenant, one of the world's major telecommunications companies has committed itself to Hamburg. A decision that is good not only for Hamburg as a location to do business. Olaf Scholz also praised the pioneering architecture and the stimulus the project has created in urban planning terms.

The TAS group of companies was responsible for developing the flagship project. In just 15 months of construction time, it erected a nine-floor office tower on schedule, giving 2,150 employees of the magenta-coloured company a place to work. The new building was financed by HSH Nordbank. "We supported this project from start to finish," said Relationship Manager Thomas Wente, who has been looking after the real estate firm for years. "Once again, we have seen the degree of professionalism with which TAS handles project realisation, including and especially if there is a hitch." For the TAS group of companies, the Telekom head office is the fourth project in City Nord, following on from the revitalisation of the Allianz head office, the building of a new 18-floor Holiday Inn hotel and the revamping of a multi-storey car park, and it marks a further important milestone in the development of the office district in Hamburg's north.

Behind the company and its three letters stand Thomas Schwarz and his son Marcus, who established TAS in 2003 as a Kommanditgesellschaft (limited partnership). From its offices in Hamburg and Cologne, the family-run business has been successfully working as an investor and project developer for company head offices, hotels and residential districts throughout Germany.

Father and son consider that they have a responsibility on multiple levels: towards society, business partners and members of staff, many of whom have been with them for years. Cooperation based on trust is also important for Managing Director Marcus Schwarz when it comes to selecting the financing banks: "We can rely on HSH Nordbank one hundred percent. Not only do our contacts have excellent expertise, they also are a good fit for our company and our values in human terms." Many thanks for these words of praise! We are very happy to hear them, and that's how it is supposed to stay.

CK UPON
ICK FOR GOOD COLLABORATION.

Marcus Schwarz
Partner
TAS Group of Companies

Thomas Wente
Client Relationship Manager,
Real Estate

Stephan Ölze
Managing Partner
TAS Group of Companies

“What we particularly appreciate is that the exchange with HSH Nordbank is a partnership of equals,” says Andreas Franke. “The collaboration is uncomplicated, decisions are transparent and agreements are implemented reliably and promptly”. Christoph Günther adds: “We are Hamburgers and our planning area is the metropolitan area around the Alster and Elbe rivers – hence a competent finance provider with tradition who knows the region and industry in detail is a wonderful fit for us.”

The most recent joint project initiated by Christoph Günther, “Oslever Hööv” in the west of the Hanseatic city was completed at the end of 2017 and gives around 300 Hamburg citizens a

AESTHETICS APPLY TO LIVING SPACE APPLY

GÜNTHER FRANKE GRUBER BAUHERREN

Christoph Günther, Andreas Franke and Christoph Gruber – the three business management experts have a clear philosophy: “Every house we build, we are as committed as if we were building it for ourselves,” says Christoph Gruber. Hence the name ‘Günther Franke Gruber Bauherren’, literally ‘masters of construction’, under which the partners have been trading since 2010. 15 years before, in 1995, they successfully developed their first joint real estate project under the name of the family-run company Jacob Jürgensen.

Since then, the three managing directors, friends since school and university, have been planning and realising high-quality living space in and around Hamburg. All told, they have completed 84 buildings so far with more than 1,000 apartments. The buildings were tailored to the requirements of the prospective residents: as modern classics they not only meet the highest design requirements, they also outlive fads and architectural currents. They are characterised by their own timeless style, which is based on creative re-interpretations of classic architectural elements.

The Hamburgers only get involved if they are 100 % convinced by a plot. Each project is managed by one partner, who puts together a team of architects, engineers and in-house specialists. What drives the three entrepreneurs: their passion for beautiful buildings.

The three individualists have been working together with HSH Nordbank for more than two decades.

new home in 130 apartments. HSH Nordbank client relationship manager Susanne Siemer accompanied the financing: “It is great to see how Messrs. Günther, Franke and Gruber burn for their projects. The three men have an excellent construction and business management understanding,” she adds, “and what is more, they attach great importance to aesthetics in their buildings.”

HTG Hoch- und Tiefbau Gadebusch GmbH, the potent and expert partner in this project with a 50% stake, boasts 50 years of experience in the construction business. We have known the managing director, Franz Gelz, for years as an accomplished businessman and civil engineer, whose know-how stands for good build quality.

TO HAMBURG
APPLY TO CUSTOM-FIT FINANCE.

Setting up solar parks, growing a food producer, a strategic investment in a chemicals wholesaler, establishing Next Commerce Accelerator – just a brief glance at but a few of our activities makes it clear that we cover a very broad field in our Corporate Clients segment. Diversity and flexibility are the characteristics for which we are known among our clients, and they are the characteristics that count if you provide SMEs with loans and banking services.

BANKING FOR SMES IS LIKE A DECATHLON.

THOSE WHO MASTER EVERY DISCIPL

In our focal industries we score with industry, product and advisory expertise, be it in Energy & Utilities, Infrastructure & Logistics, Industry & Services, Healthcare, Food & Retail, Wealth Management, Structured Finance or Merger & Acquisitions. We are an integrated corporate finance bank that offers an all-in service thanks to our positioning in the areas of structured finance and leveraged buy-outs. Our clients of long standing appreciate this – as do the many who join us every year.

Our target clients are owner-managed companies. In geographical terms, we are not limited to our home region in Northern Germany: we also successfully complete transactions in the south, west and east of Germany. And we assist German companies with their business activities outside Germany, where we have developed such new markets as Portugal and the Netherlands – a key to further growth.

Patrick Miljes,
Head of Corporate Clients

ALL TOLD, WE HAVE SO FAR FINANCED MORE THAN ABOUT

5,5 GIGAWATTS

FROM RENEWABLE ENERGIES.

CORPORATE CLIENTS
PATRICK MILJES

DR. DETLEV GRÖNE: **HEAD OF CORPORATE CLIENT BUSINESS SALES**

Departments

Teams

ENERGY & INFRASTRUCTURE – Lars Quandel
- **ENERGY & UTILITIES, GERMANY** – Inka Klinger
- **ENERGY & UTILITIES, INTERNATIONAL** – Nils Driemeyer
- **INFRASTRUCTURE & LOGISTICS** – Dr. Marcus Kleiner

WEALTH MANAGEMENT – Nico Hamm
- **SALES** – Bodo Stadler
- **WEALTH MANAGEMENT PRODUCTS** – Anna Katharina Engelbrecht
- **GOVERNANCE** – Jens Goldbeck

TRADE & FOOD INDUSTRY – Michael Rothehüser
- **TRADE** – Jens Thiele
- **FOOD INDUSTRY** – Tim Muhle

INDUSTRY & SERVICES – Christian Alpert
- **INDUSTRY & SERVICES N/O** – Volker Kieschke
- **INDUSTRY & SERVICES S/W** – Paul Bittner
- **HEALTHCARE** – Sandro von Korff

STRUCTURED FINANCE – Roland Schwab

M&A – Karsten Maschler

ABO WIND

When Dr. Jochen Ahn and Matthias Bockholt started their own business ABO Wind in 1996, Oliver Bierhoff scored the golden goal that made Germany the winner of the European Cup. The exit from nuclear power as dream of the future and wind power a side topic mockingly sneered at by many – those times are gone. HSH Nordbank – or, to be precise, its predecessor institutions – were at the time among the first banks to finance projects in the renewable energies segment. Today ABO Wind AG is one of Europe's most successful wind farm developers; all told, the company has connected more than 600 wind turbines with a performance capacity of around 1,400 megawatts to the grid. A partner by its side along the way: HSH Nordbank. We are now among Europe's top five finance providers for wind and solar projects. Pioneering spirit paying off. The founders of ABO Wind are still members of the company's management board, which plans, finances and builds not only turnkey wind farms but also offers the operational

ONE OF THE FIRST ENTERPRISES TO

ONE O

Strong for entrepreneurs
ENERGY & UTILITIES

UNDERSTAND The markets are characterised by technical, legal and structural changes.

RECOGNISE You can depend on our experience as pioneers in the sector and on our keen sense for trends. We will deploy our expertise and comprehensive nancial solutions in the execution of your projects.

SHAPE Whether your business is a utility focusing on solar, hydro or wind, offshore or onshore, we support you with all our energy.

management of wind farms, maintenance, audits, repairs and technical opinions. ABO Wind is now also planning and building photovoltaic projects. All told, around 500 specialists are working to implement the energy turnaround at the head office in Wiesbaden – in Germany and far beyond. “For the financing of two wind farms in Finland in 2017 we required a banking partner with in-depth knowledge of the Finnish market”, says Petra Leue-Bahns, Head of Finance and Sales at ABO Wind. “Once again, HSH Nordbank offered us very good and above all viable solutions within a short space of time.” A service of this quality is also possible because we have built up great knowledge and many contacts in the renewable energies sector over a period of decades. “We have a good basis of mutual trust with ABO Wind since years”, says Torsten Heidemann, client relationship manager at HSH Nordbank. “It is this which makes our collaboration so constructive and gratifying – both now and in the future.”

BUILD WIND FARMS.

F THE FIRST BANKS TO FINANCE THEM. FITS.

Torsten Heidemann,
Client Relationship Manager,
Energy & Utilities

Dr. Daniel Duben,
Project Manager Communication,
ABO Wind AG

Strong for entrepreneurs
FOOD INDUSTRY

UNDERSTAND The market for food products is constantly on the move because of changing consumer behaviour, vigorous innovation and fierce competition.

RECOGNISE Whether brands, white labels, production or trading: we know the challenges and opportunities of the business models and will do our bit to help you achieve your objectives.

SHAPE No matter where the market is heading: our sector experts feed you with fresh ideas so that you can realise yours.

VAPIANO IN FIGURES: 5550 EMPLOYEES, 205 BRANCHES, 33 COUNTRIES.

VAPIANO

A handsome olive tree, long oak tables, a bar and lounge area as well as the preparation island made of glass at the heart of the restaurant offering fresh pasta, pizza, salads and desserts – every Vapiano restaurant offers its guests the same relaxed, casual atmosphere. And this everywhere in the world. The success story of Vapiano began in 2002 with a restaurant in Hamburg. Since then, Vapiano has been setting standards in system catering with its fresh, casual dining concept. The company has grown strongly in recent years and has ambitious growth plans following its successful flotation in 2017. Last year alone Vapiano opened 27 new restaurants worldwide and has thus expanded its international footprint to 205 restaurants in 33 countries on five continents. Around 5,500 staff members work for Vapiano.

HSH Nordbank has been one of the company's financing partners for many years. "With all the changes our company has made in recent years, HSH Nordbank is a reliable partner that understands and advises us well," said Lutz Scharpe, CFO of Vapiano.

VAPIANO IN

"Vapiano has an innovative business model of an exemplary nature for the food service industry," Jan Ströhnisch, Client Relationship Manager at HSH Nordbank, said. The motto is: never stand still, constant improvements in the organisation of processes – as in the preparation of meals or the training of personnel. For example, Vapiano is breaking new ground by taking orders via terminals or their smartphone app to shorten the waiting times in its restaurants. Furthermore, the company is successfully offering more and more restaurant takeaway and delivery services to enable guests to enjoy Vapiano "anytime, anyplace, anywhere".

Further plans? By 2020, the company aims to have around 330 restaurants worldwide carrying the Vapiano logo. "Go slowly" is a rough translation of the Italian term "va piano". Something definitely does not apply to the company.

WORDS: A GOOD PARTNER. LESSO

Lutz Scharpe
CFO, Vapiano SE

Jan Ströhnisch,
Client Relationship Manager, Retail & Food

LESSONS LEARNED, MANY THINGS

Christian Nieswandt,
Head of Shipping

Strong for entrepreneurs
SHIPPING

UNDERSTAND To achieve lasting success for your business in the maritime industry you need a business model that has a future.

RECOGNISE In us you will find a team that stays the course. Even when those storms come.

SHAPE Our promise is that we will scrutinise deals down to the fine details; we will weigh up opportunities and we will offer you the kind of support you need.

IMPROVED, OPPORTUNITIES KEPT.

SHIPPING RELOADED

Yes, HSH Nordbank traditionally had very close links to the domestic shipping industry. There were times when the Bank was famed as – looking back, the claim to this fame was doubtful – the world's biggest provider of ship finance, including unfortunately the corresponding cluster risks and write-downs totalling billions of euros. It is a well-known fact that this legacy proved a huge burden on the Bank during the shipping crisis, which has been ongoing since 2008. We have meanwhile succeeded in winding most of this down.

We have learnt from past mistakes and drawn the conclusions. What this means is that although we remain active in shipping, our activity is on a completely different basis to before – with a sharpened risk awareness and a focus on successful companies with a viable business model. And, above all, on a much smaller scale. At the end of 2017, our lending volume in shipping came to nearly € 5.5 billion, having concluded new business worth over € 500 million. Instead of focusing mainly on German clients and their container ships as we had done in the past, we now work more with international clients who manage their companies successfully and are active in a variety of segments. Of course, we did ask ourselves whether we should remain active in shipping at all. The answer is yes. This is because, looking ahead, we are convinced that maritime shipping will still be promising. Not only because the industry is currently experiencing a high level of consolidation, as a result of which new, strengthened entities are being created. Freight rates and ship values have also stabilised in the wake of one of the most serious crises. The market thus now offers good opportunities to invest with a sharpened risk perspective. But what is decisive is that global trade keeps growing; at an average rate of 4.7 percent per annum over the past two decades. And how are more than 90 percent of goods transported for example from Europe to Asia; from Asia to the US and from South America to Asia? By sea, exactly. And no, there are no alternatives in sight.

FROM NEIGHBOUR TO NEIGHBOUR. FROM BANK TO

Michael Kastl,
CFO, Hapag-Lloyd

Andreas Rasch,
Client Relationship Manager, Shipping

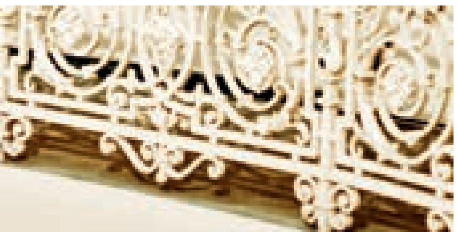
SHIPPING COMPANY. FROM HAPAG-LLOYD TO HSH NORDBANK.

HAPAG-LLOYD

Good neighbours are precious. This applies to our private lives as much as it does to the world of business. It is not surprising, therefore, to hear that HSH Nordbank and Hapag-Lloyd are joined by a long partnership. The head offices of the two companies are only a stone's throw away from each other. And, unusually, this linguistic image can be taken (almost) literally.

However, the good collaboration is not limited to the Bank providing the company with finance. A large shipping company possessing international operations such as Hapag-Lloyd of course also uses other forms of financing, such as bonds. They are placed on the capital market, where such institutional investors as insurance companies, pension funds and high net worth private individuals make direct investments. Last year, we were able to assist our shipping line neighbours in the placement of two bonds with a total volume of € 900 million as joint bookrunners of an international banking syndicate. "It always pleases us to be able to assist a long-standing client such as Hapag-Lloyd in an important placement," said Andreas Rasch, a member of the Bank's shipping team. "Interest in the bonds was very strong.".

Satisfaction was also felt by Germany's largest shipping company, which moved up into fifth position worldwide in 2017 following its merger with Arab shipping company UASC. "The placement was highly successful and contributed to optimisation of the maturity profile and financing costs," said Michael Kastl, CFO of Hapag-Lloyd. "In such a transaction, the fact that we have been in close touch with the Bank for many years and know each other well pays off." And the cooperation will, of course, continue – in a spirit of trust, from door to door in downtown Hamburg.



DOING BUSINESS MORE SECURELY AND MO

TREASURY & MARKETS

Computer systems that hedge currency risks and manage liquidity with the help of algorithms; artificial intelligence that performs market analyses for lending to public-sector clients – the topics of tomorrow that Treasury & Markets is already actively tackling. Including such questions as, what will clients want from a bank in future? Where are the opportunities presented by Robo Treasury – and what about the risks?

To allow colleagues in other departments to benefit from these ideas and findings, we summarise all of it in an innovation blog. Because Treasury & Markets is not a closed shop, it is keen to share ideas with internal and external specialists. Always on the look-out for ideas to improve the service we provide to our clients – and to enhance our own performance. We want to be prepared for the challenges of tomorrow. The markets are changing; we are driving the transformation.

In addition to these forward-looking projects, the segment does, of course, look after its core functions: placing bonds and state treasury notes, issuing investment products, responsibility for the Bank's liquidity management and refinancing and the individual hedging of interest-rate and currency risks for clients.

Treasury & Markets is of key importance to the Bank's success. It is all the better, therefore, that the segment, after realigning itself in 2016, continues to gain pace and can look back on a successful year 2017. The steady rise in income is a good indicator of this.

But it is not the only one: At the same time, we have expanded the number of domestic and international institutional investors, widened our underwriting and syndication and brought a debt fund to market readiness. We have also broken new ground in the refinancing of the Bank and opened up access to private clients. This is an important step, which we accomplished in collaboration with Hamburg's fintech Deposit Solutions. What exactly does this mean and how does it work? Find out on the next page.

HIGHLIGHTS FROM OUR RANGE OF SERVICES:

- We are closely connected with more than 800 clients, including many institutional and public-sector investors
- We assist well-known issuers of bonds and promissory notes
- We structure refinancing products for corporate clients
- We continue to enhance our deposit-taking, interest-rate and currency management – areas in which we have long-standing expertise
- We manage and hedge market price risks for our clients
- We are dependable partners to real estate companies when it comes to managing risk and we offer customised solutions

Mark Bussmann,
Head of Treasury & Markets

RE INTELLIGENTLY – THAT IS THE FUTURE. WE HAVE MADE A START.

- We have established the Treasury & Markets LDR as an innovation workshop for the capital market business
- We have successfully taken retail deposits for the first time and have thereby broadened and diversified the Bank's refinancing base

PROACTIVE ON LIABILITIES.
BROADER-BASED FUNDING MA

Dr. Tim Sievers,
CEO & founder
of Deposit Solutions

Mark Bussmann,
Head of Treasury & Markets

PROACTIVE ON LIABILITIES AND EQUITY!

As a wholesale bank, we are strong providers of finance to our corporate clients. The liabilities and equity side of our balance sheet decides how flexibly, attractively and extensively we can do so. That is where we refinance; where funding takes place. It is a pertinent matter for all banks because it determines the parameters for the entire client business. And it is where we took a giant leap forward in 2017, opening new, additional avenues for us. It is because we broadened our funding and found a new refinancing channel that enables us to spread our risk very efficiently; to be less exposed to major, single counterparties and, in so doing, to flexibly manage our need for liquidity. Even though we are wholesalers, private clients can thereby also benefit from our attractive terms and we are pleased to accept such deposits. "Access to retail clients is extremely important," said Mark Bussmann, Head of Treasury & Markets at HSH Nordbank. "This is because particularly the time deposits of private

KING US MORE INDEPENDENT AND FLEXIBLE.

clients have a positive impact on funding structure, liquidity ratios and balance-sheet structures."

We have found a strategic partner for this business: money can be deposited with HSH Nordbank online via the Zinspilot.de platform of Deposit Solutions. The success story of Deposit Solutions begins with courage, creativity and the simple as well as brilliant idea of offering savers better interest rates and banks better refinancing opportunities – uncomplicated, inexpensive and fast. The idea was so good that Dr. Tim Sievers won an EU innovation award in 2010 and established Deposit Solutions. The company meanwhile employs more than 200 people Europe-wide and had brokered savings deposits of about four billion euros to the end of 2017.

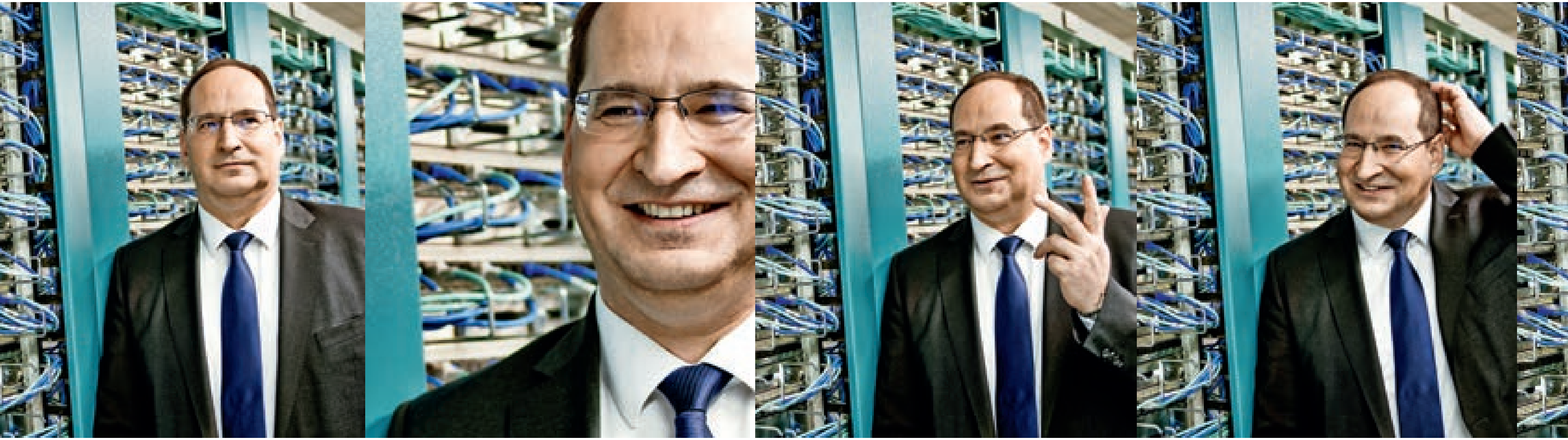
HSH Nordbank has been working with Deposit Solutions since autumn 2017. "I am pleased that the cooperation happened and has been working so well right from the off," said Dr. Tim Sievers, the company's CEO and founder of the company. We are happy too: in the first four months alone, we raised € 600 million via the platform – despite a maximum investment sum of € 100,000.

"PROFOUND DIGITAL TRANSFORMATION"

The world of IT is changing very rapidly. How is HSH Nordbank responding to this?

Ulrich Scheer: Aligning our IT to the new challenges is something we do all the time. This is evidenced by our digital strategy, for example, which extends far beyond IT. It deals with how we can use the opportunities provided by the digital world for our business model. One example is our successful banking app. At the same time, we have set up a central data platform, which provides the basis for the Bank's further digitalisation. Although we have already achieved much, we cannot allow ourselves to rest – quite the opposite. Work is now starting in earnest because we want to keep abreast of future issues.

N. A NEW BANKING WORLD. 1000



DIGITAL OPPORTUNITIES. WE'RE TAKING THEM.

What does this mean specifically?
Ulrich Scheer: We as a society are experiencing a profound digital transformation, and we are preparing for it. Improve the user experience, raise efficiency, make cooperation faster – there are plenty of issues where we want to get better. In everyday life a mobile IT world predominates, in which apps play an increasingly important role: to book a cab, for pizza delivery, for the weather, there is an app for almost everything – this is what is called the disintegrated IT world. Many banks, including ourselves, have a rather monolithic IT architecture with large blocks that are not very flexible. To pick up speed and implement projects more quickly, we will need handy systems for individual functions allowing us to respond quickly. In short, our IT landscape needs to become more agile and more flexible. This is what we are working on.

Ulrich Scheer,
Head of IT

Does this entail major investment?
Ulrich Scheer: The good thing about the new IT world is that small measures are sufficient to achieve good effects. We are making a start with projects requiring minor financial input, which will – we hope – nevertheless provide us with new opportunities.

Many businesses have recently suffered losses due to cybercrime. Are you experiencing higher threat levels?
Ulrich Scheer: Yes, we are in the same boat as other businesses. We are preparing for the new situation by strengthening our security architecture substantially and expanding it continuously. IT security is now a key element of our work. IT and thus its security is now of great importance from a regulatory perspective. It is deemed just as important by the regulators as the key factors of a bank, i.e. capital and liquidity.

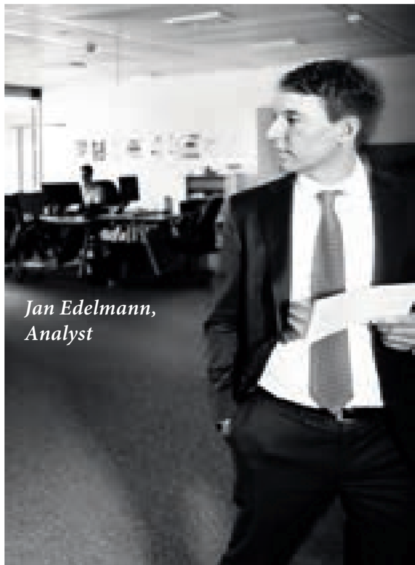
How do you keep up to date with innovations?
Ulrich Scheer: We do not have the means to push ahead with market-moving new developments ourselves, we are too small for that. But we feel very comfortable in our role of early follower. We are focusing systematically on such specifics as blockchain. For us, the focus is on innovation.

ECONOMICS

ANYONE SEEKING RAW MATERIALS MUST D

ANYONE WANTING

The oil price is up, copper is climbing to a four-year high, palladium reaches previously unseen price levels – the metal is used as a component in catalytic converters in vehicles and is therefore particularly sought-after. On the international commodities markets there is always a lot of movement; most recently, prices have risen sharply, in some cases with huge consequences for companies who suddenly have to calculate with substantially higher costs. Anyone able to guess in early 2017 that the price of a barrel of crude oil would rise by more than 20 percent within the space of twelve months would probably have got themselves some hedging. But hardly anyone did. “With our analyses and forecasts about the commodities markets we are attempting to give practical help to our clients,” says Jan Edelmann, commodities analyst at HSH Nordbank. He deals with the markets on a daily basis and gets to look behind the scenes. Jan Edelmann knows the strategies of US shale oil producers, he observes how the Chinese government manages its economy and keeps an eye on the consequences which the establishment of new technologies has. “Copper, aluminium, nickel and zinc are used in the building of electric vehicles,” he says. “Demand and thus prices remain high.” But if prices are high, cannot a new producer simply come along? “It’s not quite as simple as that,” says the economist, whose knowledge is regularly sought out by a variety of newspapers. “Ten years go by until a new copper mine is established, such a project costs a few billion euros.” Good to know. So, will commodity prices remain high? “If the global economy remains robust, it is likely they will,” Edelmann thinks. His advice: “Always keep an eye on all factors.” Good idea, but that’s really his job.



Jan Edelmann, Analyst

IG DEEP.
TO UNDERSTAND THE MARKET MUST DO SO, TOO.

The world is becoming more complex, connectivity is on the rise. Has it become more difficult to make economic forecasts?
Dr. Cyrus de la Rubia: Predicting the performance of the economy has never been easy. Nothing has changed in this respect. But it has become increasingly difficult to understand the present because we note that some patterns and principles which once used to apply no longer do so.

Can you give me an example?
Dr. Cyrus de la Rubia: If the economy does well and unemployment falls, the rate of inflation normally rises – that's what the textbooks say. For the past few years it is not only the German economy which has been buzzing, we are even getting close to full employment – and yet inflation remains low. It would seem that some of the old teachings no longer apply.

Why does the correlation between full employment and inflation no longer apply?
Sintje Boie: One important point is technological progress, for example as a result of digitalisation. It leads to lower production costs, in some cases products are being offered at lower prices thanks to new commercial structures such as e-commerce. This pushes down inflation. But we are also preoccupied by the fact that interest rates have remained low for so long. Here, the ageing population probably plays a major role.

What does the ageing population have to do with interest rates?
Dr. Cyrus de la Rubia: At present, the baby-boomer generation is gradually approaching retirement age, a phase in life when savings build up. The savings/investment ratio has a big effect on interest rates. If savings rise while investments stay steady, there is an excess supply of cash – interest rates remain low. This trend could be reversed once the baby-boomers actually enter retirement age. Then savings will be used up, which should lead to higher interest rates.

How can the Bank's clients benefit from the findings of your macroeconomic analysis?
Sintje Boie: We are engaged in a constant exchange with our clients and pay them regular visits together with our sales colleagues. Many clients are well-informed, but they look for someone with whom they can discuss their views; events such as our "Zinsfrühstück" (interest-rate breakfast), for example, provide a forum for them. In addition, we pick up on current issues in our traditional publications, we express our views in comments and provide information in modern formats such as webinars.

An important topic at the moment is that of exchange rates. Will the euro strengthen further against the dollar in 2018?
Dr. Cyrus de la Rubia: We remain positive on the euro. We also stick with our position because it is being strengthened by political initiatives in Europe.

Dr. Cyrus de la Rubia, Chief Economist

Sintje Boie, Analyst

HOW IS WHO AND WHAT WHERE BY CONNECTED

OUR STUDIES PRO

Thomas Glahe,
Client Relationship Manager, Healthcare

Christian Strauch,
Director of Distribution at apo-rot

Tom Miller,
Analyst

ECONOMICS, STUDIES

Close to the markets, close to trends, close to its clients – the analysts of HSH Nordbank translate models and theoretical knowledge into practical benefits for companies. “We want to highlight what is important and provide relevant information,” says Tom Miller. Like his colleagues, he regularly visits clients to share his knowledge.

that is, a fine-grain analysis of the sector, but also on many interviews with specialists. One example: the discussions held by Tom Miller and client relationship manager Thomas Glahe with Christian Strauch, CEO of apo-rot, one of Germany’s leading online mail-order pharmacies, which found their way into the “Healthcare Industry 2017” study.

Tom Miller’s study on the healthcare industry caused a stir in the sector. “It is important for us to work through data and facts in such a way that clients are able to use them specifically for strategic decisions,” says Miller. “We are guided by two questions: What concerns our clients? What helps them move forward?”

WHEN AND WHY?

VIDE ANSWERS THAT HELP OUR CLIENTS MOVE FORWARD. T

If you want to shape the future you have to understand the present and recognise emerging developments. This is exactly what our studies help achieve: healthcare sector, nutrition, infrastructure, renewable energies, rail, wind, fashion – the list of studies on current topics is a long one. The studies are based not only on thorough research,

The Hamburg-based company has built up a mail-order pharmacy around its branches – and it is extremely successful. “We are breaking new ground,” says Christian Strauch. “Here it is important to maintain a close exchange of ideas with other specialists. Discussions such as those with HSH Nordbank help us advance in our thinking.”

Research equals science in the ivory tower? No, we have a very different outlook. Our motto is, make as much knowledge as possible as usable as possible – for the benefit of clients.

INTERNAL AUDITING

Internal Auditing provides objective, risk-focused auditing and consulting services which extend across all of HSH Nordbank's business activities and processes. It evaluates the effectiveness, efficiency and correctness of risk management, the internal control system and of management and monitoring processes. Internal Auditing is involved in all material projects and in all changes to operational processes and structures. It has an unlimited right of information in order to fulfil its mandate. It acts independently and on its own initiative at all times.

THANKS FOR WORKING WITH US. AND TH

AND PITCHING IN WITH US. AND S

COMPLIANCE

The Compliance division works centrally and across divisions to ensure compliance with the main legal provisions and parameters within HSH Nordbank. It therefore monitors the Bank's capital market activities and applies structural measures to prevent money laundering, the financing of terrorism and other criminal acts. It furthermore oversees ongoing compliance with all relevant financial sanctions and embargoes. The basic rules of behaviour for the Bank's employees are summarised in a Code of Conduct. In conjunction with regular training events, employees are provided with a reliable guide regarding legal requirements as well as ethical and social principles. In addition, HSH Nordbank has established an external office for whistleblowers. It follows up internal and external tip-offs, including those received anonymously, and passes suspected cases on to the Compliance division.

STAFF

As the saying goes, our youth is our future. This of course is true, and we have been taking it to heart for many years. Our young colleagues, male and female, are so close to our hearts that we have been offering them not only various dual training positions and extensive trainee programmes, we also prefer to fill open positions from the ranks of our own young professionals. For these youth initiatives we were once again recognised as a provider of high-quality, career-promoting and fair training programmes and as "fair company" for interns and university graduates by Absolventa GmbH, a jobs fair specialising in career starters. We were very happy to receive this accolade – and it spurs us on in our commitment to go even further on our way.

Judith Steinhoff,
Head of Human Resources

INKING AHEAD WITH US.

HARING THE PASSION WITH US. AND CAMPAIGNING WITH US.

To avoid any misunderstanding, let us clarify: We know, of course, that it's not only about the young – it's about the right mix. Experience is important, as is in-depth sector knowledge and, obviously, a broad network. Simply all that which many of our male and female colleagues contribute. They are well-qualified, highly motivated and they form the core of our modern, successful human resources work. This, in turn, finds expression in our staff's performance ability. And as far as that is concerned it looks good to us. Otherwise we would have not been able to make the privatisation, new business and the run-off of legacy assets a success. This can only be done with good people. And we have them.

In order to continue advancing our male and female colleagues we offer them extensive opportunities for further development in personal and skills terms. But work is not everything, the work/life balance also needs to be right. That is why we offer not only flexible working hour models but also comprehensive advisory and information offerings on the subjects of family, relatives and the compatibility of family and work. These have a good take-up – and this includes our young colleagues, male and female.

Ensemble Resonanz,
RIAS chamber choir
Conductor: Justin Doyle

Elbphilharmonie, Grand Hall, sample

WE COMMIT OURSELVES EVEN IN DIFFICUL
AND NOT

T TIMES.

ONLY BECAUSE IT SOUNDS GOOD.

SPONSORSHIP

A company's success is traditionally measured in numbers, data and facts. It is about sales, profit and growth rates – but this alone is not enough. Companies need and want to be more than an integral part of economic life. They assume social responsibilities, they are also involved in social, cultural and ecological issues. It is important for them to give something back to society, which made their success possible in the first place.

For us, social responsibility is a practice we have lived for many years and from which we did not depart even in economically difficult years. Reliability matters to us – also because we know that a long-term view is necessary to establish projects such as "Kids into the Clubs". With this initiative children and young people from socially disadvantaged backgrounds are given an opportunity to do sports in a club. There they learn much more than how to stop a ball correctly or how to run with endurance: In a club the children experience success, they get to know the strengths of a group and they are able to test themselves in many different ways. In short: they discover new ways of looking at their lives and see opportunities. We are happy to be able to support them in this process.

HSH Nordbank is a founding member of the Elbphilharmonie Foundation and supports the Elbphilharmonie's programme as a classic sponsor. As a sponsor of "Resonances Season 2017/18" we contribute to ensuring that the Resonance Ensemble is able to stage classical music live in the Elbphilharmonie.

Together with the Savings Banks Finance Group we are among the main sponsors of the Schleswig-Holstein Music Festival (SHMF), which we have been supporting since its inception. Our commitment also includes the annual 10,000 euro Leonard Bernstein Award for young artists.

As a premium partner of Kieler Woche we collected around 30,000 euros for our charity "Good for kids" last year, which also enables children and young people to take part in club sports.

During the winter months we supply the homeless day centres Herz As in Hamburg and Hempels e.V. in Kiel with hot lunches. So far, we have prepared around 28,000 fresh meals for the homeless.

Last but not least, we sponsor the HSH Nordbank Run, the biggest charity run in northern Germany. In 2017 alone, it had more than 24,000 participants in 831 teams, collecting a donation total of 155,000 euros for the "Kinder helfen Kindern" (Children helping Children) charitable association.

ELBPHILHARMONIE
HAMBURG

HSH NORDBANK RUN 2016
in der HafenCity

Schleswig-Holstein Musik Festival

GUT FÜR KIDS

REPORT BY THE SUPERVISORY BOA

In the 2017 financial year, the Supervisory Board performed the tasks incumbent on it by law and in accordance with the Articles of Association. In particular, it monitored the management of the company and provided advice to the Management Board in matters relating to corporate governance. In addition to strategic matters relating to the Bank's direction, the Supervisory Board continually obtained information on the Bank's economic and financial development as well as on the development of individual business segments. The Supervisory Board was provided with explanatory information on any deviations from the plan in the course of business.

In the 2017 reporting year, the Management Board provided the Supervisory Board with regular, timely and comprehensive information on the Bank's business policy and other fundamental issues relating to corporate governance and planning, financial development, operating performance and the Bank's risk, liquidity and capital management as well as on major legal disputes and transactions and on events of fundamental significance to the Bank. The Supervisory Board was involved in any decisions that were of key significance to the Bank. The Management Board also provided the Chairperson of the Supervisory Board and the Chairpersons of both the Risk and Audit Committees with information on key issues and upcoming decisions between the planned meetings. Where resolutions had to be passed between meetings, the Supervisory Board passed these resolutions using written procedures.

In the 2017 financial year, the Bank's focus was crucially shaped – in an environment with ever increasing regulatory requirements – by the privatisation process, whilst market conditions, particularly the crisis in the shipping markets, eased slightly. The start of 2017 was characterised by the sale of the so-called market portfolio. The focus over the rest of the year was increasingly on the actual privatisation process, which was formally started with the publication of the sales announcement at the end of January 2017. The Supervisory Board was closely involved in both issues. It received ongoing information on the status of the key mile-stones on the path

RD FOR THE 2017 FINANCIAL YEAR.

towards privatisation as well on the sale of loan portfolios and accelerated winding down of NPL portfolios and – where necessary – passed corresponding resolutions. The Supervisory Board sought legal advice within this context where necessary.

MEETINGS OF THE SUPERVISORY BOARD

The Supervisory Board held ten meetings in the 2017 financial year, five of which were convened as extraordinary meetings.

At all ordinary meetings, the Management Board provided the Supervisory Board with information, based on the figures for each quarter, on the Bank's current financial situation, business performance on the whole and in the individual business segments as well as in relation to the current business plan, on the risk situation, changes in capital and on the liquidity and funding situation. The Management Board also provided the Supervisory Board with regular information on the current status of the EU proceedings and their implementation. The

In the meetings held on 18 and 26 January 2017 the Supervisory Board dealt intensively with the sale of the market portfolio and passed corresponding resolutions.

The focus of the meeting held on 16 February 2017 was the thorough discussion of the financial, investment and human resources plan for 2017–2019 submitted by the Management Board. The Supervisory Board also dealt with its Corporate Governance Report and Declaration of Conformity as well as the Report of the Supervisory Board for the 2016 financial year and the treatment of hidden reserves and profit participation certificates, whose loss participation depended on the accumulated losses of the 2016 financial year. The Supervisory Board also took note of a report on the asset management implementation project. The main subject matter of the meeting held on 29 March 2017 was the approval, based on the recommendation made by the Audit Committee, of the annual financial statements and consolidated financial statements for 2016 following the Supervisory Board's own assessment and prior discussion with the auditors of the financial statements. The other standard resolutions to be passed regarding the recommendations to be made to the ordinary Shareholders' Meeting were also passed. The Supervisory Board also used this meeting to discuss the target achievement level of the Management Board for the 2016 financial year and to decide the Management Board targets for 2016. In addition to the resolutions relating to the annual financial statements, the Supervisory Board also dealt with the approval of two intercompany agreements to amend existing silent articles of association. The Supervisory Board's agenda also included discussions on the "Report on equity investments", "Overview of secondary employment relationships of Management Board members" and the "Report on donations" of HSH Nordbank, which are conducted once a year.

On 15 June 2017, the Supervisory Board passed a resolution approving the sale of a sub-portfolio as part of the market portfolio transaction and also addressed the regulatory requirements regarding the management of non-performing loans (NPL strategy).

The topic of the market portfolio transaction was again on the agenda of the meeting held on 30 August 2017, at which the Supervisory Board took note of one case and passed a resolution on another transaction. Furthermore, the Supervisory Board was informed of the current amendments to the German Corporate Governance Code.

The Supervisory Board approved the sale of an equity investment in an extraordinary meeting held on 15 September 2017 and the change in the auditors due to the external mandatory rotation of auditors of financial statements in another extraordinary meeting held on 11 October 2017.

Another extraordinary meeting was subsequently held on 29 October 2017, at which the Supervisory Board was informed of the current status of the privatisation process.

The last ordinary meeting of the year was held on 28 November 2017, at which the Supervisory Board also addressed the results of its efficiency review carried out in accordance with Section 25d of the German Banking Act (KWG) and the evaluation of the Management Board in addition to Management Board matters. The Management Board also presented and explained its annual report on the structure of the remuneration systems. Due to a change in the Supervisory Board the Supervisory Board also addressed the election of a member to the Audit Committee.

The Supervisory Board also passed two resolutions in the reporting year by way of a written resolution procedure, one of which related to the targets for the quota of women on the Management Board and Supervisory Board.

The Supervisory Board also furthered its education in various areas over the past year. The nature of the presentations made at the Supervisory Board meetings were partly educational for this purpose. Examples of this include the topics of IFRS9, the approach adopted for the privatisation process, non-financial reporting in the Management Report in accordance with Section 289 be HGB, German Ordinance on the Remuneration of Financial Institutions (Institutsvergütungsverordnung), different topics concerning the shipping markets and IT security management.

Where individual members of the Supervisory Board were affected by resolutions passed by the Supervisory Board or its committees, either in person or on account of their function, or if other potential conflicts of interest arose, then these members did not participate in the deliberations and resolutions in the executive body concerned. The number of other significant mandates held by the Supervisory Board members can be found in the Corporate Governance Report in this Annual Report.

One member of the Supervisory Board attended less than half of the Supervisory Board meetings. This related to a conflict of interests regarding the privatisation process, in light of which the Supervisory Board member concerned did not attend the committee meetings in the first five months of the year under an appropriate agreement reached with the Chairperson of the Supervisory Board. The Supervisory Board member concerned attended four of the ten Supervisory Board meetings. Another Supervisory Board member attended less than half of the meetings of one Committee, of which he is a member. This committee met three times in the reporting year and the member only attended one of the meetings.

All other members of the Supervisory Board attended at least half of the meetings of the Supervisory Board and its committees, of which they are members.

COMMITTEES OF THE SUPERVISORY BOARD

The Supervisory Board has formed five committees from among its members that support it in its work.

The General/Nominating Committee held six meetings in the past year, one of which was an extraordinary meeting. In accordance with the rules of procedure for the Supervisory Board, the General Committee prepared the resolutions of the Supervisory Board. Where necessary, resolutions were passed by it or the Supervisory Board was provided with recommendations on the passing of resolutions.

The Risk Committee met five times during the last financial year and passed one written resolution in writing. Representatives of the auditors of the annual financial statements also took part in the meetings on a regular basis. The Risk Committee took an intensive look at the Bank's risk position and risk management system. Within this context, it addressed the updating of the Strategic Risk Framework, which provides the risk framework for business strategy and planning. In particular, reports on current events and developments and their impact on the risk situation were made to the Committee at all of its meetings. The Risk Committee also discussed individual commitments significant to the Bank and received reports on the progress made in winding down the NPL portfolios. The Risk Committee received information on all commitments subject to a submission requirement and granted its approval for those business transactions requiring approval by law and the Articles of Association. At a joint meeting with the Compensation Monitoring Committee the Risk Committee reviewed the Bank's remuneration systems to determine whether the incentives set by the remuneration systems take the Bank's risk, capital and liquidity structure into account as well as the probability and maturity of deposits.

The Audit Committee held five meetings in 2017, of which one was an extraordinary meeting, and also received additional relevant information outside of its meetings. Representatives of the auditors of the annual financial statements took part in all of the ordinary meetings. The members of the Audit Committee discussed the Bank's annual and consolidated financial statements for 2016 and relevant audit reports with the auditors. Within this context, the Audit Committee also addressed the Dependent Company Report. The Committee reviewed the independence of the auditors of the annual financial statements in accordance with the requirements set out in the German Corporate Governance Code based on the declaration of independence issued by the auditing firm and prepared the appointment of KPMG AG Wirtschaftsprüfungsgesellschaft as the auditors of the annual financial statements for 2017.

The auditors regularly reported on the current findings of their audit and presented the current status of the planning of the audit of the annual and consolidated financial statements. The Committee also regularly received reports on the appointment of the auditors of the financial statements to carry out non-audit engagements, the work of Internal Audit and compliance issues. The Committee discussed the relevant reports to satisfy itself as to the effectiveness of the risk management system – in particular of Internal Audit and the internal control system. Furthermore, the Committee addressed the findings of the securities account audit and the audit of investment services pursuant to the German Securities Trading Act (WpHG). Finally, the topics covered by the meeting also included current reports on IT restructuring and IT strategy Dealing with the change in the auditors of the financial statements was also a main focus of the work carried out by this Committee in the reporting year.

The auditors regularly reported on the current findings of their audit and presented the current status of the planning of the audit of the annual and consolidated financial statements. The Committee also regularly received reports on the appointment of the auditors of the financial statements to carry out non-audit engagements, the work of Internal Audit and compliance issues. The Committee discussed the relevant reports to satisfy itself as to the effectiveness of the risk management system – in particular of Internal Audit and the internal control system. Furthermore, the Committee addressed the findings of the securities account audit and the audit of investment services pursuant to the German Securities Trading Act (WpHG). Finally, the topics covered by the meeting also included current reports on IT restructuring and IT strategy Dealing with the change in the auditors of the financial statements was also a main focus of the work carried out by this Committee in the reporting year.

The Compensation Monitoring Committee met three times in the reporting year and also held a joint meeting with the Risk Committee. It took an indepth look at the Bank's remuneration systems and received regular reports on the status of the implementation of the requirements resulting from the German Ordinance on the Remuneration of Financial Institutions (Institutsvergütungsverornung) and on the current status of statutory developments relating to remuneration in the banking sector. In 2017, the Compensation Monitoring Committee addressed in particular the changes arising as a result of the amendment to the German Ordinance on the Remuneration of Financial Institutions that came into force in August 2017. The remuneration officer also reported to the Compensation Monitoring Committee on the results of his control activities and presented his remuneration control report, which has to be prepared once a year, to the Committee. The Chairperson of the Remuneration Control Committee also consulted the remuneration officer on relevant issues on a regular basis outside of the meetings.

There was no need for a meeting of the Mediation Committee, which is to be set up in accordance with the provisions of the German Co-Determination Act (Mitbestimmungsgesetz), to be held in 2017.

The Chairpersons of the Committees regularly reported to the Supervisory Board during the subsequent plenary sessions about the work and results of the Committees' deliberations.

AUDIT AND ADOPTION OF THE ANNUAL FINANCIAL STATEMENTS AND CONSOLIDATED FINANCIAL STATEMENTS FOR 2017

The accounting records, annual financial statements together with the Management Report and consolidated financial statements together with the Group Management Report for 2017 were audited by KPMG AG Wirtschaftsprüfungsgesellschaft. KPMG were elected as auditors and Group auditors by the ordinary shareholders' meeting held on 18 May 2017. The audits resulted in an unqualified auditor's certificate with an explanatory note on material uncertainty in connection with the ability to continue as a going concern. In this context, the auditor refers to the discussion in the Group management report in the section entitled "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" as well as to Note 1 to the Group financial statements, "Accounting principles", in which the management states that the going concern assumption for accounting and measurement purposes, as well as the continued survival of HSH Nordbank and major group companies is based, in particular, on the share purchase agreement concluded on 28 February 2018, in which HSH Beteiligungs Management GmbH sold 94.9 % of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG (hereinafter referred to as the "bidders") being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) grants the necessary approvals,
- the European Commission grants its approval for the acquisition following a viability assessment of the new corporate structure,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- hsh finanzfonds AöR submits a final settlement report on the second loss guarantee granted by hsh finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

It is further required that acceptance by market participants and other relevant stakeholders necessary for the successful implementation of HSH Nordbank AG's future business model is maintained or gained.

As set out in the Group management report in the section entitled "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" as well as in to Note 1 to the Group financial statements, "Accounting principles", this indicates material uncertainty that may cast significant doubt on the ability of the HSH Nordbank and major Group companies to continue as a going concern, as well as a risk that threatens the company's survival within the meaning of Sec. 322 (2) sentence 3 HGB. The audit opinions are not modified with regard to this matter.
Further key audit matters in the audit of the consolidated financial statements were the following:

- Appropriateness of the specific loan loss provisions set up on loans and advances to customers resulting from ship financing
- Impact of the implementation of structural measures on accounting
- Impact of privatization on accounting.

Documentation relating to the financial statements and the audit reports together with all attachments were sent to the members of the Supervisory Board. The auditors initially reported on the performance and material findings of their audit at the meeting of the Audit Committee on 24 April 2018. The Audit Committee discussed the results in detail with the auditors on this basis and on the basis of their own review. The Chairman of the Audit Committee reported to the Supervisory Board on the results of the deliberations of the Audit Committee at the Supervisory Board meeting on 25 April 2018. The auditors also took part in the meeting of the Supervisory Board and reported on the material findings of their audit. On the recommendation of the Audit Committee, the Supervisory Board subsequently agreed with the findings of the audits following its own review of the reports of the auditors and an in-depth discussion and determined that, based on the final result of its own reviews, there were also no objections to be raised. The Supervisory Board adopted the 2017 annual financial statements prepared by the Management Board and approved the 2017 consolidated financial statements. Furthermore, it adopted the report of the Supervisory Board for the 2017 financial year.

The Management Board also presented its own report on relationships with associated companies (dependence report) in the 2017 financial year to the Supervisory Board and the auditors of the financial statements in a timely manner. The auditors reviewed the dependence report and issued the following unqualified audit opinion:
„In accordance with our duly performed audit and assessment, we confirm that
1. the factual statements made in the report are correct,

2. the consideration paid for the transactions listed in the report was not disproportionately high".

The Audit Committee and Supervisory Board have reviewed the Management Board's dependence report and audit report of the auditors and discussed these with the Management Board and auditors in the context of the annual financial statements. The Supervisory Board agreed with the findings of the auditors' report because, in its assessment, no objections can be raised with regard to the Management Board's declaration regarding the dependence report

PERSONNEL MATTERS

Ms. Arp resigned as a Supervisory Board member elected by the employees with effect from 14 November 2017. On the same date Mr. Bert Michels assumed the responsibilities of Ms. Arp as an elected substitute member for the remainder of the term of office. The Supervisory Board would like to thank Ms. Arp for her many years of dedicated cooperation.

There were no changes to the Management Board during the 2017 reporting year.

The Supervisory Board would like to thank the Management Board and all employees for their considerable commitment and performance in an environment that has been difficult for the Bank.

Hamburg/Kiel, 25 April 2018
The Supervisory Board

Dr Thomas Mirow
Chairman of the Supervisory Board
of HSH Nordbank AG

CORPORATE GOVERNANCE

ALL STATEMENTS IN THIS CORPORATE GOVERNANCE REPORT REFLECT THE SITUATION PREVAILING ON 15 FEBRUARY 2018.

As an unlisted company, HSH Nordbank has recognised the German Corporate Governance Code (GCGC) voluntarily since 2005. The Management Board and the Supervisory Board of HSH Nordbank expressly support the contents and objectives of the GCGC. Corporate governance at HSH Nordbank is also principally based on the provisions of the German Stock Corporation Act, the German Banking Act and internal rules such as the Articles of Association and the rules of procedure that apply to the Management Board and the Supervisory Board as well as HSH Nordbank‘s Code of Conduct. By presenting the Bank‘s system of corporate governance and control and transparent reporting on conformity to the rules of the Code, we aim to strengthen the confidence that investors, clients and employees and the general public have in HSH Nordbank.

DECLARATION IN ACCORDANCE WITH SECTION 161 OF THE GERMAN STOCK CORPORATION ACT

In accordance with Section 161 of the German Stock Corporation Act the Management Board and Supervisory Board of listed companies must publish an annual declaration of how their management and supervision systems conform to the recommendations of the German Corporate Governance Code or deviate from them. Our aim is to conform to the Code as fully as possible even as a non-listed company. In February 2018, the Management Board and the Supervisory Board of HSH Nordbank therefore voluntarily issued the Declaration of Conformity set out below and disclosed any deviations from the Code.

DECLARATION OF CONFORMITY

The Management Board and Supervisory Board of HSH Nordbank declare that, since publishing their last Declaration of Conformity on 16 February 2017, HSH Nordbank has complied with the recommendations of the German Corporate Governance Code as amended on 7 February 2017 in every respect with the exception of the points mentioned below. Until the next Declaration of Conformity is submitted, HSH Nordbank will comply with the recommendations of the Code as amended on 7 February 2017 with the exception of the points mentioned below.

Details on the remuneration of the Management Board are governed in Sections 4.2.2 (2) sentence 3 and 4.2.3 (2), with which the Supervisory Board shall comply in structuring the remuneration system for the Management Board.

Following the elimination of the restrictions imposed by the 1st EU state aid decision of 2011 HSH Nordbank's current remuneration system for the Management Board continues to conform to the provisions of the guarantee provided by the federal states of Hamburg and Schleswig-Holstein in 2009, particularly those set forth in the „Obligations of HSH“ appendix, which the majority shareholders did not amend in view of the political interest. Under these it is not possible to pay variable remuneration to the Management Board and the requirement that the Management Board remuneration be in proportion to that of senior management and the staff overall can also not be met by the Supervisory Board.

Pursuant to Section 4.2.3.3 the Supervisory Board is to establish, in respect of pension schemes, the level of provision aimed for in each case and take into account the resulting annual and long-term expense for the company.

A defined contribution plan is in place for the Management Board members of HSH Nordbank that does not aim at a certain level of provision.

Pursuant to Section 4.2.4 the total remuneration of each one of the members of the Management Board is to be disclosed by name, divided into fixed and variable remuneration components.

This is not a GCGC recommendation, but a mandatory statutory provision for listed companies, as the German Commercial Code (HGB) stipulates a mandatory disclosure requirement for listed companies. However, as an unlisted company, HSH Nordbank is in principle not subject to this obligation. Furthermore, the parameters of the Management Board remuneration – fixed upper limit, no variable remuneration – have already been made sufficiently public in line with the requirements set out in the „Obligations of HSH" appendix to the guarantee agreement.

Pursuant to Section 4.2.5, model tables are to be used to provide certain pieces of information on remuneration and fringe benefits for each Management Board member.

As HSH Nordbank does not disclose the Management Board remuneration paid to individual members, this information is also not published. (see also Section 4.2.4)

Pursuant to Section 5.4.1 (2) the Supervisory Board is to specify concrete objectives regarding its composition, including a limit to be set for the length of service served on the Supervisory Board.

The Supervisory Board decided not to set a limit for the length of service served on the Supervisory Board, as the optimum length of service is difficult to define and, given the Bank's current situation, the aim is to retain the existing expertise within the Supervisory Board.

Pursuant to Section 7.1.2 sentence 4 the consolidated financial statements shall be publicly accessible within 90 days of the end of the financial year and interim reports within 45 days of the end of the reporting period.

HSH Nordbank published the consolidated financial statements for 2016, but not the interim reports for 2017, by the specified deadlines. The Bank is working on ensuring that the recommended deadline for the publication of interim reports is also met in the future. HSH Nordbank will presumably not publish the consolidated financial statements for 2017 within the specified deadlines.

HSH Nordbank has HSH Nordbank has complied with the recommendations set out in the Code insofar as they make sense for an unlisted corporation.

Hamburg/Kiel, 15 February 2018

For the Management Board

Stefan Ermisch

For the Supervisory Board

Dr Thomas Mirow

SUPERVISORY BOARD

COMPOSITION

HSH Nordbank's Supervisory Board consists of 16 members, of whom – in accordance with the provisions of the German Co-Determination Act (Mitbestimmungsgesetz) – half are shareholder representatives and half are employee representatives. The shareholder side of the Supervisory Board predominantly comprises expert representatives of the business world who are independent of the shareholders and the Bank. Four Supervisory Board members have held management positions at German and international financial institutions in the past One member is also a member of the Management Board of a credit insurance company. The Supervisory Board also includes a self-employed certified public auditor, a managing director of an international private equity company and a managing director of aninvestment holding company.

Section 5.4.1 of the GCGC stipulates that the Supervisory Board shall specify concrete objectives regarding its composition which, whilst considering the specifics of the enterprise, take into account the international activities of the enterprise, potential conflicts of interest, the number of independent Supervisory Board members, an age limit tobe specified for the members of the Supervisory Board and diversity. The latter objective shall, in particular, provide for an appropriate degree of female representation.

The objectives set by the Supervisory Board back in 2011 are as follows:

1. It will seek to continue to have at least the same number of international members on its Supervisory Board as it currently has (minimum one member).

2. When nominating new members to the Supervisory Board, it will also seek to avoid potential conflicts of interest in future, while also taking the rules of procedure for the Supervisory Board into consideration.

3. It will seek in future to adhere to the age limit of 68 years at the date of appointment stipulated in the Rules of Procedure for the Supervisory Board.

4. It will also seek to maintain the proportion of representation by women at least at the current level of 20 % in the future. The Supervisory Board considers an initial target of 30 % to be an appropriate proportion of women.

5. On the shareholder side, the Supervisory Board will also aim to have independent members comprise at least half of its members in the future. (Objective added in 2012)

When nominating new members, care is taken to prevent potential conflicts of interest and ensure the impartiality of the members. New members were all below the age limit of 68 years at the time of their appointment. The Nomination Committee also takes the objective of ensuring appropriate gender diversity levels into account when making proposals to the Supervisory Board regarding new members to be elected by the Annual General Meeting. As a company subject to codetermination, HSH Nordbank also falls under the scope of the German Act on Equal Participation of Women and Men in Executive Positions in the Private and the Public Sector (Gesetz für die gleichberechtigte Teilhabe von Frauen und Männern in Führungspositionen in der Privatwirtschaft und im öffentlichen Dienst), also known as the "Quota Act". The Supervisory Board has therefore once again confirmed its previous target for the proportion of women on the Supervisory Board. With a current proportion of women of 31.25 % the Supervisory Board has already met the target set by itself. The proportion of women employed by the shareholders is 25 %, while it is 37.5 % on the employee side.

A limit for the length of service served on the Supervisory Board has consciously not been set by HSH Nordbank's Supervisory Board. On the one hand, the Supervisory Board considered it difficult to define such a limit and, on the other, felt it important to retain the existing expertise of some long-standing members of the Supervisory Board given HSH Nordbank's current situation.

Under Section 5.4.1 the Supervisory Board shall also develop a competence profile for the full Board. As part of its annual efficiency review, the Supervisory Board looked at the skills, competencies and experience within the Supervisory Board and updated its competenceprofile, which was prepared for the first time in 2014. The competence profile provides the Supervisory Board with competencies represented within the Supervisory Board. This means that, when members have to be appointed to the Supervisory Board or when the Supervisory Board is looking for suitable candidates in the future, it can draw up corresponding objectives directly to make sure that competencies are replaced/additional competencies added.

Section 5.4.1 of the GCGC also provides that the Supervisory Board shall include information in the Corporate Governance report on what it considers to be an appropriate number of independent members on the shareholder side and the names of these members. Whether a Supervisory Board member is to be considered independent is determined on the basis of Section 5.4.2 of the GCGC. Under this Section a Supervisory Board member is not to be considered independent in particular if he/she has personal or business relations with the company, its executive bodies, a controlling shareholder or an enterprise associated with the latter which may cause a substantial and not merely temporary conflict of interests. HSH Nordbank's Supervisory Board considers it appropriate if at least half of the members of the Supervisory Board representing the shareholders are independent members. These are: Dr. Thomas Mirow, Silke Grimm, Stefan Jütte and Elke Weber-Braun.

PROCEDURES

The Supervisory Board appoints, monitors and advises the Management Board and is involved in fundamental decisions made by the Bank. The Management Board informs the Supervisory Board of the proposed business policy and other fundamental matters during the meetings and also orally, particularly in conversations between the Chairperson of the Management Board and the Chairperson of the Supervisory Board.

Section 25d (11) sentence 2 no. 3 of the German Banking Act (KWG) requires the Supervisory Board to evaluate the structure, size, composition and performance of the management and supervisory body on a regular basis, at least once a year. As in previous years, the Supervisory Board used questionnaires for this purpose, not only to evaluate various aspects of its own work, but also to evaluate the work of the Management Board. The efficiency review conducted at the end of 2017 revealed that the Supervisory Board is on the whole satisfied with the efficiency of its activities. In order to further improve its efficiency, the Supervisory Board used the answers to the questionnaires to approve isolated measures and identify topics for further training.

In order to ensure that the Supervisory Board's knowledge and expertise is up-to-date at all times, various submissions presented to the Supervisory Board in the past year were of an educational nature. These related in each case to current topics. Further information on the educational measures is set out in the report of the Supervisory Board.

OTHER MANDATES

In order to be able to perform their Supervisory Board duties properly, the Supervisory Board members have to devote sufficient time to these activities. This means that the individual Supervisory Board members can only have a limited number of other duties over and above their Supervisory Board activities. The Supervisory Board members of HSH Nordbank have the following number of Supervisory Board mandates at other companies:

SB member	Number of other mandates (As at: 31.12.2017)
Dr Thomas Mirow	2
Peter Axmann	3
Olaf Behm	1
Simone Graf	1
Cornelia Hintz	1
Stefan Jütte	1
Dr Rainer Klemmt-Nissen	6
Dr David Morgan	1
Dr Philipp Nimmermann	3
Elke Weber-Braun	2

Detailed information on the Supervisory Board's activities in 2017 can be found in the Report of the Supervisory Board.

REMUNERATION

The remuneration paid to the Supervisory Board is disclosed for each individual member in the notes to the annual financial statements.

MANAGEMENT BOARD

COMPOSITION

The Management Board of HSH Nordbank has consisted of four members since June 2016 and is split into the following areas of Board responsibility: CEO, CFO, CRO and front office. When selecting new Management Board members, the Supervisory Board must adhere to the relevant legal requirements. The issue of diversity plays a key role in this regard. Pursuant to the German Quota Act, the Supervisory Board has set a target of 20% female members for the Management Board of HSH Nordbank. This target was reaffirmed by the Supervisory Board in the summer of 2017. However, as there was no change in the Management Board in 2017, the target has not yet been achieved. The German Corporate Governance Code also requires in particular that women are appropriately represented, while the German Banking Act stipulates that consideration should be given to ensuring balanced and varied knowledge, skills and experience for all Management Board members. The rules of procedure for the Supervisory Board also contain requirements that the Supervisory Board and/or the General/Nominating Committee has to take into account when identifying applicants to fill a Management Board position. This means that the Supervisory Board looks at the Management Board position to be filled on a case-by-case basis and selects Management Board members taking into account the requirements of the position in question and the competencies already represented on the Management Board based on an individual job profile.

PROCEDURES

The Management Board is responsible for the management of the Bank and works with HSH Nordbank's other corporate bodies and with the employees' representatives on a basis of mutual trust in the Bank's best interests. It defines the Bank's strategic alignment in consultation with the Supervisory Board. The Chairman of the Management Board represents the Management Board as a collegial body, presides over its meetings and coordinates its work. The Management Board largely met once a week during the period under review. The members of the Management Board are jointly responsible for running the Bank's business. Its duties and responsibilities are laid down in the Rules of Procedure for the Management Board, which is supplemented by the business allocation plan

OTHER MANDATES

One Management Board member has a mandate on the Administrative Board of one of the Bank's subsidiaries. Other than this, the Management Board members do not perform any management or supervisory functions at other companies.

REMUNERATION

Information on the remuneration system for the Bank's Management Board can be found in the Management Report and notes to the annual financial statements.

SHAREHOLDERS, ANNUAL GENERAL MEETING

HSH Nordbank's shareholders exercise their rights at the Annual General Meeting. The Management Board convenes the Annual General Meeting once a year, stating the agenda and attaching the requisite reports and documents.

In addition to the agenda items that an Annual General Meeting has to cover by law, the Annual General Meeting held in May 2017 also passed necessary resolutions regarding two silent participation agreements. One extraordinary general meeting was held in November 2017 that dealt with the election of new auditors of the financial statements.

ACT ON TRANSPARENCY OF PAY

In future, the bank will be subject to the "Act of Transparency of Pay" and will implement the requirements accordingly.. Hence, the report is to be found on the Bank's homepage as well as in the German Federal Gazette (Report on Equality and Equal Pay in accordance with § 21EntgTransG.). The report is not part of the Annual Report.

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NOTE:

If at times only the masculine form is used for certain terms relating to groups of people, this is not meant in a gender-specific manner, but occurs exclusively for the sake of better readability.

This Annual Report was published on 30 March 2017 and is available at www.annualreport2016.hsh-nordbank.com. This is an English translation of the original German version of the Annual Report.

FORWARD-LOOKING STATEMENTS:

This Annual Report includes certain forward-looking statements. These statements are based on our beliefs and assumptions as well as conclusions drawn from information currently available to us from sources that we consider to be reliable. A forward-looking statement involves information that does not simply reflect historical facts, including information relating to possible or anticipated future growth and future economic developments.

Such forward-looking statements are based on a number of assumptions concerning future events and are subject to uncertainties, risks and other factors, many of which are beyond our control. Therefore, actual events may differ considerably from those forecast in the forward-looking statements. In view of this, you are advised never to rely to an inappropriate degree on forward-looking statements. We cannot accept any liability for the accuracy or completeness of these statements or for the actual realisation of forecasts made in this Annual Report. Furthermore, we are not obliged to update the forward-looking statements following the publication of this information. In addition, information contained in this Annual Report does not represent any kind of offer for the acquisition or sale of any type of securities of HSH Nordbank AG.

HSH NORDBANK AG

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HSH NORDBANK

GROUP MANAG

EMENT REPORT

BASIS OF THE GROUP

BUSINESS ACTIVITIES

Sale of HSH Nordbank AG on 28 February 2018

The federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. With the sale of HSH Nordbank AG, the federal state owners will meet the central commitment set out in the formal decision of 2 May 2016 in the EU state aid proceedings on the replenishment of the second loss guarantee issued by the federal states at that time in a timely manner, thus laying the foundation for the first successful privatisation of a Landesbank in Germany.

The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing) at least until the end of 2021. The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

The privatisation will relieve HSH Nordbank AG of a large part of the legacy burdens bundled in the Non-Core Bank. Within this context, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017.

The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time. The successful implementation of the portfolio transaction will significantly improve the Bank's financial profile, in particular by reducing the NPE ratio to around 2%, and its capital position.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of € 10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million. The signed cancellation agreement is subject, first of all, to the condition precedent of the successful closing of the share purchase agreement, second, to a corresponding notification sent to the parties to the portfolio transaction and third, as a result, to the condition precedent of the closing of the portfolio transaction.

The signed share purchase agreement, the proposed portfolio transaction and the premature termination of the second loss guarantee will influence the structure and business activities of HSH Nordbank in a variety of ways. First of all, the Bank will undergo a far-reaching transformation process that will lay the necessary foundation for the sustainable further development of the Bank's business model. Second, the Bank's net results are influenced by significant privatisation effects as at the reporting date.

Details on the privatisation process, the portfolio transaction and the second loss guarantee, as well as the associated cancellation agreement, are provided in the following sections. The opportunities and risks associated with these transactions are described in the "Forecast, opportunities and risks report" section of this management report.

Headquarters, regional focus, clients and products

HSH Nordbank AG was established in June 2003 by the merger of Hamburgische Landesbank Girozentrale with Landesbank Schleswig-Holstein Girozentrale, and is managed in the form of a German public limited company (*Aktiengesellschaft* – AG). The headquarters of the Bank are located in Hamburg and Kiel.

HSH Nordbank is one of the leading banking partners for upper medium-sized enterprises in the core region of Northern Germany. HSH Nordbank is also active throughout Germany primarily in the corporate and real estate clients business. The focus of the project financing business in the Corporate Clients division (Energy & Utilities and Logistics & Infrastructure business areas) is also on the rest of Europe. The Bank conducts business with shipping clients throughout the world. Based on classical loan financing, HSH Nordbank offers a wide range of individual financing solutions and products tailored to the needs of corporate clients, wealthy private clients, savings banks and institutional clients.

Segments, divisions and locations

The business activities of HSH Nordbank are split between the Core Bank and the Non-Core Bank in line with the Bank's value creation structures. The Core Bank includes the long-term strategic business divisions. These include the Corporate Clients, Real Estate, Shipping and Treasury & Markets segments. The Non-Core Bank includes the non-strategic and predominantly non-performing legacy portfolios, most of which date back to the years prior to 2009 and which are being largely wound down as part of the privatisation process. The administrative divisions and overall bank positions are disclosed as segments not subject to reporting requirements in the "Other and Consolidation" division.

As part of the focusing of its business activities HSH Nordbank has significantly reduced its international network of locations over the past years and closed a number of branches abroad. HSH Nordbank continues to maintain branches in Singapore, Athens and Luxembourg as well as a representative office in Hong Kong in line with its strategic direction. The branch in Luxembourg primarily provides services for the Non-Core Bank. In Germany, HSH Nordbank is represented in Berlin, Düsseldorf, Munich, Stuttgart and Frankfurt am Main. The branches listed above are of secondary importance for understanding the Group situation of HSH Nordbank.

Equity holdings and scope of consolidation

HSH Nordbank has sharply reduced its equity holding portfolio over the past few years. At the 2017 year end, the scope of consolidation for the Group financial statements included, in addition to the parent company, HSH Nordbank AG, 53 fully consolidated subsidiaries compared to 57 fully consolidated subsidiaries as at 31 December 2016. Major additions to the scope of consolidation relate, in particular, to five single-ship companies that were included in the scope of consolidation for the first time:

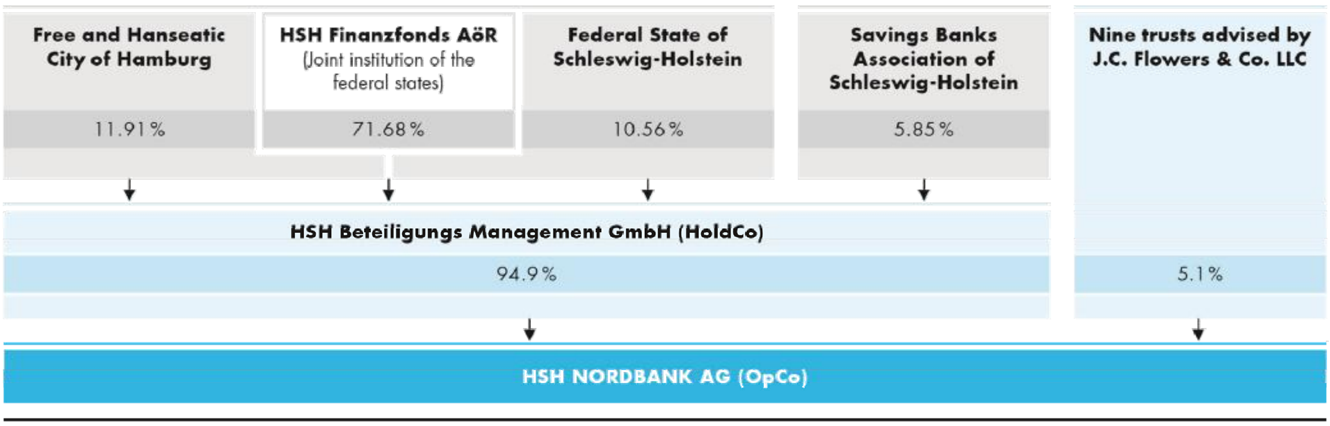
- Chasms Navigation Limited, Douglas, Isle of Man
- Cregneash Navigation Limited, Douglas, Isle of Man
- Curragh Navigation Limited, Douglas, Isle of Man
- Mooragh Navigation Limited, Douglas, Isle of Man
- Soderick Navigation Limited, Douglas, Isle of Man

The additions resulted from the realisation of collateral in connection with restructuring measures relating to a loan exposure. In the context of this realisation of collateral, HSH Nordbank AG transferred the shares in five single-ship companies that had been pledged to it to another party which holds the shares for HSH Nordbank AG on a fiduciary basis. In September 2017, the ships held by the single-ship companies were sold. Since then, these subsidiaries have no longer had any operational business activities.

Disposals relate, in particular, to the companies DEERS Green Power Development Company S.L., Madrid, and Solar Holdings S.à.R.L., Luxembourg, which are no longer included in the Group financial statements, and to six companies from the Mitco Group (single-purpose companies in the real estate sector). These disposals are the result of the sale of shares/loan receivables in the context of portfolio sales. The subsidiaries of HSH Nordbank AG do not have any branches that would be important in the interests of understanding the Bank's situation.

The impact of these changes to the scope of consolidation on the income statement is addressed, to the extent that the impact is material, in the "Earnings" section of this Group management report. More details on the scope of consolidation can be found in Note 5 (Scope of consolidation) in the notes to the Group financial statements.

OWNERSHIP STRUCTURE



Ownership structure, guarantee and EU proceedings

The principal owner of HSH Nordbank AG as at the 2017 year end is HSH Beteiligungs Management GmbH with a shareholding of 94.9%. Private investors advised by J.C. Flowers & Co. LLC also have a shareholding of 5.1%. The Free and Hanseatic City of Hamburg and the federal state of Schleswig-Holstein indirectly hold a combined shareholding of 89.35% via HSH Beteiligungs Management GmbH and 5.55% is held by the Savings Bank Association (Sparkassen- und Giroverband) for Schleswig-Holstein.

In order to secure the Bank's survival, the federal states of Hamburg and Schleswig-Holstein issued via HSH Finanzfonds AöR a guarantee in favour of HSH Nordbank on 2 June 2009 that provided capital relief (second loss guarantee), but which did not affect liquidity at that time, under which payment defaults in a specified portfolio are hedged (mainly in the Non-Core Bank). In 2013, the guarantee facility was replenished after a reduction in 2011 from € 7 billion to the original facility of € 10 billion in view of the changed underlying conditions. This measure was initially provisionally approved by the EU Commission in 2013. At the same time, the EU Commission instituted state aid proceedings to investigate whether the replenishment of the guarantee is consistent with state aid rules.

In these EU state aid proceedings, the European Commission reached a formal decision on 2 May 2016 and thereby finally approved the replenishment of the second loss guarantee issued by the federal states. The decision is based on a catalogue of conditions and commitments provided by the Federal Republic of Germany, on behalf of the federal state owners of HSH Nordbank, to the EU Commission containing the fundamental aspects of the agreement, which include, among other things, the privatisation of HSH Nordbank AG by 28 February 2018 as a central requirement.

The purpose of the structural measures envisaged in the list of conditions and commitments is to improve the financial and risk situation and create the basis for a sustainable structure and viable business model.

With the sale of HSH Nordbank AG on 28 February 2018 to private investors that are independent of each other, the federal state owners meet the EU Commission's central commitment set out in the formal decision of 2 May 2016 in a timely manner.

Further details on the second loss guarantee are set out in Note 3 of the notes to the Group financial statements. Details regarding the impact of the guarantee on the net assets, financial position and earnings in 2017 are set out in the "Economic report" section. Further information on the EU decision can be found in the Business developments section under "Major developments and events" as well as in the "Forecast, opportunities and risks report".

FUTURE OWNERSHIP STRUCTURE

Funds initiated by **Cerberus Capital Management, L.P.**[1]			Funds initiated by **J.C. Flowers & Co. LLC**	Funds initiated by **GoldenTree Asset Management LP**	Funds initiated by **Centaurus Capital LP**	**BAWAG P.S.K.** Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft
Promontoria Holding 221 B.V.	Promontoria Holding 231 B.V.	Promontoria Holding 233 B.V.	JCF IV Neptun Holdings S.à r.l.	GoldenTree Asset Management Lux S.à r.l.	Chi Centauri LLC	
17.0 %	13.5 %	12.0 %				
42.5 %			**35.0 %**	**12.5 %**	**7.5 %**	**2.5 %**

[1] Change of allocation of shares within the Cerberus initiated funds possible.

Membership in the German Savings Banks Finance Group

HSH Nordbank is a member institution of the German Savings Banks Finance Group. The German Savings Banks Finance Group has an institutional guarantee scheme: This scheme protects deposits held at a savings bank, Landesbank or a Landesbausparkasse. The objective of the protection scheme is to protect the member institutions and avert emerging or existing financial difficulties at these institutions.

The Deposit Guarantee Act (EinSiG) entered into force in Germany on 3 July 2015. The Act implements the relevant EU Directive. The German Savings Banks Finance Group has designed its proven protection scheme to meet these statutory requirements, and the scheme has been recognised as a deposit guarantee fund under the EinSiG.

Due to the ongoing privatisation of HSH Nordbank AG, the guarantee scheme needs to be changed from the guarantee scheme of the German Savings Banks Finance Group to the guarantee scheme of private banks (BdB). Within this context, the Bank is aiming to achieve a seamless transition between the guarantee schemes. The closing of the privatisation process, for example, is subject to the provision that the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of 2021. At the same time, the Bank has applied for admission to the guarantee scheme of private banks. Further details can be found in the "Forecast, opportunities and risks report" section.

External influencing factors and processes

Besides the EU decision and the privatisation that was promised within this context, other relevant material external factors influencing HSH Nordbank's business include economic and financial market developments (movements in the EUR/USD exchange rate, interest rate level, inter alia), developments in the relevant industry sectors such as the shipping industry (particularly charter rates and ship values) or the real estate market, regulatory requirements and discretionary decisions made by the supervisory authorities, external ratings, assessments of capital market participants and other stakeholders, as well as the further course of the privatisation process up until the closing date.

Within its business organisation HSH Nordbank has defined processes that form the basis for operating and managing the Bank as well as for its internal control system. The main processes include strategy and planning, corporate management, customer management, financing, capital markets as well as support processes.

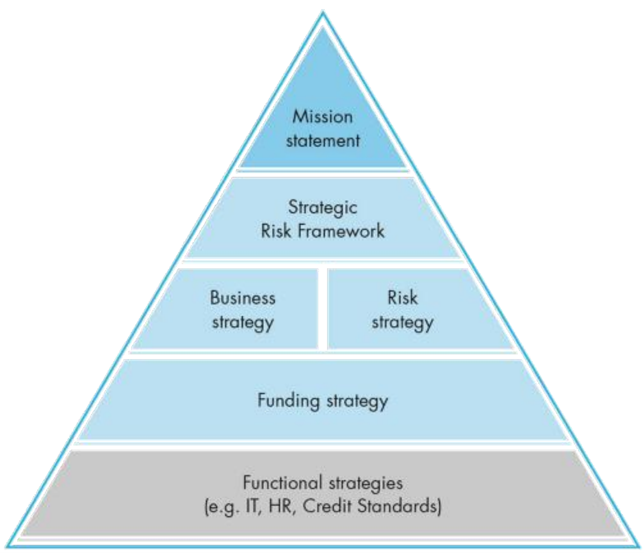
OBJECTIVES AND STRATEGY

HSH Nordbank's strategy is to be a Bank for Entrepreneurs in the larger medium-sized companies segment from the metropolitan regional base of Hamburg. Central to this perceived role is a focused and entrepreneurial approach that creates added value for clients, shareholders, the Bank and its employees.

In principle, the Bank's overarching goal is to continually develop its business model, which is firmly rooted in the northern German region. In doing so, it takes into account the requirements resulting from a rapidly changing banking environment on the one hand. On the other hand, the Bank, which will be relieved of legacy burdens, EU restrictions and complex guarantee structures in the future, is focusing on its realignment, the aim being to create a risk-optimised and agile corporate structure. A needs-based service and product portfolio, which will be continually optimised to meet client needs, and a sustainable high-performance and efficient organisation structure of what will, in the future, be a private bank will form the basis for this. The Bank's individual objectives are embedded in the strategic architecture.

Based on the Bank's mission statement, in which the objectives, strategy, purpose and values are combined in an appropriate framework, HSH Nordbank's strategy architecture includes the following central components:

STRATEGY ARCHITECTURE



The strategic risk framework, which, as a framework document, describes the direction of the Bank's risk management and establishes the foundation for the risk culture, provides consistent guidelines for effectively aligning the organisation and business operations to the basic risk-strategy principles.

The strategic risk framework includes the risk coverage potential (risk capacity), which is determined on the basis of the capital and liquidity resources available, as well as key guidelines for risk-conscious actions on the part of the Bank and the cornerstones of a sustainable risk culture. These provide the framework for the development of the Risk Appetite Statement (RAS) and the risk strategy.

Based on the risk inventory process, the RAS is split into Financial and Non-Financial RAS. It aims to provide a compressed overview of selected risk tolerance areas to determine the utilisation of the risk capacity based on various scenarios, in order to ensure that the Bank's overall objectives are met and to define the risk appetite for all major risks.

Details of the bank-specific risk types are explained in the Risk report section.

The Financial RAS consists of a catalogue of key financial ratios, while the Non-Financial RAS includes qualitative requirements relating to risk culture. Operationalisation is achieved via the risk strategy and the limit system, with the risk strategy describing how risks are managed based on the risk inventory in accordance with the business strategy and RAS. It provides a framework for the sub-risk strategies (counterparty default risk, in each case for the performing and non-performing exposure, market risk, liquidity risk and NFR with reputation risk, operational and business strategy risks). The SRF forms the basis for the business strategy and provides the key basis for planning within the Bank.

Furthermore, tolerance ranges for the utilisation of risk capacity are determined on the basis of various scenarios and the risk appetite is defined for all material risks. Details of the bank-specific risk types are explained in the Risk report section.

The business strategy, which is defined by the Management Board, describes the overriding strategic direction with regard to the business model and business area portfolio of the Bank. This transposes the overall strategic model into a specific strategic direction and plan. It describes the Bank's objectives for each key business activity and the measures to be taken to achieve these objectives. With regard to the intended change of ownership, long-term objectives take the strategic vision of a bank that is established in a private-sector environment into account. The focal point of this strategic direction lies in ensuring sustainable profitability and a sustainable capital structure, ensuring a manageable risk profile, establishing long-standing and solid customer relationships, distributing high-quality financial products and services, as well as pursuing an active cross-selling approach.

The operating business model of HSH Nordbank is undergoing targeted further development in the light of the privatisation process. The narrow framework provided to date by the guarantee structure, the EU proceedings and the catalogue of commitments and conditions will be redefined as a result of the Bank's transition from a public-sector institution to a private bank. This will create new business potential for the strategic areas of the Core Bank and provide opportunities for the Bank to further reduce the complexity of its structure. The business potential will be described for each business area in the context of the business area strategy and backed up by specific implementation measures in the various areas. An essential component for defining strategic goals and monitoring implementation are quantitative performance indicators, which are defined by a bank-wide target system as the basis for measuring performance and the effectiveness of the business strategy.

A consistent risk strategy is determined on the basis of the business strategy and the strategic risk framework. This includes developments in the key business activities planned in the business strategy taking due account of risk strategy factors and liquidity aspects as well as of the measures required to achieve these goals.

The funding strategy establishes the framework for the strategic orientation of the refinancing of HSH Nordbank. It is a core component of the Bank's business strategy. As part of this definition process, the requirements regarding liquidity resources are geared towards sustainability to ensure that regulatory and rating requirements are met at all times and that a liability structure that is optimised from a profitability perspective is achieved. Liquidity management, particularly with regard to the ongoing privatisation process, aims to achieve an above-average level of liquidity. The refinancing of the Bank is generally based on the use of various sources of refinancing. Within this context, the Bank has been tapping into a new source of financing since the fourth quarter of 2017 by offering private clients fixed-term deposit investments via the "Deposit Solutions" online platform. This new sales channel is allowing the Bank to prepare in a proactive manner for the period after the change of ownership.

Functional strategies are defined based on the basis of the Bank's core business strategies. The long-term IT objectives are set in the IT strategy. Developments in the key business activities planned for the business areas and the Bank's digitalisation strategy are also taken into account. The personnel management tools required for the monitoring and support of HSH Nordbank are anchored in the human resources strategy.

Taking account of the business and risk strategy, the lending standards define a binding and comprehensive framework for all parties concerned under which the lending business may be conducted.

HSH Nordbank's stated objectives and strategies are basically aimed at ensuring the Bank's sustainable development. When it comes to defining and implementing them, the employees of HSH Nordbank use fundamental rules of conduct summarised in the "Code of Conduct" as a guide. The "Code of Conduct" is a binding code of behaviour. As a normative basis, it provides employees of HSH Nordbank with reliable guidance for responsible action that meets the statutory requirements but also for ethical and social standards. This allows economic, ecological and social aspects to be taken into account in a balanced way.

Summarised Separate Non-financial Report pursuant to Sections 315b, 315c in conjunction with 289b to 289e of the German Commercial Code (*Handelsgesetzbuch* – HGB)

The summarised separate non-financial report can be found on the Bank's website at www.hsh-Nordbank.de/de/hsh-Nordbank/corporate-governance and does not form part of this management report.

Realignment of the Bank

As part of its realignment, according to plan the Bank is focusing on expanding its existing client relationships and business areas within a bank that will be free from EU restrictions. The regional business model will be developed further and the existing sector focus will be strengthened, particularly among clients from the medium-sized companies segment. There are also plans to further expand the real estate financing business (in Germany, but also on a selective basis abroad) and the international project financing business (in particular renewable energy and infrastructure), and to adopt a focused business approach in the ship financing segment. At the same time, the Bank is aiming to use a risk-optimised organisational structure that will be relieved of legacy burdens and the guarantee structure to reduce complexity considerably and achieve improvements in its business and operating model as a result.

The activities associated with the Bank's realignment are bundled in the Bank-wide transformation project "Reset & Go". This project involves reviewing cross-divisional products and processes, as well as organisational and cost structures, and adjusting them further to meet the needs of a medium-sized bank. Particular emphasis is being placed on establishing HSH Nordbank AG, which will be operating under a new brand with a new name after the successful closing of the privatisation process, as a client-focused and agile bank. The main focal points of the project include the development of profitable and risk-oriented growth strategies and the associated implementation plans. Collaboration between the product and customer departments is particularly important. At the same time, the Bank's operating business model is being realigned. Within this context, the reduction of complexity in processes and products, as well as in terms of the organisational structure, offers significant potential.

The strategic realignment is being combined with digital transformation. The focus in this regard is on the development of digitalised value-adding processes focusing on clients, products, the Bank's own internal business processes and corporate culture. The Bank will be pursuing a holistic and systematic approach within this context. This will mean that the Bank can design its products more efficiently and also tap into new customer groups and market potential. This will also allow processes to be streamlined on the basis of increasing automation, allowing further efficiency gains to be achieved.

The Bank's competitive realignment in the long term is characterised by strong and solid financial key figures. In this respect, the Bank has defined a strategic target vision. Within this context, the Bank is striving, as part of the realignment process, to achieve a CET1 capital ratio of at least 15 % and, following the implementation of the portfolio transaction, an NPE ratio of around 2 %. The strategic vision is that the realigned bank will have total assets of around € 55 billion, a cost-income ratio of approximately 40 % and profitability before taxes of more than 8 %.

Strategic targets of the Core Bank's business fields

The strategic divisions are being developed on an ongoing basis and their business portfolios and positioning are being adjusted to reflect the changing underlying conditions in the market and competitive environment.

The aim of HSH Nordbank in the planning period leading up to 2022 is to increase new business with risk-commensurate margins in accordance with the business and risk strategy. The successful completion of the privatisation process will provide numerous opportunities, taking into account the business potential that the Core Bank offers, to step up moves to expand new business and to broaden the Bank's client base. In addition to its business in the northern German core region, the Bank is planning to drive ahead with the expansion of its activities outside of Germany and across Europe for selected projects and sectors in the interests of ensuring a balanced portfolio structure. The sector focus on business with medium-sized clients is to be developed further, taking advantage of the high level of industry expertise.

Furthermore, product sales covering the entire range of services over and above traditional lending transactions will continue to be driven forward to strengthen sustainable client relationships and exploit the business potential in the product divisions. This applies, in particular, to the intensification of syndication activities, which should result in an increase in non-interest-related income.

The aim is to intensify new business in the Corporate Clients division. The approach of expanding business throughout Germany in the existing locations will be consistently continued in order to achieve this in a highly competitive market environment. At the same time, the potential in the core region of northern Germany as well as in the project financing business in the Energy & Utilities and Logistics & Infrastructure business areas abroad is to be exploited in a focused manner. In particular with regard to conventional corporate clients, market access is being enhanced further by way of digitalisation strategies.

The Real Estate Clients division will continue to make a risk-conscious contribution to the Bank's balanced portfolio mix taking account of the development in the German real estate markets. The profitability of transactions is the major driver for the sustained improvement in the Bank's risk/return profile. In the future, the Bank aims to expand cautiously its international activities with established internationally active clients of the Bank in European metropolitan regions.

In the Shipping division, the Bank is still aiming selectively to conclude additional new business as a strategic partner based on its long-standing expertise and in accordance with strict margin and risk requirements. The focus is on the diversification of the portfolio through domestic and international commitments with counterparties with a good credit standing.

The Treasury & Markets division includes the operational treasury function and, in Markets, the Bank's capital market and capital market-related client business. Operational treasury implements the central management of the liquidity and market price risks associated with the Bank's positions, as well as the management of the cover pool, in consultation with Bank Management. Responsibility for liquidity management and the Bank's issuance activities is also anchored in this division. Markets stands for trading with capital market and investment products, syndication as well as the corresponding sales activities and the provision of support to savings banks, banks and insurance companies.

The client divisions are generally supported by products and services provided by the Treasury & Markets, Transaction Banking and Structured Finance divisions in order to ensure an integrated product range and exploit cross-selling potential.

Stringent winding-down of legacy burdens in the Non-Core Bank

The Bank significantly accelerated the operational winding-down of non-performing legacy portfolios in the reporting year and has wound down portfolios considerably. The focused winding-down strategy is a significant strategic step on the path towards a successful change of ownership. In line with the requirements that need to be met to achieve a sustainable business model in the long run, the Bank is aiming to systematically wind down the non-strategic and non-performing portfolios until it has reached a good NPE ratio of around 2 %, in line with the German market average. The portfolio transaction agreed as part of the privatisation process should mean that this strategic objective can already be achieved in the current financial year.

COST REDUCTION AND INCREASE IN EFFICIENCY IN THE CONTEXT OF THE REALIGNMENT

Continuous improvement in the Bank's efficiency remains a high priority for HSH Nordbank. It has revised its cost and efficiency targets for the period to 2022 in view of the challenging banking environment with intensive competition and constantly increasing regulatory requirements. Within this context, it also takes into account the requirements resulting from the Bank's realignment. The objective is to achieve a sustainable, competitive cost-income ratio. As a result, HSH Nordbank is aiming to achieve a further reduction in administrative expenses and a cost/income ratio of around 40% in the medium term.

The extensive cost reduction programme implemented to date to cut administrative expenses is to be adjusted to include additional aspects in the context of the privatisation process and will continue to be implemented systematically. In this respect, the Bank is assuming the winding-down of a large part of the non-performing legacy burdens, the lifting of EU restrictions and the termination and full settlement of the second loss guarantee, allowing for substantial increases in efficiency and, as a result, the comprehensive optimisation of cost structures. This will allow the Bank to eliminate all of the expenses associated with the Non-Core Bank and the second loss guarantee, to further streamline the organisational structure and to noticeably reduce the complexity of the Bank's processes.

IT STRATEGY

Key elements of the IT strategy, which was adjusted in 2016, were successfully implemented by the end of 2017 in line with the plan. The renovated IT and telecommunications systems form the basis for innovative solutions and a continuous increase in the stability of the IT production. This means that IT has a scalable structure, meaning that it is prepared for business strategy realignment in general.

The central data platform was deployed in the reporting period and provides a consistent pool of data for key technical banking evaluations. Potential strategic courses of action for the period following a change of ownership were developed and are ready for implementation. The Bank forged ahead with the establishment of the security organisation, including necessary resource and competence enhancements.

Within the context of the further development of the business model as well as the streamlining of processes, the implementation of the digitalisation strategy will be a top priority.

MANAGEMENT SYSTEM

Key value drivers and key indicator and ratio system

The Bank's integrated management system is aimed at the targeted management of key value drivers – income, efficiency/costs and profitability, risk, capital and liquidity – in line with the statutory requirements (SREP, BCBS 239). The Bank uses a risk-adjusted key indicator and ratio system for this purpose that ensures that the Bank is managed in a uniform and effective manner. The HSH Nordbank Group is managed mainly on the basis of figures for the Group prepared in accordance with the International Financial Reporting Standards (IFRS)/the relevant prudential rules.

In addition, a multi-level contribution margin accounting system is also used to manage the individual business fields. Other components of the Overall Bank management system are the annual strategy and planning process, plan/actual comparisons and targets agreement and assessment process. The key value drivers are managed by three management committees composed of representatives of the top management level. Further information regarding this is included in the Risk Report under "Risk management by central committee structure" and "Risk reporting and measurement systems".

Management indicators of the IFRS Group

The Bank's internal control system is based on key management indicators relating to the individual value drivers of the IFRS Group. The development of these indicators is still compared, on the one hand, against the previous year and the prior-year forecast ("Economic report" section). On the other hand, their expected development in 2018 is also described ("Forecast, opportunities and risks report" section).

Compared with the previous year, the internal management indicators changed in the reporting year due to the gradual reduction in the regulatory relief effect of the second loss guarantee and its expected termination in connection with the privatisation process. As a result, the Bank is using the same-period CET1 ratio, without taking into account the regulatory relief effect of the second loss guarantee, as the key management indicator for internal control. The expression "without taking into account the regulatory relief effect" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements. The capital ratio that is calculated taking into account this hypothetical assumption is referred to as the pro forma CET1 ratio for the purposes of management reporting, and replaces the previously reported same-period CET1 ratio for management purposes.

In addition, the NPE ratio and the coverage ratio will be reported exclusively at Group level in the future. They will no longer be reported for the Non-Core Bank and Core Bank because, following the implementation of the portfolio transaction, an analysis of this ratio broken down into the Non-Core Bank and Core Bank compared with the Group will not provide any significant added informational value. With regard to the liquidity ratios, the Bank is focusing on the regulatory figures: liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). The minimum survival period in the combined stress scenario, which was previously shown among the most important key management indicators, is no longer used as the most important key management indicator within the context of internal control. As far as its most important indicators are concerned, the Bank's internal management of the liquidity situation focuses on the regulatory liquidity ratios LCR and NSFR.

A comprehensive view of the key value drivers (income, efficiency/costs and profitability, capital and liquidity) is sufficiently ensured by HSH Nordbank's integrated management system. The most important management indicators used by HSH Nordbank are defined as follows:

DEFINITION OF THE MOST IMPORTANT MANAGEMENT INDICATORS

Most important management indicators	Definitions
Net income before taxes	Net income before taxes is equivalent to the IFRS result generated before deducting tax expense.
CIR = Cost/income ratio	The CIR is a cost efficiency ratio that measures administrative expenses as a percentage of total income plus other operating income.
RoE = Return on equity	RoE is calculated as the ratio of income before taxes to average equity capital disclosed on the balance sheet and shows the return on capital. The risk-adjusted allocation of the average equity capital disclosed on the balance sheet is determined on the basis of the regulatory capital committed.
NPE ratio = Non-performing exposure	The NPE ratio measures the sum of the risk positions (EaD, exposure at default) of borrowers in default as a percentage of the sum of the Bank's risk positions.
Coverage ratio	The coverage ratio is calculated as the quotient of the loan loss provisions (individual valuations allowances and general loan loss provisions) recognised on risk positions and the sum of the risk positions in default.
Pro forma CET1 ratio (phase-in, same period) = Common Equity Tier 1	The CET1 ratio is defined as the quotient of the core Tier 1 capital excluding hybrid instruments and the sum of the risk-weighted assets, expressed as a percentage. The CET1 ratio is determined in the same period calculation (i.e. taking the Group financial statements into account) in accordance with the transitional rules (phase-in) of the Capital Requirements Regulation (CRR). "Pro forma" means that the capital ratio is calculated based on the hypothetical assumption that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.
LCR = Liquidity coverage ratio	The LCR represents the security provided to the Bank in the event of a short-term acute liquidity stress scenario of more than 30 days by maintaining a liquidity buffer (short-term stress test ratio). The LCR is calculated as the ratio of highly liquid assets to net cash outflows over the next 30 days. It is calculated internally at subgroup level for the purposes of internal control. Unlike in the previous year, the LCR is calculated without taking the institutional protection into account, i.e. taking into account the limit on the deposit guarantee for client deposits of € 100,000 per client.
NSFR = Net stable funding ratio	The NSFR (QIS) shows that stable long-term funding is secured by the Bank under stress conditions. The amount of stable funding available over one year must be sufficient to cover the existing long-term funding required. The NSFR is calculated as the quotient of the amount of available and required stable funding (≥1 year). It is calculated at subgroup level for the purposes of internal control.

Based on key value drivers and their important management indicators the following matrix of management indicators shows the key performance indicators relevant for the Core Bank and Non-Core Bank.

MATRIX OF MANAGEMENT INDICATORS

		Group	Core Bank	Non-Core Bank
Income	Net income before taxes	x	x	x
Efficiency and profitability	CIR	x	x	
	RoE	x	x	
Risk	NPE ratio	x	x	x
	Coverage ratio	x		x
Capital	Pro forma CET1 ratio	x		
Liquidity	Survival period	x		
	LCR	x		
	NSFR	x		

HSH Nordbank also uses the following two additional important management indicators for the specific management of the Core Bank and Non-Core Bank.

ADDITIONAL, MOST IMPORTANT MANAGEMENT INDICATORS OF THE CORE BANK AND NON-CORE BANK

Core bank	New business	New business includes, on the one hand, completely new credit risk incurred by the Bank designated as "acquisition of new loan" under the client responsibility of a Market division and, on the other, increases in the existing credit risk designated as a "loan increase" under the client responsibility of a Market division (also where the loan term is prolonged concurrently). Restructuring commitments – also in the case of increases in existing credit risks – are not taken into account in determining new business.
Non-Core Bank	Total assets	Total assets is the sum of the assets on the asset side or the sum of the total capital on the liability side of a balance sheet as at the balance sheet reporting date.

The extent of the indicators used at HSH Nordbank for managing the overall bank goes far beyond the important management indicators listed in this section and includes many other supporting key performance indicators, which are used by management for the purposes of managing and allocating financial resources in an effective and integrated manner. Further details regarding the key figures and ratios used for risk management are set out in the Risk Report.

HSH Nordbank also updated and refined its recovery/resolution plans in accordance with the statutory requirements. The recovery and early warning indicators defined in the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz,* SAG) and by the EBA (European Banking Authority) are regularly monitored and assessed in order to be able, where necessary, to implement targeted measures on a timely basis.

Management Board remuneration

The remuneration system for the Management Board of HSH Nordbank meets all relevant, regulatory requirements. In addition, particular attention was paid to ensuring that the remuneration system complies with the guarantee agreement of the federal states as well as the catalogue of conditions and commitments imposed by the EU in the initial EU proceedings for the approval of the granting of the second loss guarantee. The limit on the fixed monetary remuneration of each board member of a maximum of € 500,000 per year as long as HSH Nordbank AG is not capable of making dividend distributions is therefore implemented in the remuneration system. The options provided for in the EU decision of May 2016 regarding the adjustment of Management Board compensation were not used. The Management Board has unilaterally waived until further notice the granting of a success bonus following successful privatisation, which was granted to the Supervisory Board as part of the EU decision of May 2016.

General agreements have not been concluded for the early termination of a Management Board member's contract without good cause. However, it is contractually agreed that – in accordance with Section 4.2.3 of the German Corporate Governance Code – any agreed payments to a departing member of the Management Board may not exceed the value of two years' fixed annual salary (including fringe benefits) and the total of the fixed salary for the remaining term of the employment period.

In the year under review, no member of the Management Board received payments or promises of payment from a third party in respect of their activities as a Management Board member. The same also applies to payments or promises of payment from companies, with which HSH Nordbank maintains significant business relationships.

Further information on Management Board remuneration is set out in Note 65 (Related parties).

ECONOMIC REPORT

UNDERLYING MACROECONOMIC AND INDUSTRY SECTOR CONDITIONS

GLOBAL ECONOMIC RECOVERY BECOMING MORE BROADLY BASED, FINANCIAL MARKETS SHOW POSITIVE DEVELOPMENT

The global economy picked up speed in 2017. Whereas global growth came to only 3.2% in 2016, 2017 saw an expansion rate of 3.7%. Growth momentum in the US increased considerably in the course of the year. Economic output in the US increased by 2.3% in 2017 as a whole. Particularly in the eurozone, the economic upswing picked up more speed than expected, meaning that a growth rate of 2.3% was achieved in 2017, driven by rising investment and robust private consumption. China returned to stronger growth of almost 7% in a year-on-year comparison. In general, however, the trend towards a gradual slowdown in growth remains intact. Most other emerging markets also showed positive development.

In the eurozone, the Europe-friendly outcome of the elections in the Netherlands and in France in the first half of the year came as a source of relief and contributed to political stabilisation. On the other hand, there is increased uncertainty surrounding the Brexit process, with the negotiations between the EU and the United Kingdom proving to be tough. The uncertainty with regard to the political course of action in the US also remained high initially. The US Federal Reserve took advantage of the good economic situation to continue with its monetary policy normalisation. In this environment, the financial markets showed positive development on the whole, with the stock markets, in particular, making considerable gains worldwide. Yields on government bonds – with the exception of US short-term bonds – showed only a slight upward trend at best, and remained at a low level overall. On the other hand, the euro made significant gains against the US dollar, driven not least by the political and economic stabilisation in the eurozone.

SYNCHRONISED UPSWING WORLDWIDE

After a somewhat disappointing start to the year, the pace of growth in the US increased significantly, meaning that the economy expanded at a rate of 2.3% for the year as a whole, a significant acceleration compared with 2016. The main growth drivers were private consumption and investment – and particularly fixed capital investment. Exports also showed positive development, whereas government spending had a partly dampening effect. The labour market picked up and showed a further improvement, with an unemployment rate of 4.1% in December. Nevertheless, wage growth remained low, meaning that the inflation rate came to 1.5% (PCE core rate), below the Fed's price target of 2%.

China's GDP is expected to have increased by 6.9% in 2017, a rate that is up slightly on the previous year. The strong growth can be traced back, among other things, to state investment programmes and rising real estate prices. India's economy expanded by 6.7%, i.e. at almost the same pace. The Russian and Brazilian economies are showing signs of a revival again after two years of, in some cases, deep recession, even though the political situation in Brazil remains fragile.

In the eurozone, the economic upswing picked up more speed than expected. In the course of 2017, the eurozone economy grew by 0.6% and 0.7% on a quarter-on-quarter basis, meaning that GDP growth came to 2.3% for the year as a whole, the highest level in ten years. It is also encouraging to see that the upswing is broadly distributed among the EMU countries. The unemployment rate in the eurozone dropped back significantly from 9.6% to 8.7% in the course of the year, with inflationary pressure nevertheless remaining moderate. In December, the annual inflation rate came to 1.4%, well below the ECB's price target of just under 2%. The elections in the Netherlands and France led to a higher level of political stability, as populist parties failed to secure majorities contrary to widespread concerns. While the crisis surrounding independence for Catalonia resulted in an unsettled mood to begin with, it was ultimately resolved for the time being. The biggest source of uncertainty in Europe continues to stem from the United Kingdom, which applied to leave the EU at the end of March 2017. The current negotiations on the terms of the country's exit are proving tough.

The development of the German economy also exceeded expectations. The vigorous development in private consumption and investment, as well as exports, translated into strong growth momentum. Growth of 2.2% was achieved in 2017. The strength of private consumption is due to the very positive situation in the labour market, as well as the favourable income prospects. Wage development has remained moderate to date, although future bottlenecks in the labour market point towards rising wages.

STRONG EURO, DIFFERENCES IN MONETARY POLICY AND BARELY INCREASING GOVERNMENT BOND YIELDS

In the course of 2017, the US Federal Reserve continued to forge ahead with its normalisation of monetary policy. First, the target range for the Fed Funds Rate was increased in three steps, meaning that it closed the year at between 1.25% and 1.50%. Second, the Fed initiated a cautious reduction in its total assets, which had increased to 4.5 trillion US dollars as part of its asset purchase programme. Given the Fed's rate hikes, the yield on two-year T-Notes rose considerably to nearly 2%, while the yield on ten-year T-Notes hardly increased at all overall, despite the positive economic development. It came to around 2.40% at the end of the year, on a par with the level seen at the beginning of the year. This means that the US yield curve has flattened considerably from the short end.

The ECB kept its monetary policy stance largely unchanged for the time being despite the economic upswing, although the monthly asset purchases were reduced from € 80 billion to € 60 billion in the spring of 2017. The yields on German government bonds fluctuated within a narrow range in 2017 – the yield on ten-year bonds came to between 0.15% and 0.60% – meaning that there was no clear upward movement despite the dynamic economic development. This was largely due to geopolitical risks, such as the escalation of the conflict in North Korea, the very hesitant monetary stance taken by the ECB and the increasingly short supply of German government bonds.

The stock markets were on a clear upward trajectory in the course of the year. The DAX rose from 11,600 at the beginning of the year to a temporary high of 13,500 points. Germany's benchmark index closed the year at just shy of 13,000 points, an increase of 11%. The US share indices also climbed to one high after another: the S&P 500 index reported annual performance of 18%, with the Dow Jones rising by as much as 24%.

On the currency market, the euro made significant gains against the US dollar. Whereas the currency pair stood at 1.05 at the beginning of 2017, this figure surpassed the 1.20 mark at times. This is testimony to the very positive economic situation and the greater political stability in the eurozone, which is boosting confidence in the monetary union considerably.

UNEVEN TRENDS IN RELEVANT MARKETS

The **shipping markets** showed the first signs of a slight recovery in 2017. The market for container vessels and bulkers showed development that outstripped the low market expectations. The incipient recovery in charter rates was also reflected, albeit with some delay and to a lesser extent, in an increase in ship values. Second-hand prices increased slightly in the container vessel and bulker segments, in particular. On the oil tanker market, on the other hand, the downward trend in charter rates continued.

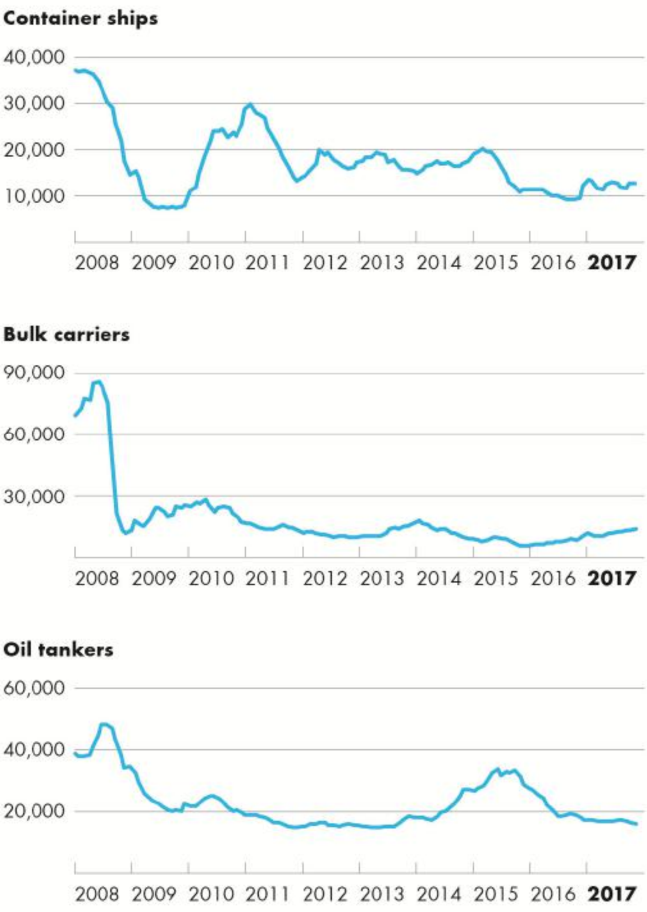
Charter rates on the market for **container vessels** showed a moderate increase in the course of the year, and were higher than operating costs in all sub-segments at the end of the year. Ship values also showed a positive trend and left the all-time lows behind them. In line with the improved macroeconomic environment, the demand for container transport showed very dynamic development in 2017 and was up considerably on the previous year. This applies, inter alia, both to the key Asia-Europe route and to transpacific trade. The continued consolidation among shipping lines and the new alliance landscape that was formed in April 2017 provided a new basis for networks and timetables in liner service, and will pave the way towards more efficient fleet utilisation. On the supply side, the initially weak fleet growth accelerated in the second half of the year, as scrapping activity decreased and the number of deliveries increased. Encouragingly, however, demand growth exceeded the increase in supply. In addition, the number of laid-up vessels fell considerably.

As far as **bulkers** are concerned, the upward trend continued in the course of 2017. After the seasonal decline in the spring, a rapid recovery was observed towards the middle of the year and both rates and prices had stabilised by the end of 2017. Charter rates in all sub-segments were higher than operating costs. The demand for iron ore and coal showed encouragingly positive development in Asia. One key factor in this respect is the high Chinese demand stemming from increasing steel production and the substitution of the country's own coal production. Bulker fleet growth is proving relatively constant due to moderate new orders, as well as scrapping levels that remained stable during the year. New ship ordering activity was stable throughout the year, meaning that the order book was only at a moderate level in 2017. The increase in transport volumes witnessed in the bulker segment since the beginning of the year, as well as the largely stable fleet development, resulted in increased utilisation levels among both smaller and larger vessels.

The charter rates for **oil tankers** were able to slow the downward trend significantly in the course of 2017. The production cuts by OPEC countries are still putting pressure on the demand side. In this respect, however, the expansion of oil production using fracking in the US is providing some relief. US exports are largely being shipped to Asia, tying up a considerable amount of tanker tonnage due to the long route. On the supply side, the strong fleet growth is putting pressure on charter rates. Nevertheless, signs of an imminent turnaround are starting to emerge: order activity slowed again in the second half of the year. In addition, a significantly larger number of ships are being scrapped due to the low rates and the increase in scrap prices.

TREND OF TIME CHARTER RATES IN THE SHIPPING INDUSTRY

(Market average, USD/day)



Once again, developments in the **real estate markets** in Germany were mostly very positive in 2017. The considerable increase in rent and property prices continued, particularly on housing markets in the cities. Thanks to the continued low interest rates against the backdrop of solid economic development at the same time, property prices once again increased at a faster rate than rent.

Construction activity remained very buoyant in 2017. The number of building permits issued, however, dropped, particularly in the construction of owner-occupied homes, and only continued to show strong growth in the **rental housing segment**. This means that in the country's large cities, the supply of housing is increasingly moving in line with demand, which remains high. As a result, the reduction in home vacancy levels, which were already very low, slowed. The large urban markets, however, remained characterised by excess demand. In the **office real estate markets,** the demand for space, which was already high to begin with, continued to increase in 2017. This was due to the considerable increase in the number of office employees. Office completions failed to keep up with demand, meaning that the vacancy levels continued to drop significantly. As a result, and especially in the second half of the year, rent levels in major cities rose considerably again, also increasing in secondary locations. The increase was more moderate in medium-sized cities. On the retail real estate markets, on the other hand, rent growth remained largely weak, with rent stagnation a far from rare occurrence. This also applied to top rents in central top locations of major cities. Although retail stores continued to benefit from strong levels of private consumption and retail sales increased significantly in the course of the year, the structural shift in favour of e-commerce, a segment that is showing sustained above-average growth, continued. Despite the comparatively low level of rent growth, **retail real estate** also benefited from the high demand among investors in the second half of the year. This resulted in what was, in some cases, a marked increase in real estate prices for all usage types in 2017.

Trends in **European office real estate markets** in foreign markets were mixed in 2017. Whilst some markets such as Madrid and Amsterdam continued to recover, rent levels stagnated in many other regions due to the persistent high level of vacancies. While the demand for space increased slightly on the London office real estate market, it remained weak due to the looming impact of Brexit. The increasing number of completions exceeded this demand by far, meaning that vacancy rates continued to rise. This resulted in a drop in rent and market at the end of the year. In the majority of other European markets, on the other hand, market values increased significantly due to continued high investor demand.

The German economy also continued its strong recovery in 2017: in the **manufacturing sector**, production growth was up considerably in a year-on-year comparison. While all industries showed positive development, the extent of the upswing varied: whereas the chemical industry and the mechanical engineering segment had still reported a slight dip in production volumes in the previous year, both industries made considerable gains in 2017. The electrical engineering and metal industry, as well as companies in the pharmaceutical industry, reported fairly strong growth. Similarly, the automotive industry increased the significant production growth seen in the previous year even further. The food industry reported increased production again, albeit only at a moderate level and on a par with the previous year.

Wholesalers reported a marked increase in sales in 2017 as against the previous year period, which was still marked by a slight decline. The German **retail sector** is also benefiting from the consumption-driven economic growth in Germany and continued to report positive sales development: both the food retail industry and the other key segments of the retail sector were able to increase their sales. While (real) growth remained dynamic, however, it was slightly less pronounced than in the previous year. The clothing retail sector also reported a pronounced increase in sales following a downward trend in the previous year.

The **health market** is growing constantly, as is the hospital market, as a result of demographic trends and medical advances. With € 336 billion in gross value added, one in eight euros of German gross domestic product was earned in the healthcare sector in the previous year. The financial situation of many hospitals remains strained despite increasing revenues. The profitability of hospitals is, however, expected to increase in the medium term thanks to the entry into force of the Hospital Structure Act (*Krankenhausstrukturgesetz*) at the beginning of 2016.

In the **logistics sector**, revenues in 2017 were significantly stronger than in the previous year period. The business climate in the German logistics industry improved noticeably in the fourth quarter of 2017 and companies are more confident about developments over the next six months, pushing the corresponding indicator up to a new high. The measured economic climate remains above the long-term average, meaning that it is still in expansive territory overall.

The global **project financing volume** fell significantly in 2017 and was down by 14.1% on the volume seen in the prior-year period (according to Thomson Reuters). The downward trend was particularly noticeable in the Europe, Middle East and Africa (EMEA) region, although in Europe, the countries of Greece, the UK, Poland, Portugal and Turkey bucked the trend by reporting a higher project financing volume than in the previous year. North and South America, as well as the Asia-Pacific region, reported significant increases.

Investments in **transport infrastructure** accounted for 19.7% of the project financing volume in the EMEA region in 2017. The major institutional investors include pension funds and insurance companies, which consider infrastructure investments to be an investment alternative in the low interest rate environment.

The expansion of **renewable energies** made further progress in both Europe as a whole and Germany in 2017. The expansion in the European wind energy market focused on the core markets of France, the UK and Germany. The conversion to bidding procedures passed in the amendment to the Renewable Energies Act (EEG) for the transitional year of 2017 resulted in an increase in demand in Germany, in particular. New installations of onshore wind energy turbine generators were up by around 15% year-on-year, with new installations in the offshore segment also increasing very considerably in 2017, at a rate of over 50%, following a downward trend in the previous year.

The expansion in the solar segment also continued in Europe. In Germany alone, new installations in the photovoltaics segment came to nearly 1,753 megawatts in 2017, around 200 megawatts higher than the new installation figures for the two previous years. New installations in 2017 nevertheless once again fell well short of the political target corridor of 2,500 megawatts of new photovoltaic output a year, due among other things to the cuts under the Renewable Energies Act (EEG) in recent years.

ENVIRONMENT FOR BANKS STILL CHARACTERISED BY CHALLENGES

IMPROVEMENT IN THE MARKET ENVIRONMENT IN THE COURSE OF THE YEAR

In light of the overall favourable macroeconomic development, the market environment for banks also improved considerably in the course of 2017. A whole number of sources of geopolitical uncertainty remain, in particular regarding how to handle the situation in North Korea and Iran, as well as the outcome of Brexit within the context of the British EU exit negotiations. Nevertheless, fears of increased protectionism or political destabilisation in Europe have failed to materialise, even though considerable uncertainty remains about the political course pursued by the US, particularly in early 2018. In particular, the encouraging results of the elections in the Netherlands and France provided a more stable outlook for Europe. In addition, the broad-based upswing in the global economy and the gradually increasing signs of a steeper yield curve based on the normalisation of monetary policy initiated by the Fed and the ECB provided the basis for a recovery in the bank earnings outlook – even though steps towards a monetary policy turnaround in Europe have yet to be taken. Within this context, share prices for European banks also continued to recover in the reporting year, albeit more moderately than their US counterparts due to profitability levels that are still lower.

In addition to the low interest rate period, which is persisting for longer in Europe than in the US and is resulting in lower net interest income at banks, structural weaknesses are still putting pressure on the European banking sector. Especially in southern Europe – and among the larger countries, particularly in Italy and Spain – these include portfolios of non-performing loans that, while on the decline, are still substantial. Although the direct burden resulting from loan loss provisions has now eased considerably in the light of the gradual economic recovery, large volumes of problem loans are still putting pressure on profitability and bank capital positions and – given the associated uncertainty for investors – could hamper consolidation efforts.

Within this context, and with regard to the management of legacy burdens, a trend emerged in the course of the year showing that both the European banking supervisory authority and the political players want to promote the winding-down of problem loans within the context of specific requirements for the banks affected, but not least also as part of constructive consolidation solutions. In both Italy and Spain, for example, resolution solutions resulted in takeovers of smaller banks by larger institutions. At the same time, financial investors, in particular, would also appear to be expressing more of an interest in playing an active role in the consolidation process. After all, from an investor perspective, the challenging market environment resulting from the low interest rates, weak earnings and intense competition creates not only risks, but also opportunities that can be exploited by ongoing consolidation. This applies both to the purchase of problem loan portfolios, as well as to takeovers of smaller institutions. All in all, these solutions have the potential to significantly strengthen the European banking market in the future.

Despite the positive macroeconomic situation in Germany, the ongoing challenging situation with regard to ship financing is one of the key issues facing the German banking market in addition to sustained weak earnings. Even after the significant need for loan loss provisions in the previous year, German ship financing banks were once again faced with burdens as, despite the gradual improvement in parts of the shipping market, the duration of the crisis is sapping borrowers' financial energy.

In light of ongoing weak profitability, German banks, in particular, feel pressed to review their strategic focus. The considerable earnings pressure in the banking sector is associated with an increasing risk that loan financing will not be priced on a risk-commensurate basis. At the same time, expenses for the high regulatory requirements and the need for investments in the future viability of institutions (keyword: digitalisation) are leaving their mark on the cost side in the form of high project and IT costs. Against this backdrop, many banks initiated comprehensive cost and efficiency programmes in order to be able to generate adequate returns on a sustained basis. Consolidation within the sector could also be an option.

KEY TOPICS OF BANKING SUPERVISION

Monitoring of institutions by the banking supervisory authority has also been intensified by the expansion of the Banking Union. This applies, in particular, to the Supervisory Review and Evaluation Process (SREP) for banks directly supervised by the ECB. At the end of 2016, the ECB had already set out its priorities for the topics to be examined in greater detail in the 2017 SREP process based on its experience. The three priorities identified by the supervisory authorities included, first, a review of bank business models and earnings drivers, second, credit risk, in particular in connection with non-performing portfolios and existing concentrations and the implications of the new IFRS 9 accounting standards and third, risk management. Within the context of risk management, the ECB used elements from the reviews conducted in 2016 for some of the key initiatives. These related, in particular, to the aggregation of risk data (BCBS 239), the use of internal risk models (TRIM), the adequacy of capital and liquidity management (ICAAP and ILAAP), as well as a review of IT risks in connection with outsourcing.

At the same time, the EBA announced a new stress test for European banks for the beginning of 2018, in which the institutions supervised by the ECB will also take part.

In addition to the challenging market environment, the banking market was also characterised, particularly in the first half of 2017, by discussions regarding the application and implementation of the European Bank Recovery and Resolution Directive (BRRD), which had already been introduced on 1 January 2016. This was largely due to different approaches to restructuring and resolution measures at Spanish and, in particular, Italian banks. Within this context, calls are being made for the harmonisation of national insolvency regulations, not least in order to boost transparency from an investor perspective and create a uniform set of rules in the European banking sector in the future. Nevertheless, the current examples tend to point more to a pragmatic interpretation of the BRRD, in particular when it comes to the treatment of legacy burdens.

A decision on the harmonisation of the European regulations concerning the design of the national liability cascades within the context of the BRRD for MREL-eligible liabilities (Minimum Requirements for Eligible Liabilities) was made in November. The arrangement provides for the introduction of a new class of instruments, non-preferred senior unsecured liabilities, which can count towards the requirements for bank MREL ratios, meaning that they contribute to the liability buffers in the event of insolvency. In Germany, the new scheme, which will have to be transposed into national law in the course of 2018, resulted in an extensive rating operation performed by Moody's with regard to the existing German senior unsecured liabilities.

The comprehensive and stricter regulatory requirements have made a significant contribution in their entirety to further strengthening the stability of the European banking system. Against the backdrop of stricter capital requirements through the gradual implementation of Basel III and the introduction of additional regulatory capital buffers, German banks on average are likely to have further strengthened their capital base in 2017. The reform of the Basel III regulations ("Basel IV") adopted in December is likely to increase the capital requirements for banks in the future. However, it is becoming increasingly clear at the same time that low market shares compared with international benchmarks and the weak earnings situation of German banks in particular are placing tight constraints on the ability to retain profits, and the focus will therefore remain on strict cost management and the consistent winding down of risk positions but also on the ongoing need for consolidation – even though the increase in capital requirements driven by the regulatory side appears to be reaching a plateau.

HSH NORDBANK'S BUSINESS IMPACTED BY UNDERLYING CONDITIONS

The highly competitive environment, which remains challenging for banks, was also reflected in HSH Nordbank's business performance. Trends in the markets relevant for the Bank were uneven in 2017. Whilst the real estate environment in Germany was largely positive, the situation in the shipping markets remained challenging despite signs of improvement. In the Corporate Clients division, the solid liquidity base of clients and the low level of interest rates had a tangible impact in an environment that remained competitive. In the context of these market developments, the Bank was able to maintain its good position in its target markets while taking account of the strict risk requirements. The volume of new business concluded was only slightly lower than in the previous year overall, despite the additional challenges faced by the Bank in the privatisation process. Margin development remains under pressure due to the intense competition. The intense competition and increase in liquidity costs, for example, resulted in a significant decline in the new business margin year-on-year and also meant that the Bank fell short of its planned ambition level.

The easing of the situation on the financial markets had an impact on the Bank's net assets and financial position and, in particular, on its net trading income. The significant depreciation and increased volatility of the US dollar against the euro in the course of the year had an impact on the Bank's earnings, net assets and financial position overall, even though the Bank's reliance on the EUR/USD exchange rate development has since been reduced considerably as a result of the significant winding-down of legacy burdens.

The uneven trends in the relevant markets were also reflected not least in loan loss provisions. Due to the ongoing difficult sector development in shipping, the Bank once again recognised high loan loss provisions for the legacy portfolios in question in 2017 (even without taking into account the additional unplanned loan loss provisions for the portfolio transaction within the context of privatisation). On the other hand, the strong earnings with regard to Real Estate Clients enabled the Bank to reverse loan loss provisions in this segment.

The Bank also responded to the continuing challenge regarding a cost base appropriate for the market environment. Controllable personnel and operating expenses were reduced considerably again compared to the previous year as part of the implementation of cost savings measures. The Bank is also using these measures to counteract cost increases caused by the large number of new regulatory requirements and charges incurred for the European bank levy and HSH Nordbank's contribution to the deposit guarantee fund.

The EU proceedings, the Bank's business performance and position are explained in detail in the following sections.

BUSINESS DEVELOPMENT – SIGNIFICANT DEVELOPMENTS AND EVENTS IN THE 2017 REPORTING YEAR

2017: POSITIVE BUSINESS DEVELOPMENT OVERSHADOWED BY ONE-OFF EFFECTS RELATING TO PRIVATISATION

In the 2017 financial year, HSH Nordbank showed positive development overall, making a significant contribution to the positive development of the privatisation process. Operating business development was characterised first and foremost by the significant winding-down of legacy burdens, positive earnings and cost development and satisfactory key management indicators. At the same time, significant one-off effects arose in the context of the privatisation process, overshadowing the business results at the reporting date. In particular, HSH Nordbank will be relieved of a large part of the non-performing legacy burdens in connection with the portfolio transaction concluded as part of the privatisation process. This will result, on the one hand, in a fundamental improvement in credit quality. On the other hand, the portfolio transaction results in considerable burdens in loan loss provisions as at the reporting date. In addition, new assessments of interest and principal repayments for the hybrid instruments had to be taken into account.

The purchase agreement signed on 28 February 2018 provides the basic prerequisite for the successful conclusion of the privatisation process, which has been ongoing for around 2.5 years. The Bank contributed to this process with its systematic restructuring strategy and its solid operating development, laying the necessary foundation for its successful privatisation.

In the 2017 reporting year, the following aspects are particularly noteworthy:

- Good operating development within the Core Bank: The new business volume developed largely in line with the plan in the reporting year and amounts to € 8.5 billion (around € 2.3 billion with new clients), down only slightly on the value for the previous year (€ 8.9 billion). In 2017, the Bank once again succeeded in operating successfully on the basis of existing and new client relationships in an environment characterised by intense competition over all, concluding new business with an appropriate risk profile.
- Significant reduction in wind-down portfolio: Even without the portfolio transaction, the Bank wound down around € -11.6 billion EaD in the Non-Core Bank taking currency effects into account, i.e. more than planned, winding down non-performing legacy loans in the amount of € -7.0 billion. The NPE ratio in the Group fell considerably as a result to 10.4 % as at the reporting date (31 December 2016: 17.5 %).
- Portfolio transaction agreed: In order to achieve the final elimination of a large part of its legacy burdens, the Bank sold further largely non-performing portfolios consisting mainly of ship

financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. This means that the NPE ratio is expected to drop to around 2% (after the closing of the transaction).

- Systematic implementation of the cost programme: Planned potential for cost savings was exploited in line with the requirements, with administrative expenses being cut considerably from € -634 million in 2016 to € -515 million in 2017.
- Capital and liquidity ratios at a high level: Key management indicators for capital and liquidity were still at a very solid level. The pro forma CET1 ratio, which is calculated excluding the regulatory RWA relief effect of the second loss guarantee (for explanatory information, see the section entitled "Management system") showed very positive development. It came to 15.4 % as at 31 December 2017 (31 December 2016: 12.6 %). The LCR came to 169% (31 December 2016: 172 %).

PRIVATISATION PROCESS ON THE HOME STRETCH

The signing of the share purchase agreement satisfied in a timely manner the central commitment set out in the formal decision of 2 May 2016 in the EU state aid proceedings.

In light of the share purchase agreement that has been concluded, the Bank expects the privatisation process to be finalised in the third quarter of 2018 at the latest, once all of the necessary conditions have been met. Within this context, the Bank is confident that it can forge ahead intensively with the necessary realignment of the Bank by continuing with its current restructuring course, allowing it to do everything in its power to contribute to an ultimately successful change of ownership. In addition, the Bank will provide constructive support in all matters that are to be discussed further among the relevant stakeholders in order to systematically promote the transformation process initiated by the Management Board to create a new bank that is geared to the private sector.

In connection with an imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, as well as other risks, such as a further increase in capital requirements due to more stringent regulatory standards, HSH Nordbank AG expects, from today's perspective, that, contrary to past plans, it will only be possible to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2024 financial year for the 2023 financial year.

SATISFACTORY NEW BUSINESS

During the reporting period, the Bank worked intensively on forging ahead with its operating business activities. The focus was on generating new business with an appropriate risk profile in a market environment that remains challenging. The Core Bank's new business showed positive development in the reporting year and falls only just short of the ambitious target. It amounted to € 8.5 billion, only just shy of the prior-year level (€ 8.9 billion). A total of around € 2.3 billion in new business was concluded with new clients. Further details on new business, in particular regarding the development of the individual segments, can be found in this Group management report in the section entitled "Segments".

The ratio of new loans disbursed to new business concluded (disbursement ratio) is more or less on a par with the prior-year level. The interest margins achieved are falling significantly due to the competitive environment and fall short of the ambition level due to higher liquidity costs. Cross-selling net income generated by various banking services over and above loan financing showed encouraging development in the reporting year. Investment products, loan commission and income from derivative business transacted with clients made a key contribution to this trend.

SUCCESSFUL REDUCTION OF LEGACY ASSETS DUE TO THE BANK'S REGULAR WINDING-DOWN STRATEGY

The Bank significantly accelerated the implementation of its focused winding-down strategy in the 2017 reporting year and implemented it successfully. This is largely due to three factors:

- after a pronounced market slump in 2016, developments on the shipping markets have been pointing for several quarters now towards a recovery trend that is better than expected. This trend was particularly evident in the container vessel and bulker segments in 2017 and is based first and foremost on a revival in demand for transportation capacities, brisk scrapping activities and the consolidation of shipping lines.
- Taking the favourable market environment in 2017 into account, the Bank has been adjusting its restructuring principles since the second half of 2017 and is focusing its restructuring strategies more on specific recovery prospects for each individual commitment. The implementation of the winding-down strategy, which has been accelerated by the factors set out above, also serves to reduce historical concentration risks and was facilitated mainly by the high coverage ratio of the non-performing legacy portfolio.
- The development of the EUR/USD exchange rate also had a pronounced positive impact on the marked reduction in the portfolio of legacy burdens. This effect contributed € -0.7 billion in the reporting period.

The Bank wound-down a total of € -11.6 billion EaD in non-performing and non-strategic loans in the Non-Core Bank in 2017. € -7.0 billion of this amount is attributable to the NPE legacy portfolio. The winding-down measures continued to focus on reducing non-performing ship financing transactions dating from the years before 2009 that were secured by the second loss guarantee of the federal state owners. As well as reducing the portfolio by implementing recovery strategies, receivables with a volume of € 2.7 billion EAD relating to continental European real estate financing, as well as aircraft, solar and shipping financing, were sold in the reporting period as part of market portfolio transactions. The winding-down measures reduce the NPE ratio significantly to 10.4% (31 December 2016: 17.5%). In addition to the market portfolio transactions described above, the legal transfer of the loan portfolio sold to hsh portfoliomanagement AöR in the 2016 financial year ("federal state portfolio transaction") was largely concluded as a structural measure in connection with the EU decision.

ADDITIONAL SUBSTANTIAL WINDING-DOWN OF LEGACY BURDENS AS PART OF PRIVATISATION PROCESS

In light of the future viability of the Bank and the good portfolio quality that it is aiming to achieve in this regard, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) within the context of the privatisation process. Broken down by asset classes, € 4.3 billion of the portfolio is attributable to shipping, € 1.0 billion to real estate, € 0.6 billion to corporate clients and € 0.4 billion to other loans. This allows the Bank to continue with its stringent winding-down strategy and to achieve, as a result of the sale, far-reaching relief from a large part of the non-performing legacy loans, as well as a smaller volume of other legacy portfolios of the Non-Core Bank.

The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In light of the portfolio transaction, the Bank has changed its commitment strategy for the individual loan receivables in the transaction portfolio from the previous individual single commitment-specific strategy (e.g. Realisation of collateral and workout) to a strategy involving the short-term sale of the loan receivable in question as part of a loan portfolio sale. On the basis of these sale strategies, the loan loss provisions for the loan receivables in the transaction portfolio were calculated on the basis of an independent expert opinion based on the IDW S1 principles, which formed the basis for the agreed purchase price of the portfolio for the Bank. This resulted, in particular, in additional unplanned specific loan loss provisions in an amount of € 1.1 billion.

STRINGENT COST PROGRAMME

The increasing pressure on earnings and margins in the highly competitive banking market and increasing costs for regulatory requirements are being countered by the ongoing cost reduction programme. In addition, substantial additional expenses were incurred in connection with the privatisation process (e.g. for legal and advisory services, data rooms) and the restructuring of major commitments in the Non-Core Bank.

In the course of 2017, the Bank made the progress it planned to make in implementing measures for controllable operating expenses. The potential for cost savings expected, based on the optimisation of the organisation and processes that has been implemented, was largely realised accordingly and, in some cases, actually exceeded slightly. The targeted management of operating expenses has resulted in a reduction in project costs, building costs and other personnel-related operating expenses in particular. As far as personnel expenses are concerned, 90% of the planned reduction has already been contractually agreed with employees as part of the 2018PLUS programme, and the Bank continued to implement its ambitious targets for personnel expenses in a systematic manner.

EARNINGS, NET ASSETS AND FINANCIAL POSITION

GOOD CORE BANK NET RESULT IN LINE WITH PLAN

In the 2017 financial year, the Core Bank, which comprises the strategic portfolios of the Corporate Clients, Real Estate, Shipping and Treasury & Markets segments, achieved net income before taxes that was in line with the plan and was also up considerably on the prior year at € 732 million (previous year: € 667 million). All segments made a positive contribution to this good overall earnings development with the Core Bank, which was better than predicted.

The total income of the Core Bank amounts to € 1,055 million, slightly higher than the prior-year value (€ 1,032 million). This was due, in particular to the increase in net interest income to € 773 million (previous year: € 680 million). The net interest income reflects both operational interest effects and effects resulting from the realisation of unrealised gains. In total, unrealised gains in the amount of € 356 million (thereof primarily in net interest income in the amount of € 266 million and in net income from financial investments and net trading income) (previous year: € 186 million) were realised in order to partly compensate for the considerable structural burdens in the Non-Core Bank. In addition to net interest income, net trading income, which includes earnings contributions from the operating client business, from the management of central liquidity and market price risks, as well as from valuation effects from client derivatives and assets measured at fair value, also made a significant contribution of € 154 million (previous year: € 186 million).

The good portfolio quality of the Core Bank, which is reflected in a low NPE ratio of 1.6%, is the reason behind the low loan loss provisions. Taking reversals of general loan loss provisions of € 164 million into account, total loan loss provisions came to € 13 million (previous year: € 47 million). The ongoing cost reduction programme was stringently implemented. Administrative expenses amount to € -302 million, around 16% lower than in the previous year (€ -358 million). The expenses for bank levy and deposit guarantee fund and the expenses for government guarantees put pressure on the net income of the Core Bank in the amount of € -50 million (previous year: € -56 million).

NON-CORE BANK IMPACTED SIGNIFICANTLY BY PORTFOLIO TRANSACTION

The Non-Core Bank, which bundles non-strategic assets and the legacy loans which are earmarked for winding-down and are largely non-performing, reported negative net income before taxes in the amount of € -1,583 million on the reporting date, which is much higher than expected (previous year: € -299 million). This result is due, in particular, to significant loan loss provision expense, which, after compensation by means of the second loss guarantee, and taking foreign exchange effects and the hedging effect of the credit derivative into account, amounted to € -1,295 million (previous year: € 106 million). This expense was attributable, on the one hand, to the original winding-down of legacy burdens, which was accelerated considerably in the reporting year. On the other hand, the portfolio transaction executed within the context of the privatisation process results, in particular, in additional specific loan loss provisions of € 1.1 billion. This portfolio transaction aims to relieve the Bank of a large part of the non-performing legacy burdens.

The significant change in the loan loss provision result is also due to the second loss guarantee, which has been fully utilised since the first quarter of 2017. As a result, the loan loss provisions incurred in the reporting year were no longer compensated for in full. This played a key role in increasing the loss in the Non-Core Bank.

In addition, the net result includes € -202 million in administrative expenses (previous year: € -299 million), as well as € -127 million in expenses for the second loss guarantee (previous year: € -189 million). The negative net result is also shaped by a drop in net interest income, which reflects the continued winding down of the portfolio. Within the context of the recognition of loan loss provisions, the resulting setting of loans to a non-accrual basis leads to a reduction in the loan volume, which also reduces interest income in accordance with the ongoing winding-down of legacy burdens.

GROUP DEVELOPMENT SHAPED BY ONE-OFF EFFECTS

The Group net result before taxes, which comprises the results of the Core Bank, Non-Core Bank, as well as segments not subject to reporting requirements and reconciliation and consolidation effects, amounted to € -453 million as at 31 December 2017 (previous year: € 121 million), meaning that it is significantly lower than in the previous year, which is largely due to the unplanned one-off effects within the context of the privatisation process. These include, in particular, the unplanned specific loan loss provisions resulting from the portfolio transaction of € 1.1 billion and income from the revaluation of the hybrid instruments of € 413 million.

The Group's operating performance was shaped, in particular, by positive results in the strategic divisions of the Core Bank, as well as by savings successes on the cost side. In addition, the realisation of unrealised gains also made a significant contribution to this development. This means that the Bank has managed, in line with its expectations, to more than compensate for the considerable burdens associated with the original winding-down of legacy burdens (excluding the portfolio transaction) and substantial guarantee, restructuring and privatisation expenses.

In addition, the Group net result was hit hard by the significant unplanned loan loss provision burdens in the Non-Core Bank in connection with the portfolio transaction.

In addition to the unplanned loan loss provisions, further one-off effects arose in connection with the reassessment of interest and principal cash flows relating to hybrid instruments in an amount of € 413 million in the net interest income of the non-reportable segments. These result from the fact that, contrary to past plans, it will not be possible, as originally anticipated, to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2020 financial year for the 2019 financial year, but rather that this will only be possible at the earliest from the 2024 financial year for the 2023 financial year.

After taxes, the Group net result comes to € -528 million as at the reporting date (previous year: € 69 million).

The return on equity for the Group calculated on the basis of net income before taxes is much lower than the prior-year forecast and is in negative territory at -9.7% (previous year: 2.5%), although it is overstated by the one-off effects described above. The further marked drop in the cost-income ratio predicted in the previous year to 32.3% (previous year: 64.8%) is partly also due to the special effects, meaning that it provides no information about actual performance development.

In the reporting year, the Bank managed to reduce the NPE ratio significantly to 10.4% (previous year: 17.5%). This development, which exceeds expectations by far, is due to the accelerated implementation of the winding-down strategy, as well as the development of the USD exchange rate. During the reporting period, the Bank halved its NPE volume in the Non-Core Bank. In light of the requirements of the ongoing privatisation process, the Bank executed the sale of a portfolio of legacy burdens within the context of the privatisation (portfolio transaction) in addition to the original winding-down, the exchange rate development and sales of receivables as part of market portfolio transactions. Within this context, the plan is to reduce the NPE volume and the NPE ratio to a level that is in line with the German market in the medium term. The Bank expects the NPE ratio to come to around 2% following the implementation of the transaction.

The coverage ratio of the entire NPE volume improved in particular as a result of the additional loan loss provisions in connection with the portfolio transaction to 63.6% (31 December 2016: 48.4%). This means that the Bank still has solid coverage of the entire NPE portfolio as at the reporting date. In the shipping portfolio, the coverage ratio comes to 64.6 % (31 December 2016: 59.8%).

The pro-forma CET1 ratio, which is also relevant from a management perspective in light of the privatisation process and is calculated on an same-period basis excluding the regulatory RWA relief effect of the second loss guarantee (for explanatory information, please refer to the section entitled "Management system") amounts to 15.4% on the reporting date, putting it at a satisfactory level, even taking the loss incurred into account. The same-period core Tier 1 capital ratio, including the regulatory effect of the guarantee, amounts to 18.5% (31 December 2016: 14.1%). The development in the capital ratios compared with 31 December 2016 is due, in particular, to the marked reduction in RWA. This largely reflects the successful NPE reduction as part of the accelerated winding-down strategy. In addition, the active management of currency risks and a strong EUR/USD exchange rate, which exceeded the Bank's expectations, also had a visible impact on the drop in RWA and the development in the capital ratios.

The liquidity ratios (survival period: > 12 months, LCR: 169% and NSFR: 114%) are consistent with the Bank's plans and are much higher than the ECB's minimum requirements at this very good level.

KEY GROUP MANAGEMENT INDICATORS

	31.12.2017	31.12.2016
Net income before taxes (€ m)	–453	121
CIR (unadjusted)	32.3 %	64.8 %
RoE	–9.7 %	2.5 %
NPE ratio	10.4 %	17.5 %
Coverage ratio	63.6 %	48.4 %
Pro-forma CET1 capital ratio[1), 2)]	15.4 %	12.6 %
LCR	169.0 %	172.0 %
NSFR	114.0 %	111.0 %

1) Same period: ceteris paribus calculation taking full account of the balance sheet amounts as at the reporting date.

2) "Pro forma" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.

Further details on the reasons underlying the business performance are set out in the following "Earnings", "Net assets and financial position" and "Segment results" sections.

NET EARNINGS

INCOME STATEMENT

(€ m)	**2017**	2016	Change in %
Interest income	3,086	3,466	– 11
Negative interest on cash investments and derivatives	– 305	– 191	60
Interest expenses	– 2,202	– 2,733	– 19
Positive interest on borrowings and derivatives	296	183	62
Net income from hybrid financial instruments	304	– 118	> 100
Net interest income	**1,179**	**607**	**94**
Net commission income	65	87	– 25
Result from hedging	– 18	– 4	> – 100
Net trading income	254	88	> 100
Net income from financial investments	90	140	– 36
Net income from financial investments accounted for under the equity method	2	3	– 33
Total income	**1,572**	**921**	**71**
Loan loss provisions in the lending business	– 2,086	631	> 100
Hedging effect of credit derivative under the second loss guarantee	810	– 475	> 100
Administrative expenses	– 515	– 634	– 19
Other operating income	22	58	– 62
Expenses for bank levy and deposit guarantee fund	– 41	– 56	– 27
Net income before restructuring and privatisation	**– 238**	**445**	**>– 100**
Net income from restructuring and privatisation	– 66	– 110	40
Expenses for government guarantees	– 149	– 214	– 30
Net income before taxes	**– 453**	**121**	**> 100**
Income tax expenses	– 75	– 52	44
Group net result	**– 528**	**69**	**> 100**
Group net result attributable to non-controlling interests	7	2	> 100
Group net income attributable to HSH Nordbank shareholders	– 535	67	> 100

Marked increase in total income, net operating interest income and the realisation of unrealised gains have a positive impact

Total income increased considerably in the 2017 financial year to € 1,572 million compared to € 921 million in the previous year. Interest income from operating activities and effects resulting from the planned realisation of unrealised gains totalling € 356 million in total made a key contribution in this regard. In addition, the remeasurement of hybrid capital instruments as a result of the reassessment of interest and principal cash flows with had a positive impact in the amount of € 413 million. The following developments in the individual income line items were relevant:

Net interest income contributed € 1,179 million (previous year: € 607 million) to total income. First, interest income from operating activities that was slightly higher than expected had a marked positive impact. On the other hand, realisation effects from unrealised gains of around € 266 million in total (previous year: € 101 million) resulting from the sale of long-term promissory note loans are included. The realisation of unrealised gains of € 298 million, which are reported in net interest income, are offset by compensating effects from hedge accounting of € 24 million, as well as by the reversal of the revaluation reserves of € 8 million. The realisation of unrealised gains is the Bank's way of counteracting the structural losses in the Non-Core Bank. The interest-bearing loan volume falls short of the prior-year value, as expected, due to the extensive winding-down of legacy portfolios in the Non-Core Bank which exceed new business. In addition, new business margins have declined, falling short of the planned level, due to the competitive situation and the Bank's liquidity costs.

The results of the Bank's planning and impact of the realignment and transformation of the Bank within the context of the privatisation process will result in the cancellation of future coupon payments as a result of the remeasurement of the hybrid capital instruments. Within this context, the changes in estimates of future interest and principal repayments will lead to a positive effect resulting from the reassessment of interest and principal cash flows in net income from hybrid financial instruments in an amount of € 413 million, which is included in net interest income.

Net commission income amounted to € 65 million in the reporting year, compared with € 87 million in the previous year. The drop in net commission income is due, in particular, to the premium expense resulting from the synthetic securitisation transaction, which has been included in this item since the fourth quarter of 2016. Cross-selling net income, on the other hand, was positive and significantly exceeded the pro rata plan.

At € 254 million, net trading income contributed significantly to total income (previous year: € 88 million). The development includes, in particular, the positive impact of net income from foreign currency (€ 76 million), the realisations in the credit investment portfolio (€ 59 million), the positive valuation effects in the derivatives area (€ 62 million) and net operating trading income of € 77 million (including hedge effects resulting, among other things, from the realisation of unrealised gains). Net trading income was hit by the valuation result recognised on EUR/USD basis swaps in the amount of € –24 million.

The net income from financial investments (including net income from financial investments accounted for under the equity method of € 2 million) amounted to € 92 million (previous year: € 143 million) and essentially comprises realisation gains from disposals of equity interests (€ 57 million), write-downs on equities (€ –61 million), realisations in the credit investment portfolio (€ 23 million), as well as effects from the realisation of unrealised gains.

Loan loss provisions characterised to a considerable degree by portfolio transaction

Loan loss provisions in the 2017 financial year were characterised, on the one hand, by amounts allocated for legacy loan exposures. On the other hand, the unplanned additional specific loan loss provisions in connection with the portfolio transaction, among other things, had a significantly negative impact in the amount of € –1.1 billion. The loan loss provisions were recognised primarily for legacy transactions in the shipping portfolio to continue to reflect the ongoing difficult market developments, despite slight recovery trends. In addition, loan loss provisions were recognised in the energy portfolio of the Non-Core Bank for commitments dating from the years prior to 2009. In contrast, the risk trend in other business sectors remained largely insignificant. The Real Estate Clients portfolio was characterised not only by additions relating to the portfolio transaction, but also by the reversal of loan loss provisions due to loan repayments and improved risk assessments.

In total, the loan loss provisions, excluding the compensation effect of the guarantee and before foreign exchange effects, came to € –1,402 million as at the reporting date (previous year: € –1,577 million), outstripping the Bank's expectations in the previous year due to the considerable additional loan loss provisions in connection with the portfolio transaction, but down on the prior-year value.

The loan loss provisions recognised, once again, for legacy portfolios in particular were no longer compensated for in full as at the reporting date because of the full balance sheet utilisation of the second loss guarantee in the first quarter of 2017. Allowing for the hedging effect resulting from the credit derivative in the amount of € 810 million (previous year: € –475 million) and including foreign exchange rate effects and the compensation effect provided by the second loss guarantee, loan loss provisions came to a total of € –1,276 million (previous year: € 156 million), putting substantial pressure on the Group net result.

The second loss guarantee of € 10 billion has been utilised in full in the balance sheet as at the reporting date. The cash drawdowns of the guarantee exceed the Bank's first loss piece (€ 3.2 billion) by € 4.1 billion. Losses submitted for settlement amount to € 0.4 billion. This means that the guarantee utilisation is gradually increasing due to the invoicing of losses under the guarantee. In light of the cancellation agreement reached, in the context of the privatisation process, between HSH Nordbank AG, HSH Beteiligungs Management and HSH Finanzfonds AöR, the guarantee is to be terminated prematurely and settled in full immediately after the closing of the share purchase agreement.

The actual payments made under the guarantee are offset by significant fees already paid for the guarantee. The premiums paid to the guarantors and recognised through profit or loss by HSH Nordbank amounted to € 3.3 billion as at the reporting date (including one-off payments of around € 0.3 billion made to HSH Beteiligungs Management GmbH in 2016). Furthermore, a further one-off payment of € 0.5 billion was made to the federal state owners in 2011, which was reintroduced into the Bank in the form of a mixed contribution of cash and in kind in 2012. The total payments made have put a corresponding strain on the Bank's capital base during the restructuring period, which started in 2009.

Noticeable reduction in administrative expenses

The administrative expenses amounted to € –515 million in the 2017 financial year (previous year: € –634 million). Savings realised in excess of the plan under the ongoing cost reduction programme for operationally controllable personnel and operating expenses were offset by unplanned special depreciation allowances of € –25 million. These were incurred in connection with the revaluation of property, plant and equipment at subsidiaries and put considerable pressure on administrative expenses in the previous year, too.

Personnel expenses, which decreased from € –256 million to € –230 million, were mainly affected by a further reduction in the number of employees according to plan as part of the headcount reduction. Compared to the end of 2016, the number of employees within the Group declined further by 238 to 1,926 (calculated on a full-time equivalent (FTE) basis).

Operating expenses (excluding depreciation/amortisation) came to € –249 million, compared with € –278 million in the previous year. Savings were made in particular with regard to IT costs due to lower costs for external service providers and project costs. The positive development in cost-cutting measures was offset in part by contrary effects relating to strategic projects, in particular (for example for the accelerated portfolio reduction). In addition, considerable expenses were still incurred to implement regulatory and accounting requirements. IFRS 10 subsidiaries account for expenses in an amount of € –9 million (previous year: € –27 million).

Depreciation of property, plant and equipment and amortisation of intangible assets came to € –36 million (previous year: € –100 million). In the previous year, write-downs to property, plant and equipment at subsidiaries resulted in an extraordinary burden on the net result of € -66 million.

Other income line items

Other operating income amounted to € 22 million (previous year: € 58 million) and largely includes income from cost reimbursements and reversals of provisions. Additions to legal risks in an amount of € –61 million had a negative impact. The item also includes effects resulting from changes in scope of consolidation that had already been incurred in the second quarter of 2017.

The expenses for the annual contributions to the bank levy and the deposit guarantee fund amounted to € –41 million in the reporting year (previous year: € –56 million).

High restructuring and privatisation expenses

Earnings were adversely impacted to a considerable degree by restructuring and privatisation expenses in the amount of € –66 million (previous year: € –110 million) incurred in connection with the burdens associated with the privatisation process (e.g. costs associated with advisory services and data rooms). In the previous year, substantial additions to restructuring provisions had put a corresponding significant strain on earnings.

Reduction in base premium expense

For the base premium (only relates to the share for partial guarantee 1) for the second loss guarantee, expenses of € –149 million were incurred in 2017 (previous year: € –214 million). The reduction in the base premium is attributable to the increase in the drawdown of the second loss guarantee. As part of the decision made by the European Commission on 2 May 2016, the base premium was reduced from 4% to 2.2% and the basis of calculation was changed with effect from 1 January 2016. Based on this decision, the base premium is calculated on the undrawn, i.e. not drawn down via settled losses, portion of the guarantee and no longer on the total guarantee facility. Despite the drop in the guarantee premium, absolute premium payments made to the guarantor put considerable pressure on the Bank's net results.

Group net result shaped by one-off effects

Overall, HSH Nordbank achieved net income before taxes of € –453 million as at the reporting date (previous year: € 121 million). The unplanned loss is due to significant expenses for specific loan loss provisions (€ –1.1 billion) incurred, in particular, in connection with the portfolio transaction. Net income before taxes also reflects further one-off effects relating to the revaluation of hybrid capital instruments (€ 413 million). After deducting tax effects there remains Group net income of € –528 million (previous year: € 69 million). The income taxes line item comprised current tax expense of € –47 million and deferred tax expense of € –28 million.

NET ASSETS AND FINANCIAL POSITION

MATERIAL ITEMS ON THE STATEMENT OF FINANCIAL POSITION

(€ m)	**2017**	2016	Change in %
Assets			
Cash reserve	6,625	3,491	90
Loans and advances to banks	3,838	4,192	– 8
Loans and advances to customers	39,174	50,910	– 23
Loan loss provisions	687	1,142	– 40
Credit derivative under the second loss guarantee	1,014	199	> 100
Trading assets	3,641	5,433	– 33
Financial investments	13,647	15,493	– 12
Non-current assets held for sale and disposal groups	139	1,382	– 90
Other assets	1,617	2,123	– 24
Total assets	**70,382**	**84,365**	**– 17**
Liabilities			
Liabilities to banks	8,271	9,501	– 13
Liabilities to customers	36,205	40,172	– 10
Securitised liabilities	12,444	16,624	– 25
Trading liabilities	3,875	5,981	– 35
Liabilities relating to disposal groups	47	65	– 28
Subordinated capital	2,252	3,536	– 36
Equity	4,373	4,950	– 12
Other liabilities	2,915	3,536	– 18
Total equity and liabilities	**70,382**	**84,365**	**– 17**

Further reduction in total assets

In the reporting year, group total assets fell considerably to € 70,382 million, due in particular to the accelerated winding-down of legacy burdens (31 December 2016: € 84,365 million).

Almost all balance sheet items were lower on the assets side, with the exception of the cash reserve. Loans and advances to banks amounted to € 3,838 million (31 December 2016: € 4,192 million). There was a particular decline in overnight deposits at other banks. On the other hand, time deposits at other banks and the repurchase agreements business increased. Loans and advances to customers came to € 39,174 million, much lower than at the end of the previous year (31 December 2016: € 50,910 million). In particular, the legacy burdens of the Non-Core Bank were reduced considerably by the sale of portfolios. This more than offset the new business in the Core Bank by far. In contrast to the lower total assets, the cash reserve increased as against the end of the previous year to € 6,625 million (31 December 2016: € 3,491 million). Liquidity inflows from portfolio sales and maturing securities contributed to higher deposits at central banks.

Total loan loss provisions covering non-performing loans amounted to € 4,494 million before compensation, which is around one-third lower than at the end of the previous year. Including compensation effects of € 5,181 million, loan loss provisions disclosed on the balance sheet are still positive at 687 million (31 December 2016: € 1,142 million). The compensation item also includes compensatory claims against the guarantor HSH Finanzfonds AöR resulting from settled losses for transactions for which loan loss provisions had already been recognised. This means that there is still an overcompensation of the loan loss provisions as at 31 December 2017. The hedging effect of partial guarantee Two is shown in the “Credit derivative under the second loss guarantee” balance sheet item. The fair value of the credit derivative came to € 1,014 million on the reporting date (31 December 2016: € 199 million), up considerably on the previous year. This is due to the impact of the portfolio transaction agreed on 28 February 2018. The increase in the market value of the credit derivative, for example, is due to changes in the allocation of transactions in the loan portfolio sold as part of the portfolio transaction from the financial guarantee to the credit derivative because the requirements for accounting under the financial guarantee are not longer met. The hedging effect for the portfolio in question is reported as at 31 December 2017, at market value in the item “Credit derivative under the second loss guarantee”.

Trading assets decreased by around one-third to € 3,641 million (31 December 2016: € 5,433 million). In addition to the securities position, the positive fair values of the derivatives in trading assets also fell. Financial investments dropped to € 13,647 million (31 December 2016: € 15,493 million). Both equity holdings in non-affiliated companies and the securities position were reduced further.

On the liabilities side, liabilities to banks decreased (€ 8,271 million, 31 December 2016: € 9,501 million). In particular, the volume of call deposits with other banks was down on the level seen at end of 2016. Liabilities to customers amounted to € 36,205 million at the end of the year (31 December 2016: € 40,172 million). Both liabilities payable on demand and term liabilities decreased. Securitised liabilities fell significantly to € 12,444 million (31 December 2016: € 16,624 million). This is largely due to a higher volume of repayments and maturities than new issues. Trading liabilities comprising negative market values of derivatives amounted to € 3,875 million (31 December 2016: € 5,981 million) and were therefore down significantly in line with trading assets.

The subordinated capital came to € 2,252 million, around one-third lower than at the previous year-end (31 December 2016: € 3,536 million). This was mainly due to maturities in profit participation capital and subordinated liabilities, as well as to the changed assessment of the expected future cash flows (IAS39 AG 8).

Reported equity was much lower at the end of 2017 than in the previous year, and amounted to € 4,373 million (31. December 2016: 4,950). This is mainly due to the negative Group net result reported for the financial year.

Business volume also down

Like total assets, the business volume decreased significantly and amounted to € 78,611 million (31 December 2016: € 93,208 million). In addition, the off-balance-sheet business also decreased: sureties and guarantees amounted to € 1,862 million at the end of the year (31 December 2016: € 2,189 million), with irrevocable loan commitments coming to € 6,367 million (31 December 2016: € 6,654 million).

STRUCTURE OF LIABILITIES BY FINANCIAL INSTRUMENT

(€ m)	31.12.2017		31.12.2016	
	Total	of which > 1 year	Total	of which > 1 year
Secured: Covered bonds and asset-based funding	15,485	11,008	16,031	13,208
of which: Covered bonds	9,014	7,096	10,076	8,616
of which: Other secured funding	6,471	3,912	5,955	4,592
Unsecured liabilities	29,881	4,095	32,534	2,937
Unsecured (senior unsecured)	11,046	8,446	17,073	13,464
Profit participation certificates and other subordinated liabilities	1,060	1,060	2,123	1,085
Silent participations	1,700	1,700	2,072	2,072
Total	**59,172**	26,309	69,833	32,766

The above table breaks down HSH Nordbank's liabilities by financial instrument and thereby takes into account the requirements of capital markets participants. Liabilities with a maturity of more than one year are separately shown. The financial instruments may be reconciled to the balance sheet line items liabilities to customers, liabilities to banks, securitised liabilities and subordinated capital. The carrying amounts of financial instruments excluding principal repayments and accrued interest are assigned to maturity bands in the above table.

One focus within the framework of long-term liabilities are securitised debt instruments (covered bonds, asset-based funding). These mainly include debt instruments issued under Pfandbrief programmes (mortgage, public sector and ship Pfandbrief programmes) as well as other asset-based funding issues, repo transactions and deposits from development banks. The total amount of secured debt instruments outstanding was € 15,485 million as at the year end (31 December 2016: € 16,031 million).

Unsecured liabilities include call and time deposits comprising mainly client deposits and other unsecured financing instruments and amounted to € 29,881 million as at the reporting date (31 December 2016: € 32,534 million). Call and time deposits account for most of the client deposits. The volume of bearer and registered bonds (senior unsecured) amounted to € 11,046 million as at the 2017 year end (31 December 2016: € 17,073 million).

The two line items Profit participation certificates and other subordinated liabilities of € 1,060 million (31 December 2016: € 2,123 million), as well as the silent participations at € 1,700 million (31 December 2016: € 2,072 million) in total represent subordinated capital. Of the silent participations, € 508 million is disclosed for hybrid financial instruments (Resparc I and Resparc II) under the Securitised liabilities balance sheet line item as at the reporting date. Due to the changed assessment of the future cash flows (IAS 39 AG 8 effect), the amounts reported under silent participations are down on the previous year (see Note 7).

Capital and funding

RWA AND CAPITAL RATIOS
(SAME PERIOD)

	31.12.2017	31.12.2016
Risk-weighted assets (RWA) (€ bn)	22.2	28.6
Overall capital ratio	30.6 %	24.8 %
Tier 1 capital ratio	23.5 %	18.7 %
CET1 capital ratio	18.5 %	14.1 %
CET1 capital ratio (full implementation of Basel III)	18.1 %	13.4 %
Pro forma CET1 capital ratio[2]	15.4 %	12.6 %

[1] Same period: ceteris paribus calculation taking full account of the balance sheet amounts as at the reporting date.
[2] "Pro forma" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, valuation allowances that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.

CET1 ratio at a good level despite burdens from winding-down of legacy burdens within the context of privatisation

As part of the privatisation of HSH Nordbank, the second loss guarantee provided by the federal state owners is to be settled in full and terminated in 2018. This means that the regulatory relief effect of the guarantee will cease to apply as of the beginning of March. A corresponding cancellation agreement for the second loss guarantee was signed on 28 February 2018. It is subject, among other things, to the condition precedent of the successful closing of the share purchase agreement. For further details, reference is made to the section entitled "Sale of HSH Nordbank AG on 28 February 2018". As a result, HSH Nordbank is using a same-period pro forma CET1 ratio, excluding the regulatory RWA relief effect of the second loss guarantee, as the key management indicator. Taking into account this hypothetical assumption (for details, refer to the "Management system" section of this Group management report) – and based on pro forma RWA in an amount of € 26.2 billion (31 December 2016: € 36.2 billion) – this produces a pro forma CET1 ratio (key management indicator) of 15.4%, which is considerably higher than both the value as at 31 December 2016 of 12.6% and the ambition level of around 13% that was planned for the end of 2017. Against the backdrop of the share purchase agreement signed on 28 February 2018, the agreement on the portfolio transaction and the cancellation agreement for the second loss guarantee, which was also signed on 28 February, the regulatory CET1 capital ratio is expected to no longer be recognised as a securitisation arrangement taking into account the regulatory relief effect as of March 2018.

The same-period core Tier 1 capital ratio (CET1 ratio, phase-in), which also includes the regulatory relief effect of the second loss guarantee, amounts to 18.5% as at 31 December 2017, meaning that, despite the considerable burdens resulting from the portfolio transaction agreed within the context of privatisation, it is significantly above the value at the end of 2016 (14.1 %) and the ambition level of around 13.0 % planned for the end of 2017.

The significant increase in the capital ratios is due, in particular, to the marked drop in RWA. The drop was higher than planned, with RWA falling by around € 6.4 billion compared with 31 December 2016 to € 22.2 billion. This development is due, in particular, to the significantly accelerated reduction of legacy burdens in the 2017 financial year. In addition, the active management of currency risks and a strong EUR/USD exchange rate, which exceeded the Bank's expectations, also resulted in a drop in RWA, which had a marked impact on the development in the capital ratios.

Assuming the full implementation of the Basel III rules (fully loaded), HSH Nordbank's same-period CET1 ratio increased to 18.1 % compared to 31 December 2016 (13.4 %).

As was the case on 31 December 2016, there is no free regulatory guarantee buffer for the second loss guarantee (free capacity for expected and unexpected losses) as at 31 December 2017 either. Part of the regulatory RWA burden for the portfolio secured under the federal state guarantee is reflected as a deduction from the regulatory equity capital. There is no capital deduction item as at 31 December 2017, meaning that this item is down by around € 0.6 billion as against 31 December 2016. The reduction is due to the additional loan loss provisions recognised in connection with the planned portfolio transaction, which had already had an impact on the Bank's reported equity on the reporting date. The RWA attributable to the senior tranche of the federal state guarantee also fell considerably in 2017 due to the active winding-down of the legacy portfolio, which made an additional contribution to the increase in CET1 ratios.

SREP requirements met

As part of the supervisory process in the Banking Union, HSH Nordbank was assigned an individual minimum capital ratio by the ECB that is reviewed annually as part of the SREP process. This capital ratio was adhered to at all times during the reporting period. Since 1 January 2017, an SREP minimum requirement of around 8.9% (Pillar 2 Requirement "P2R" incl. the combined capital buffer requirements) has applied to HSH Nordbank.

REGULATORY CAPITAL RATIOS

(NOT SAME PERIOD)[1]

(%)	**31.12.2017**	31.12.2016
Overall capital ratio	31.4 %	24.2 %
Tier 1 capital ratio	23.2 %	18.5 %
CET1 capital ratio	18.7 %	13.9 %
CET1 capital ratio (full implementation of Basel III)	17.8 %	13.1 %
Leverage ratio	7.7 %	6.9 %

1) Not same period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only included in part).

REGULATORY CAPITAL

(NOT SAME PERIOD) [1]

(€ bn)	**31.12.2017**	31.12.2016
Regulatory capital	7.0	6.9
of which: Tier 1 capital	5.2	5.3
of which: CET1 capital	4.2	4.0
of which: additional Tier 1 capital	1.0	1.3
of which: supplementary capital	1.8	1.6
Risk assets (RWA)	22.2	28.6
of which: Risk assets counterparty default risk	18.6	23.4
Leverage exposure	67.0	77.0

1) Not same period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only included in part).

The financial holding group, which arose in 2016 as a result of the establishment of HSH Beteiligungs Management GmbH as a holding company in connection with the measures set out in the EU catalogue of conditions and commitments, has also been assigned a minimum capital ratio by the ECB as part of the supervisory process in the Banking Union which is in line with the statutory regulations and is reviewed annually as part of the SREP process. In this regard, a core Tier 1 capital ratio of 4.5 %, plus capital buffer requirements that then amount to around 5.8 % in total, has applied to the financial holding group since 1 January 2017. The CET 1 capital ratio (not same period) came to 10.2 % as at 31 December 2017 (31 December 2016: 6.5 %). The increase in the CET1 capital ratio is essentially due to the fact that the provisions for regular future guarantee premiums under the federal state guarantee at the level of HSH Beteiligungs Management GmbH were reversed due to the significantly shorter settlement period. On the other hand, provisions for the supplementary premium had to be recognised, although these are not likely to result in a same-period CET1 capital ratio of less than 10 % due to the capital protection clause.

HSH Nordbank's leverage ratio was a very solid 7.7 % as at 31 December 2017 (31 December 2016: 6.9 %). The development takes into account the drop in the relevant business volume during the reporting period. A statutory binding minimum leverage ratio value has not yet been defined. With the amendment of the CRR, the leverage ratio, based on the Tier 1 capital, is likely to be set at a binding level of 3 % for all institutions as a minimum requirement.

Detailed information regarding HSH Nordbank's capital and RWA forecast is set out in the "Forecast, opportunities and risks report" of this management report in the section entitled "Forecast report including opportunities and risks".

Funding activities expanded further

HSH Nordbank continued to successfully implement its funding strategy, using various sources of refinancing, over the past year. In the reporting period, the raising of funding (with a volume of € 5.0 billion) was comfortably higher than the planned volume (€ 4.1 billion). The lower volume of bond issues in the retail segment was more than compensated for through placements to institutional investors.

The Bank successfully placed a public-sector Pfandbrief in the second half of the year, marking the continuation of its Pfandbrief benchmark strategy. The bond has a volume of € 500 million and a term of three years.

In addition, further long-term USD funds were raised via the ABF platform. First, an existing transaction, backed by corporate loans, was increased by € 150 million. In addition, a new issue was concluded with a volume of USD 400 million. The transaction is secured using real estate loans and has a term of four years.

Since the fourth quarter of 2017, the Bank has been offering fixed-term deposit investments to retail customers via the "Deposit Solutions" platform, allowing it to open up a further funding channel. This move has been taken to counteract the significantly lower retail funding volume due to the low interest rate environment. This new funding channel means that the Bank is very well-prepared for the period after the change of ownership. In addition, the private client deposits have a positive effect on the funding structure.

The level of deposits also contributed to the implementation of the funding strategy. Total deposits amounted to € 25.0 billion as at 31 December 2017 (31 December 2016: € 29.7 billion). Furthermore, as at 31 December 2017, the Bank held liquidity reserves in the form of credit balances at central banks in the total amount of around € 6.6 billion and collateral eligible for refinancing at central banks in the amount of € 9.3 billion, which the Bank can access at any time. The high level of deposits allows the Bank to continue with its funding strategy and take account of the uncertainty that is inevitably linked with the complex privatisation process. The Bank is prepared to accept a significant negative impact on its earnings situation in this regard, which will be reflected in temporarily increased interest expense.

In addition to the successful implementation of the raising of funding, the market portfolio sales concluded at the beginning of 2017 and in the course of 2017 and inflows from the settlement of losses also contributed to the further improvement in the Bank's liquidity situation.

The regulatory requirements governing the liquidity ratios and the assumptions applied by the Bank as part of its forecasts were adhered to during the reporting period. The liquidity ratio as defined in the German Liquidity Regulation (LiqV) came to 1.79 as at 31 December 2017 at individual institutional level (31 December 2016: 1.92), which is still significantly above the minimum regulatory requirements. The liquidity coverage ratio (LCR, short-term minimum liquidity ratio, key management indicator) was calculated for the first time without taking the institutional protection into account (for details, refer to the section entitled "Management system"), and reached a very good level of 169 % as at 31 December 2017 (31 December 2016: 172 %), which was also significantly above the minimum requirements. The NSFR (structural liquidity ratio, key management indicator) came to 114 % at 31 December 2017 (31 December 2016: 111 %), putting it above the 100 % mark and therefore above the anticipated future regulatory requirements.

The liquidity development report as at 31 December 2017 shows a survival period in the combined stress scenario of more than twelve months (31 December 2016: ten months). The regulatory requirement of one month was therefore clearly exceeded.

The two rating agencies, Moody's and Fitch, regard the conclusion of the EU proceedings as an important milestone and assess the structural measures leading to an improvement in the financial and risk profile as positive in principle. This applies in particular, to the portfolio transaction, which is designed to relieve HSH Nordbank AG of non-performing loans and ultimately also strengthen its capital position. Nevertheless, the agencies consider the uncertainty during the change of ownership and the planned smooth transition with regard to the deposit guarantee fund to be particular challenging. As expected, adjustments were made to the rating position after the signing on 28 February 2018. While the two agencies agree with regard to the prospective impact of privatisation on the Bank's financial and risk profile (in particular solid capital position and considerably improved asset quality), they currently take different views with regard to the effects on the Bank's long-term rating. While Moody's expects the Bank's rating position to improve in light of the significant improvement in its financial profile, Fitch believes that the rating position could deteriorate, in particular due to the planned change in the deposit guarantee fund (exit from the German Savings Banks Association (DSGV)), the associated impact on refinancing and the future shareholder structure (no controlling majority owner) if the improvement in the individual rating is not sufficient to compensate for these aspects. The two agencies will reach a final decision on the future rating position based on the closing of the privatisation transaction.

FINAL ASSESSMENT OF HSH NORDBANK'S POSITION

In the 2017 financial year, the Bank showed positive operational development, meaning that it made a significant contribution to the positive development of the privatisation process. New business activities developed satisfactorily overall, the significantly accelerated winding-down of legacy burdens was implemented successfully and cost potential was exploited as planned. This means that, in particular, the pro forma CET1 capital ratio, the cost-income ratio and new business, as well as other key management indicators are at a satisfactory level overall, allowing the Bank to largely achieve its relevant targets in the reporting year, exceeding them in a number of sub-segments. At the same time, the Bank and its employees have done everything in their power to support the privatisation process and showed considerable commitment in the extremely labour-intensive phase leading up to the signing and beyond. This laid the foundation required for the share purchase agreement, which was signed on 28 February 2018.

In the future, HSH Nordbank AG will become a commercial bank with exclusively private owners. The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. The new group of owners is characterised by a high level of expertise and many years of experience with commitments in the international financial sector. The federal states of Hamburg and Schleswig-Holstein and Sparkassen- und Giroverband für Schleswig-Holstein have concluded a corresponding share purchase agreement for all of their indirectly held HSH shares (a total of 94.9 percent), achieving the first successful privatisation of a Landesbank in Germany. At the same time, an agreement was reached within the context of the privatisation to relieve HSH Nordbank of large parts of the non-performing legacy loans, as well as to cancel the second loss guarantee prematurely. The closing of the share purchase agreement, the portfolio transaction and the cancellation agreement for the second loss guarantee are subject to certain conditions. The closing of the privatisation agreement (share purchase agreement) is scheduled for the second or third quarter of 2018.

The portfolio transaction agreed in connection with the privatisation process caused significant negative valuation effects within loan loss provisions as at the reporting date, resulting in a substantial loss and overshadowing the otherwise positive development. The Group net result before taxes amounts to € -453 million as at 31 December 2017 (31 December 2016: € 121 million). This result is due, above all, to unplanned loan loss provision burdens in the Non-Core Bank which were recognised in connection with the complete sale of the largely non-performing Non-Core Bank portfolios on the reporting date and relate, in particular, to individual specific loan loss provisions in an amount of € 1.1 billion.

In light of its operational progress and the privatisation process, which has been successful so far, HSH Nordbank considers its development to be positive overall. The measures implemented within the context of privatisation will contribute to a business model for the Bank that is sustainable in the long run and will facilitate the sustainable realignment of its activities.

Details regarding the continuing challenges, as well as opportunities and risks of future development, can be found in the Forecast, opportunities and risks report.

SEGMENT REPORTING

SEGMENT OVERVIEW[1)]

(€ m)		Corporate Clients	Real Estate	Shipping	Treasury & Markets [1)]	**Core Bank**[1)3)]	Non-Core Bank	Other and Consolidation[1)4)5)]	**Group**
Total income	**2017**	**218**	**185**	**91**	**561**	**1,055**	**72**	**445**	**1,572**
	2016	251	218	127	436	1,032	36	–147	921
Loan loss provisions (including credit derivative)[2)]	**2017**	**–53**	**2**	**63**	**1**	**13**	**–1,295**	**6**	**–1,276**
	2016	– 5	–	52	–	47	106	3	156
Administrative expenses	**2017**	**–124**	**–54**	**–40**	**–84**	**–302**	**–202**	**–11**	**–515**
	2016	–149	–57	–53	–99	–358	–299	23	–634
Net income before taxes	**2017**	**41**	**127**	**94**	**470**	**732**	**–1,583**	**398**	**–453**
	2016	89	148	104	326	667	–299	–247	121
Segment assets (€ bn)	**31.12. 2017**	**12**	**10**	**5**	**21**	**48**	**12**	**10**	**70**
	31.12. 2016	12	11	6	19	48	22	14	84

[1)] Adjustment of the previous year's figure due to the transfer, in 2017, of funding books in which securities issued by HSH are managed from the sphere of non-reportable segments (Other) to the Treasury & Markets segment.
[2)] Summary of the loan loss provisions in the lending business and hedging effect of credit derivative under the second loss guarantee line items.
[3)] Core Bank is the total of the four segments: Real Estate, Shipping, Corporate Clients and Treasury & Markets.
[4)] Net income before taxes including result from restructuring and privatisation.
[5)] Consolidation also includes the effects from differences in accounting.

Net result of the Core Bank in line with the plan

The Core Bank, in which HSH Nordbank's strategic activities are combined, continued to largely forge ahead with its new business as planned in the 2017 reporting year in what remained a challenging environment, and thus made further progress in implementing its client- and sector-based strategy. Overall, the new business of the Core Bank showed positive development and is slightly below the ambitious planning. It amounted to € 8.5 billion, only just shy of the prior-year level (€ 8.9 billion).

Broken down by segment, new business in the Corporate Clients division was down considerably on the previous year and the planned level as a result of the ongoing intense competitive environment. In this area, care was taken to adhere stringently to an appropriate risk profile, which logically meant that the Bank had to accept a development that was lower than planned. In the Real Estate division, performance was up slightly on the previous year and up considerably on the planned value due to the good market position. The targeted management of the risk profile in the shipping segment generally results in extremely selective new business being transacted at a predictably low level. In the past reporting year, new business in the Shipping division was considerably higher than the low figure achieved in the previous year, although it fell considerably short of the planned value.

As at 31 December 2017, the Core Bank achieved net income before taxes of 732 million, which is in line with the plan and is up considerably in a year-on-year comparison (previous year: € 667 million). The good overall operating performance of all segments of the Core Bank, the realisation of unrealised gains and the reversal of general loan loss provisions contributed to this. The net result was hit by a temporary increase in the liquidity built up during the privatisation period. The costs incurred in this regard are recognised in the customer segments.

The total income of the Core Bank, which has increased slightly as against the previous year (€ 1,032 million) to € 1,055 million, reflects not only the new business concluded, but also planned and achieved effects from the realisation of unrealised gains by sales of promissory note loans in the amount of € 356 million. In addition, the net result of the Core Bank benefited from positive loan loss provisions compared with the Non-Core Bank amounting to € 13 million in total after the reversal of general loan loss provisions of € 164 million (previous year: € 47 million).

The implementation of the ongoing cost reduction programme in line with the plan also contributed to the improved net result. Administrative expenses, for example, have fallen from € –358 million to € –302 million, a drop of around 16 % as against the previous year. The net result of the Core Bank includes € –22 million, i.e. around 15 % of the total guarantee expense.

The Core Bank achieved a return on equity of 20.8 % on the basis of this positive result (31 December 2016: 20.7 %), which is in line with the plan. The cost-income ratio of the Core Bank amounts to 28.2 % (31 December 2016: 34.6 %). Both values include effects relating to the realisation of unrealised gains. This means that they are overstated and exceed the targeted level that can be achieved in the long term as a result.

Total assets of the Core Bank amounted to around € 48.4 billion as at 31 December 2017 (31 December 2016: € 48.4 billion). The increase due to the temporary increase in liquidity resources during the privatisation period, which is reflected in the Treasury & Markets division, is offset by the declining development in segment assets in the other segments of the Core Bank.

The NPE ratio is down in 2017 as a whole as a result of the NPE reduction. As expected, it comes to a low level of 1.6 % (31 December 2016: 1.9 %).

KEY CORE BANK MANAGEMENT INDICATORS

	31.12.2017	31.12.2016
Net income before taxes (€ m)	732	667
CIR (unadjusted)	28.2 %	34.6 %
RoE	20.8 %	20.7 %
NPE ratio	1.6 %	1.9 %
New business (€ bn)	8.5	8.9

Further information can be found in the explanatory comments on the individual segments.

Segment results of the Core Bank

The **Corporate Clients** segment is well diversified and organised on a sector-specific basis. It combines the Energy & Infrastructure, Trade & Food, Healthcare, Industry & Services and Wealth Management business areas. In addition, the business unit offers the consultancy areas of structured financing, leveraged buy-out and mergers & acquisitions from a single source for all clients of the Bank. The Corporate Clients segment generated net income before taxes of € 41 million in the 2017 reporting year (previous year: € 89 million). This includes total income of € 218 million (previous year: € 251 million), which primarily reflects business developments in an extremely competitive environment. The significant decline in net income before taxes is due mainly to significant impairments in a few individual cases. In addition, burdens resulting from the offsetting of earnings in connection with the temporary increase in liquidity resources during the privatisation period led to the significantly lower net result compared with the previous year.

New business amounts to € 3.1 billion, down considerably on the previous year's volume (€ 3.8 billion). While the Trade and Food Industry areas achieved/exceeded the plan value for new business, the planned volume was not achieved in full at divisional level. Nevertheless, the Bank was successful, particularly in the Industry & Services area, in stepping up its product distribution via its stable client relationships, increasing its cross-selling net income as a result. In the Energy and Infrastructure segment, the volume of receivables was increased in an extremely competitive market by approximately € 0.4 billion to € 5.7 billion in the 2017 financial year. The focus was on financing for transport infrastructure and data networks. The renewable energy segment achieved successful market entry in the Netherlands and further expanded its market position in Ireland.

The **Real Estate** segment made a significant earnings contribution for the Bank of € 127 million in the 2017 financial year (previous year: € 148 million). This segment has once again managed to further strengthen its good market position and once again exceed the new business expectations. New business was expanded, despite the ongoing competitive environment, to a total of € 4.7 billion (previous year: € 4.6 billion), with falling interest rate margins putting pressure on income. The high level of market penetration in the core northern German region was maintained. The positive development in business with western German metropolitan regions and with international institutional investors also continued in the fourth quarter of 2017.

Total income amounted to € 91 million in the **Shipping** segment, significantly below the level witnessed in the previous year (€ 127 million). This is due to a drop in net interest income, due in particular to the decline in the loan volume, as well as to lower net trading income. Net income before taxes came to € 94 million as against € 104 million in the previous year. The loan loss provisions amount to € 63 million (previous year: € 52 million) and contain reversals of general loan loss provisions. Guarantee expenses came to € -18 million (previous year: € -18 million) and put significant pressure on the net result. All in all, the shipping market was still characterised by an ongoing challenging market environment in 2017 despite a slight recovery in the container vessel and bulker subsegments. The new business with various international shipping companies with good credit ratings did not quite reach the planned value in 2017, coming in at € 0.5 billion, but is nevertheless up on the previous year (€ 0.3 billion).

The **Treasury & Markets** segment achieved net income before taxes of € 470 million (previous year € 326 million), which also includes the effects incurred as a result of the realisation of unrealised gains from the sale of promissory note loans. In addition to these effects, which were also incurred within the context of the optimisation of cover pools in the public sector Pfandbrief business, the net result also reflects the operational successes in the banking book activities and the derivatives business. In the fourth quarter of 2017, the client business, excluding syndication activities, exceeded the prior-year value due to the significant contribution to earnings made by the deposit business with savings banks and institutional clients.

The Core Bank net result contains the main net results of the **Transaction Banking** product division. The Transaction Banking product division achieved a net result of € 26 million, up considerably on the prior year (€ 17 million). Following the deduction of attributable costs, this includes, in particular, income from the use of products by customers in the deposit business, in account management and in the area of payment transactions, as well as in the documentary business in foreign trade and export financing. The division was thus able to make a tangible contribution to the Bank's cross-selling income. In particular, net commission income, which is strategically important to the Bank, remains on a par with the previous year in a challenging environment. Under the Bank's internal business management policy, net income of the Transaction Banking product division is fully disclosed in the customer departments and, as a result, in the net results of the individual segments.

Segment results of the Non-Core Bank

The Non-Core Bank reported a negative net result of € –1,583 million as at 31 December 2017, which is much lower than expected (previous year: € –299 million). The substantial loss is mainly due to significant unplanned loan loss provision expense in connection with the portfolio transaction. Within the context of the privatisation process, the Bank will be relieved of a large part of the non-performing legacy burdens as a result of the portfolio transaction, giving rise to significant additional unplanned loan loss provisions expense as at the reporting date.

Total income in the Non-Core Bank amounted to € 72 million (previous year: € 36 million). Net trading income, which reflects increases in value in the credit investment portfolio in particular, made a significant contribution of € 84 million to this amount (previous year: € –53 million). The marked drop in net interest income from € 15 million as at 31 December 2016 to € –9 million as at 31 December 2017 is due first and foremost to a drop in the interest-bearing loan volume due to the accelerated winding-down of the non-performing legacy portfolios.

Net income before taxes was negatively impacted, in particular, by very high loan loss provision expense of € –1,413 million (previous year: € –1,594 million). Loan loss provisions recognised mainly for shipping loans and the energy wind-down portfolio were compensated for in the guaranteed portfolio by the guarantee up to its full balance sheet utilisation. Taking into account the compensation effect and including foreign exchange rate effects and the hedging effect of the credit derivative, loan loss provisions in the Non-Core Bank after the guarantee effect amount to € –1,295 million. In the previous year, loan loss provisions after compensation came to € 106 million. The significant change is due to the second loss guarantee, which has been fully utilised since the first quarter of 2017. As a result, the loan loss provisions incurred in the reporting year were no longer compensated for in full. This played a key role in increasing the loss in the Non-Core Bank.

Administrative expenses came to € –202 million (previous year: € –299 million) and include € –25 million in unplanned write-downs to property, plant and equipment at subsidiaries (previous year: € –66 million) in connection with the market transactions associated with the winding-down of the portfolio that were executed in the first half of 2017. The expense for the second loss guarantee amounts to € –127 million (previous year: € -189 million). This means that around 85 % of the total guarantee expense is attributable to the Non-Core Bank. The expenses for bank levy and deposit guarantee fund amounted to € –9 million (previous year: € –15 million). The total assets of the Non-Core Bank fell considerably to € 11.7 billion as at 31 December 2017 due to the reduction in the portfolio (31 December 2016: € 22.3 billion). This is due, in particular, to the accelerated reduction of legacy burdens.

The NPE ratio of the Non-Core Bank remains at a high level despite legacy burdens being wound down to a much greater extent than planned, coming in at 67.7 % (31. December 2016: 63.6 %). The coverage ratio amounts to 65.2 % (31 December 2016: 47.7 %) and reflects solid risk coverage in the NPE portfolio on the whole. The sharp increase in the coverage ratio is linked to the additional loan loss provisions resulting from the portfolio transaction. In the shipping portfolio of the Non-Core Bank, the coverage ratio has risen from 59.2 % as at 31 December 2016 to 67.5 % as at 31 December 2017.

KEY MANAGEMENT INDICATORS OF THE NON-CORE BANK

	31.12.2017	31.12.2016
Net income before taxes (€ m)	–1,583	–299
NPE ratio	67.7 %	63.6 %
Coverage ratio	65.2 %	47.7 %
Total assets (€ bn)	11.7	22.3

Results “Other and Consolidation” division

Administrative functions and overall bank positions are disclosed in Other under “Other and Consolidation” as segments that are not subject to reporting requirements. “Consolidation also comprises items that reconcile the internal reporting results presented in the segment report to the Group financial statements prepared in accordance with IFRS. In addition to the measurement and disclosure differences the result from restructuring and privatisation is allocated in full to this division.

In addition, the hybrid capital instruments were included under “Other and Consolidation” for internal management purposes. In this respect, the net result from the reassessment of interest and principal cash flows of € 413 million for the hybrid capital is reported in net interest income under “Other and Consolidation”. The reassessment of interest and principal cash flows is due to the imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank. Due to the associated risks, HSH Nordbank AG expects, from today's point of view that, contrary to past plans, it will only be possible to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2024 financial year for the 2023 financial year.

Within this context, the net income before taxes comes to € 398 million as at the reporting date (previous year: € -247 million). The net result was hit, in particular, by restructuring expenses of € -66 million (previous year: € -110 million) incurred in connection with the planned headcount reduction and ongoing privatisation.

The segment assets of “Other and Consolidation” mainly include the liquidity reserve. Segment assets as at 31 December 2017 came to € 10.2 billion (31 December 2016: € 13.8 billion). The decline is related, in particular, to measures in the context of liquidity management as well as EUR/USD exchange rate changes.

EMPLOYEES OF HSH NORDBANK

The human resource strategy supports the overall bank strategy and provides the framework for operational human resource functions. It attaches great importance to ensuring that quantitative and qualitative staffing levels are in place and to managing and avoiding related personnel risks. This goes hand in hand with the ability to attract and retain motivated employees willing to perform.

The Human Resources division is responsible for its governance function, especially in managing personnel expenses and implementing, complying with and enhancing the legal and regulatory principles and guidelines, e.g. in respect of the German Ordinance on the Remuneration of Financial Institutions (InstitutsVergV). Modern and reliable operating processes form the basis for all topics relating to human resource functions.

EFFECTIVE RESOURCE MANAGEMENT

The successful implementation of the programmes initiated by the Management Board in 2015/2016 to permanently reduce administrative expenses continued in 2017. The target for the planned workforce reduction in 2017 was almost reached in a socially responsible manner with the help of the arrangements agreed with the Works Council. The number of employees had decreased to 1,926, based on full-time equivalents (FTE), by the 2017 year-end in the course of the ongoing reduction in staff within the HSH Nordbank Group (31 December 2016: 2,164). Changes to the scope of consolidation also had an impact on the headcount. The number of employees (FTE) at HSH Nordbank AG (single entity) had fallen to 1,690 by the end of 2017 (31 December 2016: 1,902).

FULL TIME EMPLOYEES IN THE GROUP

	31.12.2017	31.12.2016
Full-time equivalents(FTE) in the Group[1]	**1,926**	**2,164**
of which: Women	719	820
Men	1,207	1,344
Employees in Germany	1,838	2,068
Employees abroad	88	96
Total number of employees in the Group[2]	**2,295**	**2,613**
Employee key ratios and figures		
Part-time employment ratio (%)	26.7	27.2
Average age[3] in years	45.9	45.3
Average length of employment in years	14.5	13.7

1) Total number of employees excluding trainees, temporary staff and interns.
2) Headcount.
3) Head offices only; does not include branches or subsidiaries.

FOCUS ON MODERN HR DEVELOPMENT

The development of all employees is the focal point of human resource functions for HSH Nordbank. In 2017, the offering was aimed, in particular, at meeting the requirements of a changing bank in an agile market.

Emphasis was placed on the further development of sales skills using targeted training sessions, workshops, meetings, conferences and dialogue at in-house events in all customer departments. There are also programmes for the further development of managers with the focus on change and implementation skills. An interesting range of occupational and health-oriented seminars rounds off the HR development programme of HSH Nordbank.

YOUNG PROFESSIONALS PROGRAMME EXPANDED FURTHER

In addition to the development of all employees, measures were taken again in 2017 to further strengthen the recruitment and promotion of our young professionals. HSH Nordbank offers high-quality education for the Bachelor of Arts/Science degree in business management/information systems and for the office management specialist occupations. A total of 29 students/trainees were employed in 2017.

In the past year, twelve students completed their dual studies at HSH Nordbank with a very good or good overall score and received a permanent job offer. These young professionals now have further promotion possibilities following their training.

For new entrants to the profession, HSH Nordbank offers a 24-month trainee programme covering a wide range of topics. High-quality training is hereby ensured by comprehensive and in-depth insights into each of the Bank's fields of activity. A total of 17 trainees were employed in 13 business units in 2017.

Due to its exceptional young professionals programme, HSH Nordbank was again honoured in 2017 by Absolventa GmbH as a provider of a career-enhancing and fair trainee programmes and was recognised as a "Fair Company" for its good treatment of trainees and university graduates. The young professionals programme is a key element for counteracting the demographic trend and the increasing average age of HSH Nordbank's employees. Last year, HSH Nordbank developed a target for a balanced demographic employee structure for 2020 for this purpose. Vacant positions are used to achieve this target and – as far as possible – are filled by young professionals. HSH Nordbank had adopted new approaches for this purpose and has successfully used social media and Internet platforms to recruit.

FURTHER EXPANSION OF EXEMPLARY HEALTH CARE AND SOCIAL MANAGEMENT SERVICES

Employees are provided with extensive health care and social management services in an integrated approach. Besides in-house seminars, these also include individual counselling for employees, managers and whole teams. HSH Nordbank also supports the work-life balance of its employees by offering comprehensive counselling and information services on such topics as "maternity and parental leave", "child care" and "caring for relatives". The services offered are regularly reviewed and flexibly tailored to employee requirements.

CLEAR COMMUNICATION STRATEGY PREREQUISITE FOR A SUCCESSFUL CHANGE OF OWNERSHIP

The wide range of health care and social management services offered as well as the interesting work opportunities make HSH Nordbank an attractive employer in a challenging, competitive environment with a clear objective for the future. Managers at HSH Nordbank have made it their responsibility to enter into open dialogue with all employees on the privatisation process, and also on the associated uncertainties. Ultimately, a clear communication culture creates trust and is a prerequisite for the success of the Bank.

REMUNERATION TO EMPLOYEES

The specific design of the remuneration systems that apply at HSH Nordbank aims to harmonise the interests of the Management Board, employees and shareholders and to motivate the Management Board and employees to act in the interests of HSH Nordbank and make full use of their individual potential.

The remuneration system for employees below the Management Board level is based on a total remuneration approach, counteracts any significant dependence on variable remuneration and thereby prevents the employees from taking excessively high risks for the purposes of realising a variable remuneration potential. The amount of the total budget for the variable performance-related remuneration is determined on the basis of the Bank's performance, which is calculated using parameters that reflect the success of the Bank. In addition to achieving key financial ratios these parameters are also based on the Bank's strategic objectives amongst other things. They take account of the concept of sustainability and are always tailored to the business model as well as the Overall Bank strategy and risk strategy, which are updated on an annual basis.

The budget for the Overall Bank for variable performance-related remuneration of the employees is distributed to the employees taking into account the performance of the divisions and based on the achievement of individual objectives. Fixed upper limits for the ratio of variable to fixed remuneration were set for all employees of the Group in accordance with the German Ordinance on the Remuneration of Financial Institutions (Institutsvergütungsverordnung – InstitutsVergV) in order to avoid disproportionately high variable remuneration.

In accordance with the specific requirements of the InstitutsVergV, HSH Nordbank defines a group of employees as so-called risk takers, who have a significant influence on the overall risk profile of the Bank by virtue of their function. In accordance with the InstitutsVergV, parts of their variable remuneration are paid on a deferred basis and are dependent on the Bank's sustained performance in line with the regulatory requirements, among other things.

The InstVergV, which has applied since 2010 and sets out provisions on the regulatory requirements that the remuneration systems of institutions have to meet, has been implemented on an ongoing basis - most recently in 2015 – in the Bank's collective agreements. The negotiations with the Bank's co-determination bodies on the new requirements set out in the InstitutsVergV 3.0, which was published in August 2017, commenced at the end of 2017. As well as updating the remuneration system to reflect the regulatory requirements, there are also plans to adjust the system to reflect the new parameters of HSH Nordbank in 2018.

Details on the remuneration paid to employees are published in a separate remuneration report on HSH Nordbank's website in accordance with the InstitutsVergV. The remuneration report does not form part of the management report.

MANAGEMENT DECLARATION PURSUANT TO SECTION 289F (2) NOS. 4 AND 6 OF THE GERMAN COMMERCIAL CODE (HANDELSGESETZBUCH – HGB)

EQUAL OPPORTUNITIES AND WOMEN IN MANAGEMENT POSITIONS AND DIVERSITY CONCEPT

HSH Nordbank is continuing to actively address the issues of equal opportunity and the promotion of women with the assistance of its equal opportunities officer. The Bank set the following quotas in line with the law, which came into force in May 2015, regarding equal representation of women and men in management positions in the private sector and public services and the resulting introduction of Section 76 (4) of the German Stock Corporation Act (AktG):

At the level of managers reporting directly to the Management Board, HSH Nordbank was aiming to achieve a ratio of 16 % women. It has almost reached this objective, with a current figure of 15 %. The department head ratio, on the other hand, exceeds the target at 19 % (target of 15 %).

The efforts made to promote young female professionals in particular will allow the Bank to fill vacant positions at the next higher level from the large group of female department heads in the future. To this end, the "Equal Opportunity Promotion Plan" was already expanded back in 2016 to include further measures such as workshops on female promotion and the embedding of this topic in the overall bank objectives.

STATISTICS ON EQUAL OPPORTUNITIES AS AT 31.12.2017

	Women	Men	Total	Women	Men
	Number			Ratio	
Managers reporting directly	3	17	20	15 %	85 %
Heads of department	11	48	59	19 %	81 %
Total	**14**	**65**	**79**	**18 %**	**82 %**

[1] Head Office excluding employees released from their duties

In August 2015, the Supervisory Board approved a target of 20 % for the proportion of women on HSH Nordbank AG's Management Board, which was to be achieved by 30 June 2017. To date, HSH Nordbank has been unable to meet this objective. In July 2017, however, the Supervisory Board renewed its objective of appointing a female member of the Management Board by 30 June 2022, which corresponds to a quota of 25 % based on the Bank's current size.

Topics such as equal opportunities, diversity and female promotion are also of importance for the composition of the Supervisory Board. Under the requirements of Section 111 (5) AktG, also newly introduced in 2015, HSH Nordbank is required to set targets for the proportion of women at the Supervisory Board level as well. Deadlines for achieving these targets are to be agreed at the same time and reasons given if such targets are not met.

One of HSH Nordbank's top priorities is to ensure a composition of the Management Board and Supervisory Board that is appropriate for the Bank and meets the different requirements of the responsible boards and, as a result, to ensure the adequate exercise of management and control functions. This means that, in addition to the described targets for the proportion of women on the Management Board, there are additional requirements aimed at achieving the balanced composition of the Management Board and Supervisory Board. The rules of procedure for the Supervisory Board, for example, state, in Section 6 (3c) (aa), that, when filling a post on the Management Board, consideration should be given to ensuring balanced and varied knowledge, skills and experience for all Management Board members. In addition, with regard to the age of the members of the Management Board, a limit applies pursuant to Section 6 (3c) (bb) of the rules of procedure for the Supervisory Board, according to which the members of the Management Board should not have turned 65 at the time of their appointment.

With regard to diversity in the Supervisory Board, the Supervisory Board had already adopted the objective in 2011, based on what were, at that time, new requirements of the German Corporate Governance Code (DCGC), of ensuring that the prevailing proportion of women would also not fall below 20 % in the future either. The Supervisory Board considers an initial target of 30 % to be an appropriate proportion of women. With a current proportion of women of 31.2 % the Supervisory Board has already met the target set by itself. The proportion of women on the shareholder side is currently 25 %, and 37.5 % on the employee side. In addition, the Supervisory Board had already set objectives back in 2011 and 2012 that aim to ensure that the composition of the Supervisory Board is as diverse as possible. The objectives deal with the composition of the Supervisory Board in terms of including international members, avoiding any conflicts of interest, an age limit, the percentage of women already described above and the impartiality of the members. The status of the target achievement is calculated annually and shown in the Corporate Governance Report.

In addition, the Supervisory Board has created a competence profile that is reviewed on an annual basis and sets out the skills required for activities on the Supervisory Board of HSH Nordbank. This does not require that all members of the Supervisory Board cover all competencies. Rather, the competencies should be covered by the Supervisory Board as a whole. Each member of the Supervisory Board has submitted a self-assessment of his/her competencies, producing a general overview. When filling a Supervisory Board position, the competence profile is taken as a guide in order to ensure that the Supervisory Board remains diverse in its composition, also with regard to the competencies represented on the Board. Another aspect of good corporate governance with regard to the diversity of the Supervisory Board is the requirement that a sufficient number of independent members are represented on the Supervisory Board. As a result, the Supervisory Board specifies, in the Corporate Governance Report, which four members it considers to be independent.

REPORT ON EVENTS AFTER THE REPORTING DATE

In its decision of 2 May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings in favour of HSH Nordbank AG. One essential commitment related, among other things, to the sale of HSH Nordbank by 28 February 2018. Within this context, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing) at least until the end of 2021. The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

In addition, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of € 10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management GmbH and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million, which will put pressure on the statement of income in the first quarter of 2018.

At the same time, HSH Finanzfonds AöR will make a payment to HSH Nordbank to compensate for the losses that have not yet been settled based on a separate settlement procedure. The signed cancellation agreement is subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

FORECAST, OPPORTUNITIES AND RISKS REPORT

FORECAST REPORT INCLUDING OPPORTUNITIES AND RISKS

The following section should be read in conjunction with the other sections in this management report. The forward-looking statements contained in this forecast report are based on assumptions and conclusions based on information available to the Bank at the time this management report was prepared. The statements are based on a series of assumptions that relate to future events and are incorporated in HSH Nordbank AG's corporate planning. The occurrence of future events is subject to uncertainty, risks and other factors, many of which are beyond HSH Nordbank AG's control. Actual events may therefore differ considerably from the following forward-looking statements below. Assumptions made by the Bank in the planning process are addressed in greater detail in this forecast report.

In its decision of 2 May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings involving HSH Nordbank AG. One of the key commitments entered into vis-à-vis the EU Commission was the privatisation of HSH Nordbank AG by 28 February 2018. Within this context, full compliance with the catalogue of conditions and commitments (in particular, the successful outcome of the viability review of the future Bank that is set out therein) must be ensured, and all regulatory requirements, in particular the minimum capital requirements, must be met. In order to implement the privatisation commitment, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several renowned investors on 28 February 2018 by concluding a corresponding share purchase agreement. The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. The sale is subject to various conditions which must be fulfilled before the closing of the transaction.

As a result, one of the key assumptions used in the Bank's corporate planning with regard to the ongoing sale process of HSH Nordbank AG is that the outstanding conditions for the closing of the transaction are fulfilled and that the privatisation process is completed successfully as a result. The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's membership of the guarantee scheme of the Savings Banks Finance Group (SFG) for a further three years after the closing of the share purchase agreement, at least until the end of 2021.

Simultaneously with the successful conclusion of the share purchase agreement, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio consisting largely of non-performing loans (in particular ship financing) to a special-purpose entity from the sphere of the investors (the portfolio transaction). The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of share purchase agreement. Its successful implementation would lead to a reduction in the NPE ratio at HSH Nordbank AG to below 2%.

The successful execution of this portfolio transaction and the associated reduction in the NPE ratio are key assumptions used in the Bank's corporate planning over and above successful privatisation.

A further significant assumption with regard to corporate planning is the termination of the Sunrise guarantee. In light of the privatisation, HSH Nordbank AG and HSH Beteiligungs Management GmbH reached an agreement with HSH Finanzfonds AöR on the premature termination of the agreement on the provision of a guarantee facility in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of €100 million (cancellation agreement). As a result, the corporate planning assumes that, taking into account the settlement procedures set out in the cancellation agreement, the entire guarantee facility of € 10 billion will be drawn down by HSH Nordbank AG and paid by the guarantor to HSH Nordbank. The implementation of the cancellation agreement is also subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

In this respect, the Bank's forecasts and assumptions assume that the privatisation process will be completed as planned overall, i.e. with the closing of the share purchase agreement and the two other agreements concluded within this context (namely the portfolio transaction and the cancellation agreement). Responsibility for the closing of the share purchase agreement – which, as already explained, is also a prerequisite for both the portfolio transaction and the cancellation agreement – lies with the owners and investors and depends on the approvals referred to above; the Management Board of HSH Nordbank AG will do everything in its power to support this closing. As it is not, however, possible to objectively predict the course and outcome of the privatisation process with absolute certainty, the privatisation process involving HSH Nordbank AG creates significant uncertainty regarding the implementation of the corporate planning, as well as accounting and measurement.

Other key planning assumptions include the smooth transition to the private-sector deposit guarantee fund of the Federal Association of German Banks (*Bundesverband deutscher Banken*), including the acquisition of fully fledged membership within 3 years, a gradual improvement in the rating position along with a normalisation of the funding spread, a reduction in total assets, surplus liquidity and a change in the funding structure taking into account retail deposits, volume expansion in the Core Bank and an improvement in gross margins, an increase in the cross-selling business with a lower impact on capital, a significant reduction in administrative expenses, the further recovery of the shipping markets and, in particular, the recovery of the container shipping industry.

Assessments that form the basis for corporate planning and, in particular, the planning of the development in loan loss provisions, take into account the information available at this time. These assessments are dependent on factors that are mostly outside the control of the Bank and are therefore subject to a significant degree of uncertainty. By way of example, material uncertainty factors with regard to the development of loan loss provisions include, for example, the development of the relevant market parameters such as freight and charter rates, ship values, the US dollar exchange rate, as well as the development of the macroeconomic environment.

Following the successful completion of privatisation, the assumptions taken as a basis for planning purposes may change considerably as a result of the new ownership structure and the potentially modified strategic objectives and plans of the new owners.

In this section, HSH Nordbank AG will address in detail the material opportunities and risks of the forecasts for the key management parameters as well as the going-concern assumptions. Opportunities are defined as possible future developments or events that may give rise to a positive divergence from the forecast or an objective for HSH Nordbank AG. In contrast, as part of the forecast report, risks are defined as possible future developments or events that may give rise to a negative divergence from the forecast or an objective for HSH Nordbank AG. The risk types specific to the Bank are then explained separately in the “Risk Report” chapter.

In light of the privatisation process, the following forecast refers exclusively to the operating company, HSH Nordbank AG, unless explicitly indicated otherwise below.

ANTICIPATED UNDERLYING CONDITIONS

Unless otherwise stated, statements made regarding the underlying conditions are based on internal assessments and estimates.

Good prospects for a continued strong recovery – risk factor of increasing protectionism

The outlook for the economy is good in general. After accelerating considerably in 2017, the global economy could grow at a similar rate this year. The upswing is being driven by the industrialised nations, but also by emerging markets such as Russia and Brazil, which have pulled themselves out of recession and embarked on a gradual recovery phase. The US is expected to grow at a rate of 2.7% in 2018. In the short term, the tax reform implemented by the US government could provide growth impetus, as it provides companies with incentives to step up their investments. We also expect the high growth momentum to continue in the eurozone. GDP, for example, could expand by a good 2%, which is considerably higher than the growth potential of the EMU area. China's economic growth is expected to slow to 6.2% in 2018 as against the previous year as part of a continued trend towards a gradual growth slowdown. This positive outlook is, however, based primarily on the assumption that the increasingly protectionist tendencies that are currently emerging, triggered by the announcement of import tariffs imposed by the US government, will not result in an escalation of trade conflicts.

Global economy with continued high growth

Although the US is unlikely to reach the high growth rates of above the 3% mark seen in the second and third quarter of 2017, the upswing remains very solid and is only expected to slow slightly in the second half of 2018. The reduction in corporation tax implemented as part of the US tax reform, which should prompt companies to up their investments, will provide a boost. The positive situation on the labour market is likely to result in a gradual increase in wage growth, which should push the rate of inflation up. We expect inflation to come to 2.2% at the end of the year (core PCE rate).

We do not expect to see any abrupt economic slump in China, but rather a renewed slowdown in growth. Growth is expected to come to 6.2 % in 2018, compared with 6.9 % in 2017. The high level of debt in the private sector, in particular in the corporate sector, poses a mounting risk.

In the eurozone, growth looks set to continue in 2018, because the economic environment is looking very positive in light of interest rates that remain very low and political stabilisation, which is boosting confidence in the eurozone. Investments are on the rise and private consumption is fairly robust, meaning that the economy should grow by at least 2% over the year as a whole. Risks hanging over the upswing still include the arduous Brexit negotiations and the March parliamentary elections in Italy, which saw populist parties receive a considerable boost and will make the upcoming phase involved in forming a government difficult. The inflation rate in the eurozone should have increased slightly to 1.5% by the end of the year, which is still well below the ECB's price target of just below 2%. Inflation is not expected to reach a level that the ECB deems adequate until 2020/2021.

In Germany, too, sentiment indicators and the data released suggest that the upswing is continuing at a high speed. In 2018, a growth rate well above the 2% mark is expected, on a par with the level already seen in 2017. The labour market is in better shape than it has been for a long time – the unemployment rate recently dropped to a low of 5.3% – which is likely to make it increasingly difficult for the corporate sector to find skilled workers.

Fed with further interest rate moves, ECB to end asset purchases, rise in interest rates moderate by historical standards

In light of the strong economic momentum, the Fed is expected to continue with its strategy of interest rate hikes in 2018 and increase the target range for the Fed Funds Rate to between 2.00% and 2.25% by the end of the year. This means that US government bond yields are likely to head north – in particular, the yield on ten-year bonds should show more of a reaction to the economic upswing and the key rate hikes in 2018. In our opinion, the yield on ten-year T-Notes could come in at just over 3% at the end of 2018. The ECB bond purchase programme (QE) is expected to be terminated at the end of the year at the latest. Over the next few months, the central bank is likely to communicate how it plans to proceed with the programme. The ECB recently took its first "mini step" towards an exit from QE. As we approach the end of the asset purchases, the prospect of an initial rate hike is gradually starting to appear on the horizon. We do not, however, expect this step to be taken until the end of 2019. While German government bond yields are unlikely to be able to decouple completely from the rise in interest rates in the US, the increase is likely to be fairly moderate given that the ECB's monetary policy will remain expansive for the time being. At the end of 2018, the yield on ten-year German government bonds is expected to come in at just over 1%. The biggest risks both for the real economy and for the global financial markets could lie in increasingly protectionist measures on the part of the US – the US government already introduced import duties on steel and aluminium at the beginning of March – and subsequent reactions by third countries, or in a more pronounced slowdown in China.

The euro has made short-term gains against the US dollar, reaching a level of 1.25. The gains for the euro have recently decreased, because the interest rate differential between the two sides of the Atlantic is expanding with the prospect of rate hikes by the Fed. Looking ahead to the future, however, the euro could once again gain ground against the US dollar, because HSH Nordbank expects the ECB to break ties with its ultra-loose monetary policy as well. HSH's plans are based on a slightly stronger USD exchange rate.

Outlook for relevant markets

The moderate recovery on the **shipping markets** should continue – with the exception of the tanker segment. The increase in charter rates is also reflected in an increase in ship values. In the tanker segment, on the other hand, a recovery is yet to emerge, even though this market is also benefiting from the more favourable global economic conditions.

As far as **container vessels** are concerned, 2018 is expected to bring a continued moderate recovery trend. It is expected that both charter rates and ship values will increase. Demand growth will show similarly dynamic development to that witnessed in the previous year. On the supply side, however, fleet growth will start to pick up as scrapping activities are set to decrease slightly and more deliveries are expected. We expect to see a further revival in new order activities. The new ships would, however, only come on the market after some delay, meaning that the market recovery should continue in 2019, too. Geopolitical risks with the threat of trade restrictions could, however, start to put a damper on container handling.

Demand growth for **bulkers** is expected to stabilise in 2018 and become more solid beyond this year as well. The long-term outlook is, however, characterised by the heavy reliance on import demand for coal and iron ore from the Asian region, particularly from China, as well as the uncertainty regarding the development of environmental policy objectives, as well as steel production. Despite a slight drop in scrapping activity, fleet growth and, as a result, tonnage supply will remain at a relatively low level in 2018 due to the small number of deliveries and moderate level of new orders in the previous year. The positive development in 2017 as a whole, as well as the increase in transport volumes extending beyond 2018, will result in an increase in the utilisation of the existing fleet, which should lead to a moderate increase in charter rates and in ship values.

The **oil tanker market** will continue to stabilise in 2018. The demand growth for oil tanker tonnage will remain moderate. The OPEC production cuts will continue to hold things back until the end of the year at the very least, although this could be partially offset by the increasing crude oil exports from US. The supply side is also looking a bit brighter in 2018. The slowdown in fleet growth is the result of declining deliveries and increased scrapping activity. Utilisation is expected to remain at a relatively low level and is only expected to increase slightly in the following years. This means that both charter rates and second-hand prices are expected to fall slightly again. As far as 2019 is concerned, we expect to see a recovery emerge, albeit at a slow pace, in light of the dwindling tonnage growth.

HSH Nordbank uses an average value based on independent external forecasts of the leading market research institutions, Marsoft and MSI, for its assessment of future developments in the shipping industry.

The majority of Germany's **real estate markets** should continue to benefit from the favourable underlying economic conditions in 2018 and show positive development. On the **housing markets** in most large cities, however, demand is likely to grow at a slower pace than in the past due to the declining influx of inhabitants. It will still, however, cover the growing supply of housing resulting from brisk new construction activity, meaning that vacancy levels will remain low. The retail sector is benefiting from the positive consumer sentiment and increasing household income. Demand for space, however, is growing at an increasingly slower pace, not least because consumers are buying more online. On the **office real estate markets**, declining vacancy rates can be expected due to only a slight increase in completions and demand for space that is hardly flagging and remains buoyant. Office rents are therefore likely to continue to increase considerably, not least in central locations and also to a significant extent in secondary locations. In the **commercial real estate** segment, on the other hand, rents are likely to stagnate in most cases, with a slight increase only in selected top locations. Residential rents should increase more slowly as the number of completions increases. The statutory limits placed on rent increases on the re-letting of homes, however, are only likely to take effect in the event of supplementary measures. Given the price level reached after the strong increases in previous years and based on gradually rising interest rates, house prices and the market values of office properties will show only a moderate increase in 2018. The market values of retail properties are only likely to dip slightly from the current level in view of the ongoing structural change and depending on the location and the type of business.

Overall, incoming orders, the positive sentiment indicators and employment development in the **manufacturing sector** point towards a further upward trend in industrial activity. However, it is not only the economic slowdown in China that is putting pressure on heavily export-oriented sectors of the manufacturing industry, such as automotive, engineering, electronics and chemicals in the medium term. The long-term consequences of the Brexit vote cannot yet be predicted, but should gradually become clearer in 2018 as the exit negotiations progress. The ongoing discussion regarding combustion engines, in particular diesel vehicles, is likely to put pressure on the export prospects of the German automotive industry. In addition, it remains to be seen to what extent the US government – after the introduction of punitive tariffs on steel and aluminium imports in March 2018 – will, in fact, implement more protectionist measures, e.g. with regard to the survival of the North American Free Trade Agreement (NAFTA). Overall, and in addition to geopolitical risks, this continues to pose a considerable downside risk to the global economy and, of course, in particular to the German export industry. The economic upswing in the US as a result of the expansionary fiscal measures that are currently being implemented (among others, tax cuts) and the continued more optimistic economic outlook in the eurozone are to be seen as positive factors. This means that the upward trend in growth rates will be sustainable for the time being. The food industry is also likely to continue with its growth trend due to consumer behaviour of private households that remains encouraging, but is expected to lose momentum.

The outlook for the international business of companies operating in the wholesale and foreign trade sector is positive due to the increasing growth momentum in **German industry**. In particular, cyclical intermediate industries are likely to continue to reap the benefits in this regard.

The positive underlying conditions caused by the good employment situation are also having a beneficial effect on the **retail** sector. However, momentum is likely to slow, as increases in real wages of private households will be lower as a result of increasing inflation. e-commerce is also likely to remain a retail growth driver in 2018.

The willingness among companies to make new (equipment) investments should increase considerably across the sector thanks to the brisk demand at home and abroad, as well as the further increase in capacity utilisation. The change in investment appetite is likely to have a continued positive effect on lending demand. Looking at all banks in Germany as a whole, the favourable financing conditions in conjunction with positive business expectations in the corporate sector were already reflected in an accelerated increase in the number of book loans to domestic (non-financial) companies in 2017: the annual growth rate at the end of the fourth quarter of 2017 showed significantly higher growth momentum than for loans to private households.

The revenues reported by companies in the **logistics industry** should be able to maintain the high rate of growth seen in 2017 for the time being. However, this cyclical sector is subject to the risks of a general macroeconomic downturn and a weakening in global trade, also possibly as a result of increasing protectionist measures.

Brexit is not yet expected to have any real economic impact on the logistics industry to speak of in 2018. The economic climate in the German logistics industry is expected to remain above the long-term average at the beginning of the year 2018 as well, and to remain in expansive territory overall.

The increase in transport demand as a result of continued strong global economic growth on the one hand and high maintenance requirements on the other are providing positive stimuli for investments in **transport infrastructure**. Institutional investors are likely to continue to be important.

The prospects for the expansion of **renewable energies** remain mixed as far as 2018 is concerned: whilst the capacity added is likely to stagnate at a good level overall in Europe, there are definitely growth opportunities globally. A distinction, however, has to be made between wind and solar energy: the substantial increase in capacity added witnessed in the German wind energy segment over the last few years is expected to slow slightly. The move to bidding procedures implemented in connection with the amendment to the Renewable Energies Act (EEG) will still result in a temporary increase in demand for the transitional year of 2018. As of 2019, however, a marked downward correction in capacity added is likely to follow. The EEG amendment is not, however, likely to have an impact on existing facilities. New installations are likely to increase again in the rest of Europe. The absolute increase in generation capacity in the solar energy sector in Germany – and also in Europe as a whole – is likely to be moderate over the next few years due to the European climate protection targets and cost degression, although it will return to an upward trend. The outlook is, however, made bleaker by restrictions on state subsidies. The target set by the German federal government of constructing 2.5 gigawatts of additional capacity per year in Germany is also likely to be missed again in 2018.

Ongoing challenging environment for banks

In light of the ongoing geopolitical and economic uncertainties in connection with the economic policy course pursued by the new US government, the implementation of the vote by the British electorate to leave the EU (Brexit), which could put pressure on banks operating on a cross-border basis, as well as potentially high levels of volatility in the financial markets, the macroeconomic environment for banks is likely to remain challenging in 2018 – even though the prospects, particularly in Europe, and the global economic situation, are looking much brighter overall at the beginning of this year than at the start of last year. One of the consequences of Brexit could involve eligible counterparties in the United Kingdom within the meaning of the EMIR no longer being recognised, and the related privileges with respect to regulatory capital backing in accordance with the CRR being lost for trading risk positions.

In terms of monetary policy, signs are gradually emerging of the prospect of a turnaround in Europe as well. Although the ECB is likely to maintain its expansive monetary policy in the first instance, meaning that the pressure on net interest income resulting from the low interest rate environment will continue to increase for the time being, European banks should also be able benefit from a steeper yield curve in the medium term – with positive effects on the income side. Institutions must, however, continue to attempt to offset the negative effect on profitability resulting from the current low interest rate environment by expanding income sources that are not dependent on interest rates (for example, commission income) and by reducing costs further.

In a European comparison, the need to adapt is the most pronounced in the German banking market, as German institutions have below-average sources of income that do not rely on interest, low credit margins due to the intense competition and, at the same time, very high cost-income ratios. As a result, while German banks are likely to reap above-average benefits from a steeper yield curve, they are still exposed to considerable pressure on profitability. As a result, the gradually increasing pace of consolidation is likely due, on the one hand, to the high cost pressure while, on the other, it points towards the potential to be exploited in the German banking market.

Regulators and market participants will continue to focus more on an increasingly comprehensive view of the capital adequacy of banks. Besides the introduction of additional capital buffers (capital retention, early warning and systemically relevant buffers) this is particularly important regarding the extent to which banks are prepared for the new regulatory standards for bail-in eligible liabilities. These relevant capital requirements that form part of the resolution mechanism include in particular the institution-specific minimum requirements for regulatory capital and eligible liabilities (MREL) defined by the national banking supervisory authorities and resolution authorities.

Other fundamental adjustments can already be identified alongside these capital requirements that are being increasingly defined. The changes summarised under Basel IV, which, amongst other things, will serve to improve the comparability of RWA profiles and the reduction of complexity concerning risk identification, are at the same time aimed at the harmonisation of supervisory practices in the EU and are designed to improve transparency vis-à-vis the markets. In particular, the changes include capital floors when using internal models (so-called “CSA floor”), limiting capital savings through the use of internal risk parameters (“IRB constrained”), greater consideration of interest rate risk in the banking book and an adjustment of the approaches adopted for capital backing of securitisations. This means that a gradual increase in capital requirements is likely from 2022 at the latest.

As part of the Supervisory and Evaluation Process (SREP), the EBA stress test that was launched at the beginning of 2018 is likely to become a focal point, in addition to the focus on the winding-down of non-performing loans and the review of internal models (TRIM). Back in December, the EBA, as in previous years, published extensive data on major European banks in order to increase market transparency and market discipline. As well as taking IFRS 9 elements into account, the stress test itself also models, in particular, the impact of the current low interest rate environment, as well as the implications of an interest rate shock. Results for the 59 participating major banks are scheduled to be published in mid-2018. HSH Nordbank will not be taking part in the stress test owing to the extensive realignment, which will result in a significantly different risk profile.

New accounting and reporting regulations

In addition to a wide range of new requirements with respect to future capital resources, one focal issue is the implementation of the new provisions governing accounting for financial instruments in accordance with IFRS 9, which apply as a mandatory requirement for the purposes of the Group financial statements as of 1 January 2018. These new regulations come hand-in-hand with changes in the classification of financial assets and the calculation of loan loss provisions.

With regard to the impact of IFRS 9, HSH Nordbank expects to see an improvement in the core Tier 1 capital ratio (same-period CET1 ratio) of approximately 1.0–1.2 percentage points at the time of the initial application of IFRS 9 on 1 January 2018. This is due to the considerable difference between the nominal values and the market values to be recognised in the future under IFRS 9 for the largely non-performing loan portfolio sold as part of the portfolio transaction, meaning that the volume and the risk weight of the senior securitisation tranche for the Sunrise guarantee are significantly reduced. This leads to a significant decline in RWA for the Sunrise portfolio after the guarantee, and thus contributes significantly to the positive effect of IFRS 9. Within the context of the analysis of the pro forma CET1 ratio (for an explanation of the pro forma CET1 ratio, see the section entitled “Management System”) HSH Nordbank expects this effect to lie within a range of +/- 0.1 percentage points. The quantitative effects of the changeover to IFRS 9 – insofar as they are known at the time of planning – have been included in HSH Nordbank’s bank planning.

For details regarding the expected changes in accounting due to the introduction of IFRS 9, reference is made to Note 1 of the notes to the Group financial statements. In addition to detailed qualitative descriptions of the impact of IFRS 9, Note 1 of the notes to the Group financial statements also comments on the quantitative effects of the first-time application of IFRS 9 on reported equity, as well as on the CET1 ratio.

Furthermore, the Basel Standard 239 (BCBS 239) gives rise, for example, to comprehensive future requirements regarding risk data aggregation including the IT architecture and risk reporting by banks. In this connection, it is likely that most banks will have noticeable investment needs in order to develop a comprehensive reporting system for granular lending data and credit risk data to meet the regulatory requirements (AnaCredit). The increasing focus on the issue of cyber security will also require adjustments to IT systems to meet the new challenges.

The introduction of a tax on trading in financial instruments (financial transaction tax), which is still under discussion, would result in a significant reduction in income from the capital markets business. An agreement, however, is yet to be reached on the draft, which is currently being discussed. In view of the varied regulatory requirements accompanied, on the one hand, by noticeably higher costs and, on the other, by exacting regulatory requirements regarding capital adequacy, banks will be required to continuously review their business models and constantly improve efficiency to be able to ensure sufficient profitability and maintain the ability to build up capital from their own resources.

EXPECTED BUSINESS DEVELOPMENT OF HSH NORDBANK

2018 – privatisation process expected to be completed successfully

With regard to the share purchase agreement that was signed on 28 February 2018, the Bank expects the change of ownership to be implemented as planned in the second or third quarter of 2018 once the necessary approvals have been obtained and the further conditions have been met, meaning that the commitments made in the EU state aid proceedings on the replenishment of the second loss guarantee can be honoured. In addition, the Bank expects that the agreement on the portfolio transaction relating to the planned spin-off of a large part of the non-performing legacy burdens from the Non-Core Bank, and the cancellation agreement reached with regard to the second loss guarantee, can be completed and implemented.

Based on the restructuring progress achieved in the 2017 financial year, as well as the overall satisfactory operating performance, the Bank expects to be able to forge ahead with the transformation process that it has initiated in the 2018 financial year. In this respect, the Bank remains cautious in its forecast, in particular due to the considerable uncertainty that will naturally remain up until the closing date of the privatisation process.

In detail, the Bank expects, with regard to the key management indicators, that

- the new business of the Core Bank will be moderately higher in 2018 as a whole than in the previous year (2017: € 8.5 billion). The net income before taxes and the RoE of the Core Bank are likely to be clearly in positive territory, although they are likely to remain below the values reported in 2017, which benefited from one-off effects.
- the winding-down of high-risk portfolios will be completed within the context of the portfolio transaction planned in connection with the privatisation, meaning that the NPE ratio in the Group and the Core Bank will come to around 2 %). At the same time, the total assets of the Non-Core Bank will fall considerably. The net income before taxes of the Non-Core Bank is likely to be clearly in the red again, but significantly less so than in 2017, when the portfolio transaction posed a considerable burden.
- the cost reduction programme, which has been running to plan so far, will be systematically continued, and further optimisation potential at cost and process level will be identified at Group level as part of the new Reset & Go transformation project.
- The Group net result before taxes will still be shaped by the implementation of the privatisation process and by restructuring costs, as well as by a compensation payment made for the termination of the federal state guarantee. This means that both net income before taxes and the RoE will once again be negative, but much less so than in 2017.
- the pro forma CET1 ratio, which is calculated excluding the regulatory RWA relief effect of the second loss guarantee (for details, see section entitled "Management system") will adhere to the ambition level of 15 %.

In general, the plans assume that it will be possible to exploit further earnings and cost potential in the event of the successful closing of the share purchase agreement as part of the privatisation process. It is assumed that the closing of the share purchase agreement could have a positive impact both on the Bank's key management indicators and on the assessment of investors and rating agencies alike. Furthermore, the planned spin-off of a large part of the legacy burdens thanks to the portfolio transaction and the termination of the second loss guarantee will considerably reduce complexity in the Bank's processes and organisational structure, which is expected to result in significant efficiency gains.

In the strategic vision for 2022, the Bank expects, based on total assets of around € 55 billion, to have good asset quality with an NPE ratio of no more than 2 %, a solid capital position with a CET1 ratio of around 15 %, a good cost/income ratio of around 40 % and an adequate RoE before tax of at least 8 %.

The following statements assume that all of the requirements for the completion of the privatisation process will be met, establishing a business model that is sustainable in the long term and securing the Bank's survival as a result.

With regard to the consequences of unsuccessful completion of the sale process, reference is made to the information in the section entitled "Formal decision in the EU state aid proceedings".

Earnings forecast

For the 2018 financial year, the Bank expects to be able to achieve a moderate increase in its new business (key management indicator for the Core Bank). The positive development of the privatisation process to date should favour new business development accordingly, in particular after the closing date. With regard to the margins that can be achieved, HSH Nordbank is taking into account the continued challenging market environment and expects to see persistent margin pressure overall. Gross margins are expected to remain at the level seen in 2017, which is still adequate, on the whole, while net margins should increase moderately as a result of the gradual slight decline in funding costs. At the same time, the Bank aims to continue to drive forward sales of the range of services offered over and above loan financing to optimally exploit the business and earnings potential and generate additional commission business.

The earnings side will be strengthened further by the focused increase in new business and product sales. This will allow the Bank to counteract the loss, in particular, of interest income from non-strategic portfolios as a result of the progressive winding-down. Nevertheless, the portfolio transaction will not be able to compensate for the winding-down of portfolios of legacy burdens within the Non-Core Bank. As a result, HSH Nordbank expects to see a significant decline in total income at Group level in 2018 as a whole. A large part of this decline compared with the 2017 financial year is due to the loss of one-off effects (valuation effects from the reassessment of interest and principal cash flows relating to hybrid capital instruments, as well as special effects from the realisation of unrealised gains) incurred in the 2017 financial year.

Overall satisfactory operating earnings driven by all segments are expected for the Core Bank. With regard to the Non-Core Bank, HSH Nordbank expects that it will only play a minor role following the implementation of the portfolio transaction. The plan is to transfer the sold portfolios with retroactive effect from 1 January 2018 in the event of successful closing, meaning that total income in the Non-Core Bank will fall and reach an insignificant level compared with the Group's total income.

Opportunities and risks in the earnings forecast

Opportunities

The successful and early completion of the privatisation process would offer numerous opportunities for stepping up moves to expand new business and broaden the client base, taking into account the business potential in the Core Bank which could be realised, in particular, after the abolition of the restrictions and obligations contained in the catalogue of conditions and commitments. This could allow additional earnings potential to be exploited. The business opportunities in the corporate sector included in the list of conditions and commitments, for example, particularly the opportunity to finance German clients including their foreign investments as well as foreign clients, provided they are seeking transactions in Germany, could have a positive impact on the new business planned for the corporate clients sector.

Once the significant uncertainty associated with the privatisation process has been cleared up, the Bank could once again play a more active role, in particular with regard to its existing portfolio, as a stable banking partner, further expanding its objective of establishing itself as a bank for entrepreneurs. The Bank's refinancing costs could also fall more significant than expected in the event of the successful completion of the privatisation process, which would strengthen its competitive standing.

A sharper increase in income of the Core Bank could arise, if, for example, new business and product distribution with clients develops better than expected, for example as a result of higher margins achieved in the market, stronger than planned product sales or an unexpected high loan demand.

Furthermore, a sharper, strategic focus of the Corporate Clients division on the renewable energy sector, among others, as well as the planned expansion of structured and commission-based products could have a positive impact on the Core Bank's total income.

As long as the shipping markets remain in the familiar restructuring phase and the conclusion of new business at adequate margins is not possible, potential new business remains very limited. If the shipping markets make tangible sustained progress, for example, through a significant reduction on the supply side, an increase in new business can again be expected.

A sharper than planned increase in the US dollar viewed in isolation would have a positive impact on income generated by the US dollar business. In addition, a more pronounced increase in interest rates than planned could have a positive effect on income.

Risks

Delayed closing or any deterioration in the macroeconomic environment – not least due to trade policy or geopolitical effects – and conditions in relevant markets would probably result in a lower than assumed demand trend for loan financing. The competitive situation could also put more pressure on margins than expected.

The Bank's increased funding costs due to its restricted access to the capital markets and resulting increased margin requirements may limit the volume of new business planned and, as a result, reduce the earnings base. Reference is made to the "Opportunities and risks in the funding forecast" section with regard to further risks that could have a negative impact on the planned refinancing costs.

Measurement losses on debt instruments and derivatives in the existing portfolio arising as a consequence of market developments or tensions in the financial markets also cannot be ruled out. IFRS measurement effects resulting from movements in the US dollar or interest rates as well as basis swaps could have a more adverse impact than expected, although US dollar sensitivity has decreased markedly since 2016 and will continue to decrease. Future planned results may be adversely impacted by a further appreciation in the US dollar. Total income may also be adversely impacted by uncertainties (for example, due to significant changes in exchange rates following an increase in interest rates) associated with the realisation of unrealised gains by selling securities or promissory note loans that is planned for 2018.

Furthermore, a higher than expected employee turnover in sales divisions could make it more difficult to achieve the new business and income objectives.

If the expected increase in interest rates does not occur as planned, this would lead, viewed in isolation, to lower income from the investment of liquidity position.

In addition, potential adjustments to the business model, as well as the planned expansion of structured and commission-based products, which is expected to be driven considerably from the financial year 2019 onwards, might not have the expected impact on earnings. The delayed closing of the share purchase agreement could also put pressure on new business and the Bank's future earnings situation due to uncertainty.

Forecast for administrative expenses

The strategic realignment of HSH Nordbank plans to reduce administrative expenses further in the period leading up to 2022 within the context of the Bank's realignment so that the Bank can achieve an appropriate cost-income ratio of around 40 % and an RoE before taxes of around 8 % in the long term.

As far as 2018 as a whole is concerned, HSH Nordbank once again expects to see a marked reduction in the administrative expenses that can be controlled operationally. The cost-income ratio (key management indicator for the Group and the Core Bank), which benefited from one-off effects in 2017, is likely to increase in spite of the lower cost base at both Group and Core Bank level. The reduction is to be achieved in the first instance by the systematic implementation of the cost reduction programme (2018PLUS) that has been pursued to date. The main measures associated with this programme include an accelerated reduction in staff numbers, as well as reductions in operating expenses, in particular in connection with the further streamlining of the organisational structure, the ongoing simplification of key processes, the optimisation of the product portfolio and the ongoing realignment of IT.

With the future-oriented further development of IT and the system landscape, the Bank is aiming to leverage considerable efficiency potential in the medium to long term. These efforts aim primarily to establish a one-system strategy in the securities business and to concentrate on the core systems/core processes of a Bank focusing on the medium-sized company segment. IT is driving the digitalisation strategy in this respect. This first of all allows the Bank to tap into client groups and market potential, e.g. using what is known as a "digital corporate platform". Second, this approach is associated with the optimisation of recurring processes, which is often summarised under the key term "robotics". In addition, the Bank is aiming to optimise application development and support. The Bank hopes that this will allow it to exploit efficiency potential, highlighting its own objectives as far as the ambitious cost planning is concerned.

The cost reduction programme, which has been running since 2014 overall and was last adjusted to reflect the latest requirements in May 2016, generally aims to achieve a sustainable and efficient structure for the Bank in this period of transformation. The Bank is planning to develop another cost reduction programme in the 2018 financial year to support the Bank's realignment, which has now been initiated. The plan is to implement this new programme before the year is out. To this end, efficiency levers and measures relating to operating expenses are currently being identified as part of the Reset & Go transformation project and will be implemented after the closing date at the earliest following consultation with the Bank's social partners. Significant potential arises with regard to the expected reduction in complexity that is to be achieved by the closing of the portfolio transaction and the resulting substantial reduction in the Non-Core Bank portfolio, as well as by the termination of the guarantee. The Bank also expects to be able to exploit further efficiency potential relating to controllable operational administrative expenses, even though additional restructuring costs will be incurred in 2018.

In light of the future streamlined and mid-sized structure of an agile bank whose risks have been reduced considerably, the Bank expects the number of employees to be gradually reduced further in the planning period leading up to 2022. Another significant reduction was already achieved in 2017 as a whole without having to make significant cuts relating to the client and product range. However, there remains the important task of retaining qualified staff at HSH Nordbank in order to secure key competences and limit operational risk.

Opportunities and risks in the forecast for administrative expenses

Opportunities

If the privatisation process is completed successfully, there will be an opportunity to continue to adapt the current cost structures and realise additional cost potential. This potential could arise from possible synergies and, where appropriate, from new strategic options.

HSH Nordbank is confident that it will achieve its stated objectives after also taking account of the successes already achieved in the past. Successful implementation of the programme would make a substantial contribution to increasing the Bank's efficiency on a sustained basis.

The individual measures implemented, such as organisational changes and extensive adjustments in the IT and HR areas, will be continuously reviewed as part of the measures controlling process to ensure the successful implementation of the cost plan.

Also with regard to the expected reduction in the number of employees as part of the current cost reduction programme, the Bank is assuming that the measures initiated will continue to be implemented successfully. In this context, employee turnover higher than that assumed in the Bank's plan would have a positive effect on planned personnel expenses.

In the case of further reductions in total assets, and therefore refinancing requirements, savings may be achieved in terms of the Bank's planned expenses for the bank levy and deposit guarantee fund, assuming that other calculation parameters (for example the institution risk factor) remain the same.

Risks

If the cost-saving measures are not implemented as planned, in particular due to risks affecting business operations that cannot be predicted, it cannot be ruled out that some costs will not be able to be reduced to the extent desired or not as quickly as planned. In addition, unexpected cost increases in individual divisions resulting from, inter alia, the constantly increasing regulatory requirements and support for the privatisation process, could exceed the cost reductions achieved in other areas. The dimensions are difficult to predict. Unavoidable consequences for administrative expenses are possible. In connection with the restructuring and cost programmes, there is also the risk that, in order to achieve the desired cost targets, additional restructuring and transformation outlay will be required over and above the outlay that is already planned.

Similarly, it is impossible to rule out a scenario in which the reduction in headcount associated with the measures is not implemented as planned or results in an increase in operational risk due to higher turnover or the reduced effectiveness of internal control functions, or in implementation risks, for instance, in the area of internal bank projects. The risk of losing key expertise may also be increased as a result of the personnel measures taken.

It may not be possible to identify or implement other measures associated with privatisation to achieve efficiency gains to the extent necessary or such measures may only be implemented by incurring higher restructuring expenses, resulting in the planned cost savings not being achieved.

HSH Nordbank may also be required to make special payments because of its membership of the support fund of the Landesbanks and the European bank levy in the event that future compensation and support measures result in the underfunding of these organisations. It is currently not possible due to the calculation method used, which is based on the relative development of institution-specific parameters compared to the sector, to assess whether and to what amount such payments will arise. However, such payments may adversely impact earnings in general.

In addition, there is a risk of additional expenses for legal and litigation costs resulting from legal risks in connection with certain refinancing operations due to additional claims risks and unfavourable court decisions.

Changes in calculation parameters (for example, the institution risk factor) may result in increased contributions payable by the Bank for the bank levy and deposit guarantee fund.

Furthermore, new, as yet unidentified, primary expenses or additional project-specific costs for implementing the relevant requirements might arise as a result of regulatory changes (for example, the introduction of a financial transaction tax, new regulatory changes), which may adversely impact future administrative expenses.

Forecast for loan loss provisions

Within the context of the privatisation, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio, consisting largely of non-performing loans, to a special-purpose entity from the sphere of the buyers of the shares in HSH Nordbank on 28 February 2018. In detail, this portfolio transaction relates, in particular, to non-performing exposures (NPE) – consisting mainly of ship financing. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of share purchase agreement.

Within this context, the Bank's plan is for the NPE ratio at HSH Nordbank AG to amount to around 2 % at Group level following the implementation of the portfolio transaction.

In this respect, the Bank expects its loan loss provisions in 2018 to be down considerably on the level seen in the 2017 financial year. The Bank expects its additions to specific loan loss provisions, as one component of loan loss provisions, to fall in the high double-digit million range. Loan loss provisions are likely to continue to focus on shipping loan exposures. In this respect, it is assumed that the moderate recovery on the shipping markets will continue at a slow pace in 2018. The NPE ratio, which will be reduced to a level that is sustainable in the long run as a result of the portfolio transaction, will then come in at the low level of around 2 % that will be achieved during the planning period. Based on the Bank's plans, the coverage ratio in 2018 will remain at the good level seen in 2017.

Currency translations gains or losses recorded in loan loss provisions are heavily influenced by the movement in the EUR/USD exchange rate and would also have a discernible effect on loan loss provisions on an increasing weakness of the euro. Hedging instruments will continue to be used in principle to hedge foreign exchange positions held in portfolios no longer covered by the guarantee or in the absence of any residual hedging effect.

The loan loss provision plan is based on valuation models that also take into account the regulatory environment, the expected development of risk parameters over time as well as the Bank's empirical values in critical situations in addition to portfolio developments and key macroeconomic data (including the EUR/USD exchange rate, charter rates and ship values).

HSH Nordbank uses a weighted average of independent external forecasts of the leading market research institutions, Marsoft and MSI, for its assessment of future developments in the shipping industry.

A key driver of the amount of loan loss provisions is also the breakdown of impaired loan commitments into "capable of recovery" (and therefore recognition of a specific loan loss provision based on the assumption of the continuation of the borrower's business) or "not capable of recovery" (and therefore recognition of a specific loan loss provision based on the assumption of a workout). The plans for loan loss provisions are based on the assumption of a recovery on the shipping markets/recovery in the container shipping industry, as well as the continuation of the current commitment strategies and, as a result, the assumption that HSH Nordbank is prepared to provide further financing. Developments over the past years have, however, shown that the ability to make forecasts in a volatile environment is limited.

With regard to the UK's Brexit vote and exit from the EU, HSH Nordbank expects real estate prices to drop. With regard to the Bank's real estate financing portfolio in the UK, which has a volume of around € 1.3 billion EaD, the Bank does not expect to see any additional need for loan loss provisions in connection with Brexit.

Details on the loan loss provision plan and expected payment defaults are set out in the "Default risk section" ("Planning for loan loss provisions and losses") in the risk report.

Opportunities and risks in the forecast for loan loss provisions

Opportunities
Loan loss provisions would be lower than expected, if the relevant market parameters and macroeconomic environment developed more favourably than assumed. After its successful privatisation and the portfolio transaction, the Bank will have a much more balanced portfolio with improved asset quality, meaning that the earnings burdens resulting from loan loss provisions could also be much lower than assumed in the plans.

Risks
The risks relating to loan loss provisions that are higher than planned can be broken down into the following aspects: Firstly, less favourable macroeconomic and sector-specific/market-specific developments than assumed in the plans. Secondly, regulatory risks resulting from adjustments to the statutory and regulatory framework. Thirdly, single commitment-specific risks (e.g. changes in the recovery and resolution strategy). And fourth, bank-specific risks, including from the settlement of the second loss guarantee, which is to be redeemed.

As far as original loan loss provisions are concerned, there is uncertainty with regard to the need for impairment losses, in particular in the ship financing business, but also with regard to real estate financing, due to volatility and the cyclical nature of the market environment for key sub-portfolios. Material uncertainty factors relate, in particular, to the development of the US dollar exchange rate, political risks, for example in the form of tariffs/barriers to trade, the interest rate environment, as well as significant segment-specific market parameters, such as freight and charter rates and ship values in the shipping market, or real estate prices and rents in the real estate business, which are used as key input parameters for modelling within the context of planning loan loss provisions. If these parameters show less favourable development than expected, then it is impossible to rule out an increased volume of new defaults, or a scenario in which the recoverability of individual commitments cannot be achieved in the planning period as assumed in the loan loss provisions plans. This could lead to unplanned burdens caused by additional loan loss provisions. In particular, in view of the ongoing overcapacity in the shipping markets, it is impossible to rule out a scenario in which the extent and timing of the market recovery do not materialise as planned, which could increase the need for loan loss provisions considerably in this case, or in the event of constant or falling charter rates and ship values.

In addition, it is impossible to rule out a scenario in which real estate prices fall significantly following the UK's Brexit vote and exit from the EU. Additional loan loss provision expense could arise with regard to the Bank's real estate financing portfolio in the UK as a result.

A fall in the EUR/USD exchange rate would cause the amount of payment defaults in the US dollar portfolios to increase and would therefore result in an increase in loan loss provisions for unhedged portfolios, as loan loss provisions are partly held in US dollars.

Single commitment-specific risks could result in additional loan loss provisions due to changes in the commitment strategy, in particular if assessments of the recoverability of borrowers change, resulting in changes in the willingness on the part of the Bank to provide further funding for problem loans. Changed assessments of the recoverability of a borrower could, for example, result in loan loss provisions having to be set up based on the assumption of a workout and, as a result, the realisation of collateral.

With regard to regulatory risks, the impact of new accounting standards (in particular IFRS 9) could have a negative impact on loan loss provisions extending beyond the changeover effects that are currently included in the Bank's plans. The actual changeover effect at the time of initial application is still associated with uncertainty, since, first of all, the final validation of certain parameters and models on which the calculation of loan loss provisions and fair value is based (e.g. PD and LGD) is still pending. Second, the quality assurance of the opening balance sheets is not yet complete. For example, higher than planned required general loan loss provisions as a result of a deterioration in the risk parameters may adversely impact loan loss provisions in the lending business or capital on the adoption date.

Concerning bank-specific risks, there is the risk that, with regard to the guarantee cancellation agreement that has been concluded, the losses calculated by the Bank based on the defined guarantee settlement mechanism will not be recognised in full by the guarantor. This sort of scenario would result – compared with the assumptions made by the Bank on the full utilisation of the second loss guarantee – in a reduction in the hedging effect and would therefore result in additional expenses within loan loss provisions corresponding to the amount of the reduction in the hedging effect. In this scenario, an agreement has been reached in the share purchase agreement that the purchase price for the shares in HSH Nordbank will be reduced by a corresponding amount. At the same time, it has been agreed that a corresponding amount of capital will be injected at HSH Nordbank by the new owners.

Capital and RWA forecast

For this year and as at the end of 2018, HSH Nordbank assumes that the capital ratio will continue to be significantly above the SREP requirements. Since 1 January 2018, an SREP minimum requirement of around 10.2 % (Pillar 2 Requirement "P2R" incl. the combined capital buffer requirements) has applied to HSH Nordbank for the CET1 ratio.

With regard to the CET1 ratio, HSH Nordbank does not expect to see any net burden resulting from the changeover to IFRS 9 at the beginning of 2018. The IFRS 9 transitional arrangements in accordance with the CRR will not be applied. HSH Nordbank therefore expects a positive change in the core Tier 1 capital ratio (same-period CET1 ratio) at the time of the initial application of IFRS 9 on 1 January 2018. For details regarding the expected impact of the introduction of IFRS 9, reference is made to Note 1 of the notes to the Group financial statements.

In light of the share purchase agreement signed on 28 February 2018, the agreement on the portfolio transaction and the cancellation agreement for the second loss guarantee, which was also signed on 28 February, the regulatory CET1 capital ratio is expected to no longer be recognised as a securitisation arrangement taking into account the regulatory relief effect as of March 2018, but rather will correspond to the pro forma CET1 ratio excluding the regulatory RWA relief effect of the second loss guarantee calculated based on hypothetical assumptions (for details, see the section entitled "Management system").

In the further course of the year, the planned closing of the portfolio transaction (following the closing of the share purchase agreement in 2018) is to result in a significant reduction in RWA.

At the end of 2018, HSH Nordbank expects a slight increase in RWA overall as against 31 December 2017 based on a stronger US dollar, the expected new business and the elimination of the regulatory RWA relief effect of the federal state guarantee.

In this respect, the Bank nevertheless expects to be able to report a same-period CET1 ratio that is significantly higher than the SREP requirements and is consistent with its current ambition level of 15 % at the end of 2018.

The transfer of the majority of the shares in HSH Nordbank AG from the current shareholders to the holding company in 2016 resulted in the creation of a financial holding group subject to banking supervision, at the level of which banking supervision requirements, particularly minimum capital requirements (4.5 % CET1) as well as additional capital buffer requirements (around 1.9 % CET1), are to be complied with. According to the plan, the Pillar 1 minimum capital requirements pursuant to CRR (4.5 % CET1) and additional capital buffer requirements are complied with at this banking supervisory application level, which is temporarily relevant until the sale of HSH Nordbank AG is closed (share purchase agreement). After the sale of HSH Nordbank has been closed (share purchase agreement), HSH Nordbank will no longer form part of the financial holding group. This means that the capital requirements at the level of the financial holding group would no longer apply to HSH Nordbank.

The transposition of the Bank Recovery and Resolution Directive – BRRD) into national law (Recovery and Resolution Act – *Sanierungs- und Abwicklungsgesetz* – SAG) will result in a new capital requirement in 2018. The European Single Resolution Board will set an institution-specific ratio for the regulatory capital and eligible liabilities to be maintained at a minimum for HSH Nordbank (Minimum Requirements on Eligible Liabilities – MREL). For this year and as at the end of 2018, HSH Nordbank assumes that the MREL ratios will be significantly above the SREP requirements.

Within the context of the further development of the regulatory requirements, a large number of potential changes will be made with regard to market, operational and counterparty risks.

The capital ratios may be impacted in future by the intended changes to the regulatory requirements (sometimes referred to as "Basel IV"). HSH Nordbank expects that this will not have any significant impact prior to 2022. This means that a gradual increase in capital requirements is likely from 2022 onwards at the latest. The Bank will adjust its business and capital management to reflect the expected Basel IV burdens in order to keep any impact on the capital ratios at a minimum. As a result, the Bank does not anticipate any significant burden in the period leading up to 2022.

Opportunities and risks in the capital and RWA forecast

The aspects referred to in the "Loan loss provision forecast" section could generally also result in the capital position developing in a manner that deviates from the plan due to higher earnings burdens or increases in RWA. The opportunities and risks can also be broken down into aspects relating to the macroeconomic, sector and market-specific developments, the overall regulatory framework and single commitment-specific and Bank-specific factors.

Opportunities

Opportunities for the capital ratios and RWA result from more favourable trends in the relevant market and risk parameters and the optimisation of the capital structure. The closing of the sale of HSH Nordbank (share purchase agreement) to the new owners and, as a result, the implementation of a sustainable business model may lead to an increase in income and the optimisation of the cost structure with positive effects on the Bank's capital position.

If the EUR/USD exchange rate remains at the high level reached on 31 December 2017, or the EUR/USD exchange rate strengthens even further, then the capital ratio could be significantly higher than expected.

Earnings development that outstrips expectations in 2018 would also have a positive impact on the capital ratio.

Risks

Significant macroeconomic risks regarding the capital ratios and RWA result from a potential deterioration in the market and risk parameters in the Bank's core markets, including a stronger US dollar. In addition, there is the risk, in particular, that defaults of individual and/or also major borrowers with significant loan volumes, for instance in the absence of a market recovery in the shipping industry, will result in a marked increase in RWA and loan loss provisions and put considerable and direct pressure on the capital ratios as a result.

In addition, risks to the capital ratios could emerge from the regulatory environment, for example due to regulatory interpretation decisions or audits.

It is possible, for example, that additional individual and increased capital requirements could arise from the regular SREP process carried out in the Banking Union. Additional discretionary decisions made by the supervisory authorities and industry-wide capital requirements (capital buffer for systemic and anti-cyclical risks) could therefore result in RWA burdens or higher capital requirements. Discretionary decisions by the supervisory authorities with regard to model risks/validations could, for example, be made in the context of the Targeted Review of Internal Models/TRIM or in relation to HSH's application regarding a waiver of the inclusion of the effects of the portfolio transaction in the future LGD/PD estimates in the internal models.

If the market recovery in the shipping market, which is one of the aspects assumed in the Bank's planning, fails to materialise, or in the event of a deterioration of the real estate market (in particular in real estate values), or if the macroeconomic environment is considerably weaker or the USD exchange rate is much stronger (downside scenario), this would lead to a significant deterioration in the risk parameters and measures would have to be taken to strengthen the capital ratios (for example, reduction of new business and securitisation of portfolios) in order to comply with the regulatory requirements (Pillar 2 Requirement) at the level of the HSH Nordbank subgroup. If capital buffer requirements (Pillar 2 Requirement) are not met in this sort of scenario despite measures being taken, then a capital conservation plan would have to be prepared in accordance with Section 10i (3) of the German Banking Act (KWG). For details, please refer to the following section "Special risks resulting from the financial holding group".

Risks relating to adherence to the MREL ratio for HSH Nordbank lie in the national transposition of the adopted Directive Amending the EU Bank Recovery and Resolution Directive (BRRD) with regard to the ranking of unsecured debt instruments in the event of insolvency in accordance with Article 108 BRRD, which could have repercussions for the eligibility of liabilities as eligible liabilities within the meaning of the MREL.

The further development of the regulatory requirements could result in further burdens for the capital ratios resulting from the proposed changes to the regulatory requirements – partly referred to as "Basel IV" – probably on a gradual basis from the year 2022 until 2027.

For HSH Nordbank, stricter rules concerning counterparty risk resulting from Basel IV will be of particular relevance. HSH Nordbank extensively uses models approved by the supervisory authorities to map counterparty risk (Internal Ratings Based Approach – IRBA). Under Basel IV, the plan is to significantly restrict the benefits resulting from the use of IRBA models by basing the capital backing more closely on the standard approach (CSA floor), by limiting the use of the IRBA model to certain exposure classes as well as limiting the use of internal risk parameters (Constrained IRB).

The bank-specific risks are currently still determined by the privatisation process. If the portfolio transaction, which was signed on 28 February 2018, is not executed, or is not executed as planned, after the closing of the share purchase agreement, or if material deselections are made, significantly reducing the portfolio that is sold, then the RWA reduction that is planned within this context will not occur and this will put pressure on the capital ratios. In addition, the non-recognition of losses in connection with the settlement mode agreed in the cancellation agreement on the second loss guarantee could put a temporary strain on the capital ratios. This temporary strain would be offset by a capital injection in a corresponding amount made by the buyers of the shares in HSH Nordbank set out in the share purchase agreement.

As far as the risks relating to capital associated with the privatisation process are concerned, reference is made to the section entitled "Opportunities and risks of the formal decision in the EU state aid proceedings". If several of the risks for the capital ratios described above or the risks relating to capital set out in the section entitled "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" occur in combination with each other, then additional measures to strengthen capital may need to be taken by the owners and/or third parties at all regulatory levels.

Special risks resulting from the financial holding group

The formation of a holding structure under the EU decision should have mainly relieved HSH Nordbank of a proportion of the high guarantee fees, which have adversely impacted the business model and restructuring efforts. HSH Nordbank as the parent institution of the financial holding company (HoldCo) for prudential purposes is, nevertheless, required to comply with the regulatory requirements at the financial holding group level until the closing of the privatisation transaction (share purchase agreement). In this regard, the intended relief for HSH Nordbank only has a limited effect on the financial holding group due to the regulatory requirements. This results in restrictions, particularly with respect to the requirements for compliance with capital ratios, large exposure limits, regulatory reporting and the recovery plan. HSH Nordbank's Management Board has no influence over the decisions made by the HoldCo. The following section describes the special risks for HSH Nordbank AG resulting from the financial holding group, which will, however, cease to apply at the time of the closing of the share purchase agreement:

With regard to the financial holding group subject to banking supervision, there is a risk that, in the event of a downside scenario (weaker macroeconomic environment, deterioration in the market parameters in the real estate market as well as on the shipping markets, significantly stronger USD exchange rate, burdens associated with further loan loss provisions), it will not be possible to meet all capital buffer requirements extending beyond the Pillar 1 minimum requirements pursuant to the CRR (4.5% CET1) at the level of the financial holding group due to the high premiums for the federal state guarantee.

Non-compliance with the capital buffer requirements, which exceed the Pillar 1 minimum requirements pursuant to CRR, would mean that a capital conservation plan would have to be prepared for the Group in accordance with Section 10i (3) KWG and, until its approval, additional restrictions under Section 10i (3) KWG, for example regarding the possibility of making distributions on equity instruments, would have to be observed.

In this sort of scenario, measures would have to be taken by the shareholders or third parties to strengthen the capital ratios in order to adhere to the capital buffer requirements at the level of the financial holding group before the conclusion of the privatisation process.

If the closing of the share purchase agreement is delayed and it cannot be executed as planned in 2018, the regulatory requirements would still have to be adhered to at the level of the financial holding group.

There is also the risk that the banking supervisory authorities could set additional capital requirements for the financial holding group subject to banking supervision over and above the Pillar 1 minimum requirements pursuant to CRR and the buffer requirements consistently applied across institutions. The banking supervisory authority has considerable discretionary powers in respect of the above-mentioned risks regarding non-compliance with capital requirements.

The capital forecast for the financial holding group is based on the assumption of the full settlement of the guarantee in 2018 in connection with the privatisation. If there are delays regarding the full settlement date and therefore the expiry of the guarantee, additional premium expenses would adversely affect the capital ratio at the level of the financial holding group.

With the formation of HSH Beteiligungs Management GmbH, HSH Nordbank as the "parent institution" is also required, under Article 11 (2) CRR, to comply with the large exposure regulations (Part 4 of the CRR) at the financial holding group level. The additional large exposure limit to be observed is based on the regulatory capital at the Group level of the financial holding group. However, as this is significantly lower than in the subgroup of the HSH Nordbank Group due to premium obligations assumed under the guarantee of the federal states of Hamburg and Schleswig-Holstein, the limit represents a powerful limiting factor in the Bank's large exposure monitoring. HSH Nordbank has also applied the lower regulatory capital at the Group level of HSH Beteiligungs Management GmbH as a parameter for the purpose of its major risk management, meaning that it has set limits for its trading and credit lines as a precautionary measure to reduce the risk of exceeding the large exposure limit.

A reduction in the large exposure limit may result in restrictions on the choice of restructuring instruments that can be used for loan recoveries, or the large exposure limit may be exceeded by individual existing large exposure cases. This risk will also cease to apply at the time of the closing of the share purchase agreement and the associated dissolution of the financial holding group.

Funding forecast

The funding forecast is still influenced to a considerable degree by the upcoming privatisation of the Bank. The Bank plans to gradually reduce the liquidity resources built up prior to privatisation in order to hedge against uncertainties in the course of the 2018 financial year. In particular, the intention is to use the reduction in the deposit level and the long-term raising of funding to transform and optimise the liabilities side of the balance sheet, taking into account the conservative liquidity management that is still required.

The Bank expects to continue to successfully implement its diversified funding strategy in 2018. The Bank's asset business will continue to be refinanced primarily by placing secured and unsecured bonds with institutional investors and by the deposit business transacted with the Bank's corporate clients and with private clients.

The investment of fixed-term deposits by private clients will also be expanded further. In addition to the online Deposit Solutions platform, there are also plans to increase the distribution of the investments via other providers as well. This will allow the Bank to compensate for the lower sales of retail bonds in a market that has become significantly smaller overall. It will therefore establish a new sales channel outside of the savings bank sector and create a broader base for the Bank's refinancing following the planned change in ownership.

The funding plan is based on access to the relevant markets, in particular to institutional depositors in Germany. In addition, the retention of the investment grade rating is a key prerequisite for the implementation of the funding strategy. Another focus is on the issuing of covered bonds (Pfandbriefe) as private placements as well as on the public sector capital market, to the extent permitted by market conditions. The asset-based funding platform will be further expanded by the Bank. Based on lower USD requirements, the Bank also uses these funding opportunities for the cost-effective refinancing of the lending business in euros and other currencies.

With regard to the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) (key management indicators in the IFRS Group), HSH Nordbank expects the ratios to remain more or less constant compared with the end of 2017 due to the planned transformation of the liabilities side. Nevertheless, it still expects to adhere to the corridor of 80 % to 120 % set out in the catalogue of conditions and commitments. HSH Nordbank also expects that all other supervisory requirements such as the survival period in the liquidity development report for the combined stress scenario will continue to be complied with at a comfortable level.

Deposit business is a key component of the Bank's refinancing mix. HSH Nordbank intends to make further improvements to deposit and depositor structure. The regulatory liquidity ratios and requirements will be complied with at all times, also under stress conditions. Details regarding this can be found under Liquidity risk in the "Risk report" section.

The market portfolio sales concluded at the beginning of 2017 and inflows from the settlement of losses have contributed to the improvement in the Bank's liquidity situation. Further liquidity inflows are expected for the 2018 financial year. Significant payments are expected from the portfolio transaction, as well as from the full settlement of the second loss guarantee. Within this context, the Bank has assumed, in its liquidity planning, that the purchase price for the portfolio transaction will be paid immediately after the closing of the share purchase agreement, i.e. upon the completion of the privatisation process. With regard to loss settlement, the Bank expects this to be achieved at this point in time as well.

Even under unfavourable market conditions, stable access to refinancing sources that are largely independent of capital market developments, such as fixed term deposits made by private clients in direct sales, for example via online platforms, and deposits from clients of savings banks and other financial networks, as well as access to secured refinancing sources such as Pfandbriefe and asset-based funding, are of paramount importance.

Under the list of conditions and commitments, which forms the basis for the EU decision and was accordingly reflected in the Bank's planning, the proportion of US dollar business in the Core Bank refinanced by primary US dollar funding (and not by derivatives) is to be at least 55 % as at the 2017 and 2018 year ends.

The implementation of the Bank's privatisation will involve a change in the deposit guarantee fund. The funding plan is based on the assumption of a smooth transition in the deposit guarantee fund. The plan is that HSH Nordbank can keep its full membership of the institutional protection scheme of the Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of the year 2021, by which point it will have obtained senior membership of the deposit guarantee fund of the Federal Association of German Banks.

The two rating agencies, Moody's and Fitch, regarded the conclusion of the EU proceedings as an important milestone and assessed measures leading to an improvement in the financial and risk profile as positive in principle. This applies, in particular, to the portfolio transaction that was concluded on 28 February 2018, which will relieve the Bank of non-performing loans and ultimately strengthen the capital position as a result. Nevertheless, the agencies consider the uncertainty during the change of ownership phase and the planned smooth transition with regard to the deposit guarantee fund to be particular challenging. This applies to Fitch, in particular, which believes that the rating position could deteriorate, in particular due to the planned change in the deposit guarantee fund (exit from the German Savings Banks Association (DSGV)), the associated impact on refinancing and the future shareholder structure (no controlling majority owner) if the improvement in the individual rating is not sufficient to compensate for these aspects. The Bank's future rating position will therefore be determined by the scheduled implementation of the change of ownership, as well as the Bank's realignment against the backdrop of a challenging market environment. With regard to the planned refinancing costs, the Bank expects that the successful privatisation will reduce the Bank's refinancing costs, assuming an improvement of the rating position.

Opportunities and risks in the funding forecast

Opportunities

The fulfilment of the funding objectives is mainly influenced by external factors. A positive capital market environment would support the implementation of the issuing strategy in the course of 2018. A sustained expansive monetary policy on the part of the ECB and the associated generous liquidity resources are likely to tend to have a positive impact on the refinancing options and costs.

The currently limited access to the capital markets would gradually improve by the continuing and successful implementation of the intended privatisation of HSH Nordbank in line with the plan, as this would reduce an important uncertainty factor. The gradual reduction in liquidity resources via the reduction in the deposit level and the raising of funding may lead to an improvement in the earnings situation.

Movements in the EUR/USD exchange rate are also relevant for the liquidity situation, as changes in the US dollar exchange rate have an effect on the amount of liquidity to be provided as cash collateral for derivatives (for example basis swaps) used partly for US dollar funding purposes. The cash collateral to be provided would decrease on a depreciation of the US dollar, thereby improving the liquidity position.

Risks

Execution of funding measures in the market would be made more difficult by potential tensions in the financial markets. A more than expected restrictive monetary policy adopted by the major central banks could also significantly limit the refinancing options and increase funding costs.

There is still no unrestricted access to the capital markets despite the refinancing successes achieved over the past few years. The privatisation of HSH Nordbank required under the list of conditions and commitments, the viability review of the new corporate structure required in this connection and approval of the acquisition by the EU Commission might also lead to possible investor reluctance in the long-term segment, which could have a significant adverse impact on the Bank's funding.

Should the purchase price payment for the portfolio transaction and the loss settlement agreed in the cancellation agreement for the second loss guarantee be delayed, this could have a negative impact on the Bank's planned liquidity position.

Should the expected improvement in the rating position fail to materialise, the planned reduction in the deposit level, the long-term raising of funding and the transformation and optimisation of the liabilities side of the balance sheet may not be implemented, and funding costs could rise with a corresponding negative impact on earnings.

Potential rating downgrades, which, despite the recently confirmed investment grade rating, cannot be excluded during the further privatisation process leading up to the closing date, particularly in the case of unplanned developments, would fundamentally restrict the refinancing options via the capital markets, trigger outflows of short-term funds and increase funding costs. A rating downgrade by Moody's or Fitch would result in a rating outside investment grade. Adverse developments, particularly during the further privatisation period leading up to the closing of the share purchase agreement (for example a decrease in capitalisation, non-compliance with the minimum capital requirements, liquidity burdens, an unplanned deterioration in earnings or setbacks in the privatisation process, for example with regard to the fulfilment of the closing conditions) could negatively affect the rating or directly put significant pressure on funding and funding costs, trigger significant outflows of short-term funds or fundamentally restrict HSH Nordbank's funding options. In the event of a rating downgrade, the Bank would have to take additional measures to secure an appropriate liquidity position due to the very short-term refinancing (see Group explanatory note 53: Residual maturity breakdown of financial instruments in the Group financial statements as at 31 December 2017) and the high existing depositor concentration on institutional investors. In the event of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

Should a smooth transition and inclusion in senior membership of the guarantee scheme of the Federal Association of German Banks not succeed as planned, this could lead to a significant outflow of deposits and a significant increase in funding costs. Also, as a result of the different manner in which the deposit guarantee funds work, i.e. institutional protection under the protection system of the German Savings Banks Finance Group versus protection of deposits, there is a risk of liquidity outflows associated with the change in the deposit guarantee fund.

HSH Nordbank's liquidity and funding plan is based on assumptions about client behaviour based on the deposit base and durations, especially with regard to the trend of short-term deposits. In particular in critical, exceptional situations there is the risk that the relevant behavioural assumptions used for the simulation scenarios prove to be incorrect, resulting in considerable unplanned liquidity outflows.

Should access to the existing sources of refinancing deteriorate, this would also severely limit the funding options and would adversely impact the Bank's rating.

Part of the assets denominated in foreign currency are refinanced via derivatives (for example, via EUR/USD basis swaps). An appreciation in the US dollar results in an increase in the cash collateral to be provided and therefore exerts pressure on the liquidity situation under otherwise similar conditions.

The regulatory liquidity ratios such as the LCR, NSFR and minimum survival period in the combined stress scenario would deteriorate regardless of any intentional control measures taken such as, for example, a reduction in short-term deposits. Additional liquidity requirements could arise under the ECB's SREP process as a result of discretionary decisions.

It is also possible that additional requirements in various prudential regulatory areas such as liquidity may arise from the regular SREP process carried out in the Banking Union within the scope of discretionary decisions of the banking supervisory authorities.

If additional measures to strengthen liquidity are required in the event that one of the risks described in this section materialises, which cannot be implemented by the Bank itself or without state aid, this could result in the resolution of HSH Nordbank. Reference is made to the "Opportunities and risks of the formal decision in the EU state aid proceedings" regarding the impact of this.

As far as the risks also relating to liquidity and funding associated with the privatisation process, reference is made to the section entitled "Opportunities and risks of the formal decision in the EU state aid proceedings".

Further information on liquidity risk is set out in the "Risk report" section.

Formal decision in the EU state aid proceedings

The replenishment of the second loss guarantee from € 7 billion to € 10 billion by the federal state owners in June 2013 against the backdrop of changed underlying conditions and future regulatory requirements was initially provisionally approved by the EU Commission on 2 May 2016. This guarantee measure was provisionally approved by the EU Commission in the 2013 financial year and has strengthened the Bank's CET1 capital ratio since then. At the same time, the EU Commission had instituted state aid proceedings to investigate whether the replenishment of the guarantee is consistent with the state aid rules. These state aid proceedings were concluded by the decision of the EU Commission.

The EU decision is based on a list of conditions and commitments, under which the Federal Republic of Germany as representative of HSH Nordbank's federal state owners and the EU Commission agreed measures to provide legacy asset relief to the Bank. The replenishment of the second loss guarantee has been technically classified by the EU Commission as so-called resolution aid, and HSH Nordbank is regarded as not being viable in terms of state aid prior to the restructuring. The operating company was to be restructured in such a way that would enable the successful sale of this company by 28 February 2018. The transfer in rem of the shares to a buyer (closing) may be made at a later date. The participating bidders must have the necessary financial resources and proven sector expertise to manage the operating company as a profitable and active competitor. Furthermore, the intention was set out to sell HSH Nordbank by 28 February 2018. Both the measures to relieve the Bank of legacy burdens and the sale of HSH Nordbank AG were agreed in a timely manner by concluding corresponding agreements and have laid the foundation for a permanent structural improvement in the Bank's financial and risk situation.

Within this context, the Bank expects, based on the information available and with regard to the ongoing sale process of HSH Nordbank AG, that the conditions that still have to be met, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review of the future Bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust and competition authorities and the confirmation of the extension of the Bank's full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of the year 2021, will be fulfilled and that the privatisation process will be completed successfully.

Regarding the prohibition of dividends and distributions, the EU decision stipulates that the operating company may not make any payments during the divestment period on profit-related equity instruments (such as hybrid financial instruments and profit participation certificates), unless such are contractually or legally owed. These instruments are also to participate in losses, if the balance sheet of the operating company were to disclose a loss excluding the reversal of reserves. Furthermore, the operating company will not pay any dividends until the sale is completed. The exceptions to this are dividend payments in the amount legally permitted from the operating company to the holding company to be formed.

In connection with the imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, HSH Nordbank AG expects, from today's perspective, that it will not be possible, contrary to past plans, to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2020 financial year for the 2019 financial year as originally anticipated, but rather that this will only be possible at the earliest from the 2024 financial year for the 2023 financial year.

Opportunities and risk resulting from the formal decision in the EU state aid proceedings

Opportunities

The successful completion of the privatisation process would create a significantly improved basis for establishing a business model that is sustainable in the long run and for enabling the sustainable and successful realignment of the Bank.

Similarly, the closing of the privatisation process would improve the Bank's business activities and funding situation and put an end to uncertainty for clients and employees, as well as capital market participants.

The execution of the share purchase agreement and, as a result, the assumption of the ownership position by the investors would expand the Bank's business and refinancing opportunities and thus to further contribute to the strengthening of the business model.

Risks

Should the individual outstanding conditions for the closing of the share purchase agreement not be met in full or in part or within the time frame that is currently planned, this would significantly jeopardise the further implementation of the business model and, as a result, the Bank's future prospects.

If the portfolio transaction relating to the sale of a portfolio of largely non-performing loans agreed within the context of privatisation can only be implemented in part, this could hamper the viability review carried out by the EU Commission and potentially pose an obstacle to the closing of the share purchase agreement.

In the event that the privatisation process is not implemented, that the necessary viability review on the new corporate structure is not performed, or that the approval of the acquisition by the EU Commission is not obtained, either in full or in part, or if this is not achieved within the currently envisaged time frame, then HSH Nordbank would have to suspend its new business and manage its assets to the extent legally permitted with the objective of achieving a privately managed orderly wind-down. The long-term survival of HSH Nordbank in its present form would not be ensured in this case. Also in view of the fact that cessation of new business would also include the deposit business – this sort of situation would have a significantly adverse impact on funding and funding costs, trigger significant outflows of short-term funds or fundamentally restrict HSH Nordbank's funding options. In this case, additional measures on the part of the owners and/or third parties and, where necessary, extensive sales of receivables with corresponding losses on disposal would be required to strengthen the liquidity situation. The same would apply if the Bank were to become involved in an orderly wind-down for this or other reasons.

In this regard, the Bank analyses different scenarios as a precaution in coordination with the ECB and the federal states in order to ensure sufficient process certainty in a theoretically possible adverse privatisation process.

Furthermore, it cannot be excluded that in the event that the privatisation process does not progress in line with the plan, in the event of a managed orderly wind-down or in other situations the resolution conditions laid down in Regulation (EU) no. 806/2014 (SRMVO) are met, this could result in resolution measures being ordered by the competent resolution authorities (for example, conversion of equity instruments and debt capital into core Tier 1 capital, a so-called "bail-in"). The long-term survival of HSH Nordbank would not be ensured even in this case.

In addition, there is the risk that the implementation of the EU decision will fail due to statutory, supervisory or contractual conditions or it is not implemented within the specified time frame, which could have a negative effect on HSH Nordbank's access to the capital markets, HSH Nordbank's rating, planning and ultimately its long-term survival.

Under the list of conditions and commitments, the Bank is required to limit annual new shipping business to € 1.2 billion. In addition, the catalogue of conditions and commitments contains restrictions relating to the Corporate Clients division (restricted to German clients and their investments in Germany and abroad, as well as foreign clients, provided that they are seeking transactions in Germany), a waiver on the part of the Bank not to resume the already discontinued asset-based aircraft financing business, and an extension of the ban on proprietary trading and the restriction of external growth by prohibiting the acquisition of control in other companies.

In the event that the trend in the shipping markets is significantly better than planned or good business opportunities arise in other business sectors, these restrictions could have a negative effect on potential transactions.

In light of the agreement in principle reached with the EU Commission, HSH Nordbank AG remains a member of the Savings Banks Finance Group during the sale process. All issues of HSH Nordbank AG (excluding equity/instruments with equity characteristics, notably under paragraphs 41, 44 of the EU Commission Communication 2013/C 216/01 of 30 July 2013 ("Banking Communication")) therefore fall under the voluntary institutional protection of the guarantee fund of the Savings Banks Finance Group (Section 39 (1) of the Framework Statute). Under the voluntary institutional protection there is no legally binding entitlement to support measures vis-à-vis the protection scheme in the event of the occurrence of a guarantee case. Should HSH Nordbank AG's membership in the Savings Banks Finance Group end as scheduled with the completion of the change of ownership (closing), its membership in the guarantee fund of the German Savings Banks Finance Group would continue to apply for a further two years in accordance with Section 94(4) of the Framework Statute. In the long term, HSH Nordbank AG is aiming to achieve membership of the guarantee scheme of the Federal Association of German Banks, where possible following on seamlessly from its membership of the guarantee scheme of the German Savings Banks Finance Group.

If a smooth transition and admission to the guarantee scheme of the Federal Association of German Banks cannot be achieved as planned, or if the Bank cannot keep its full membership of the institutional protection scheme of the Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of the year 2021, this could lead to a fundamental outflow of deposits, triggering a significant increase in funding costs.

The going concern assumption for accounting and measurement purposes, as well as the continued survival of HSH Nordbank AG and major group companies is based, in particular, on the share purchase agreement concluded on 28 February 2018, in which HSH Beteiligungs Management GmbH sold 94.9 % of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG (hereinafter referred to as the "bidders") being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF) Luxembourg) grants the necessary approvals,
- the European Commission approves the proposed new corporate structure after performing a viability review,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation;

It is further required that acceptance by market participants and other relevant stakeholders necessary for the successful implementation of HSH Nordbank AG's future business model is maintained or gained.

Overall appraisal and net income forecast

2018 will be a crucial year of transformation for the Bank, even if it will not signal the end of the realignment process. On the one hand, the coming months will be shaped to a considerable degree by the implementation of the closing conditions to ensure the conclusion of the privatisation process in a manner that can be deemed successful from today's point of view. On the other hand, the operational measures aimed at the realignment of a corporate structure that will be risk-optimised and agile in the future will be defined and implemented as soon as possible. Overall, the Bank is confident, based on its plans, that the efforts made to date and the privatisation process, which the Bank currently believes to have developed in a positive manner, will result in a business model that is sustainable in the long term, provided that the process is completed successfully.

In the reporting period, the Bank set the course for a successful privatisation process. The marked acceleration in the winding-down of legacy burdens, operational development that was largely in line with the planned development, and the cost optimisation achieved have created a solid basis. At the same time, the agreements reached within the context of the privatisation process, in particular the Bank's fundamental relief from non-performing legacy loans thanks to the portfolio transaction and the cancellation agreement on the second loss guarantee will result in considerable structural optimisation.

The Bank, which will have been privatised when the share purchase agreement is executed, will develop additional business opportunities in Germany and abroad together with its new international owners, which boast expertise in the financial services sector, under a new brand and free from the existing EU restrictions. The focus will remain on medium-sized corporate clients, as well as clients in the real estate, energy, infrastructure and shipping sectors, to which the Bank aims to provide support in all relevant issues relating to financing with a comprehensive product and consultancy approach. In order to improve its profitability, the Bank has identified a large number of measures on both the earnings and the cost side that will be addressed and implemented in 2018. The strategic vision for 2022, with total assets of around € 55 billion, an NPE ratio of no more than 2 %, a CET1 ratio of around 15 %, a cost-income ratio of 40 % and an RoE before tax of at least 8 %, will be pursued in a rigorous and focused manner.

Results are to reap considerable benefits from the implementation of the strategic measures over the next few years. The 2018 financial year will still be shaped to a considerable degree by the implementation of the privatisation process, as well as by the planned additional restructuring costs. As a result, taking into account the compensation payment of € 100 million for the premature termination of the second loss guarantee, a loss before tax of around € 100 million is forecast for the 2018 financial year. The net income forecast is subject to potential effects resulting from closing and the related change of ownership. At the same time, the pro forma CET1 ratio is expected to come in at around 15 % and the NPE ratio at around 2 %.

In principle, the Bank remains cautious in its earnings forecast for the whole of 2018 given the continuing challenging environment for banks in general and HSH Nordbank in particular.

There are, however, also challenges associated with the earnings forecast and the future development of HSH Nordbank. In summary, these relate primarily to risks resulting from adverse developments during the closing process associated with privatisation and, as a result, the fulfilment of the closing conditions agreed as part of the share purchase agreement. In this extremely complex privatisation process, the Bank will continue to do its utmost to support its owners, who are responsible for the sales process. The Bank's aim is to bring a change in ownership that makes sense from a financial perspective to a successful conclusion.

In addition to the specific risks in connection with the privatisation process, the Bank will also face other general challenges. These include, first of all, possible setbacks in the recovery for container vessels and bulkers and a further deterioration in the tanker segment, a possible slowdown in the real estate markets, a significantly stronger USD exchange rate, the low level of interest rates, as well as a competitive environment and volatile financial and currency markets (in particular US dollars); secondly, changing assessments of the rating agencies and the steadily increasing requirements imposed by the European banking regulators; and thirdly, it is of key importance that, despite a multitude of influencing factors (e.g. discretionary decisions on the part of the banking supervisory authorities, assumed long-term recovery of the shipping markets), the minimum capital ratios are complied with at both the HSH Nordbank sub-group level and the financial holding group level (HSH Beteiligungs Management GmbH) and that liquidity requirements are complied with at all times despite possible adverse developments in the privatisation process or, for instance, in the event of reactions of the rating agencies with a negative impact.

In connection with imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, the Bank expects to be able to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2024 financial year for the 2023 financial year.

In order to fulfil the net income forecast for the financial year 2018, HSH Nordbank's planning needs to be implemented as intended and the risks described in this forecast report must not materialise.

Details on the bank-specific risk types are explained in the following Risk report section.

RISK REPORT

RISK MANAGEMENT SYSTEM

Principles of risk management

Active risk management represents a core component of the overall bank management at HSH Nordbank. The current version of the Minimum Requirements for Risk Management (MaRisk) laid down by the Supervisory Authorities serves as the main framework for the design of our risk management system. In addition, comprehensive requirements resulting from the Supervisory Review and Evaluation Process (SREP) have to be observed.

HSH Nordbank defines risk as the threat that unfavourable future developments may adversely affect the Bank's assets, earnings or financial position.

In order to identify material risks as defined by MaRisk, HSH Nordbank conducts an annual risk inventory. This includes a review of the existing quantitative and qualitative criteria for determining materiality taking due account of the Bank's risk tolerance and if necessary such criteria are redefined. In the current year the inventory process was restructured and, in particular, risks were broken down into "financial risks" and "non-financial risks (NFR)". Financial risk is defined as the risk of a change in the value of an asset having an impact on the financial figures. Non-financial risk is the risk of losses arising from inadequate internal procedures, controls and the Bank's operating activities. Whilst the Bank by itself has hardly any influence on the movement in value of an asset, but can maintain a capital or liquidity buffer for this, non-financial risks can be influenced by the Bank itself primarily through stringent management, adequate staffing and resources and a risk appetite derived from the risk culture. A non-financial risk governance process under the overall responsibility of the Group Risk Management and Compliance divisions will be implemented in 2018 that ensures that the NFR is managed on an integrated and stringent basis. The material risk types at HSH Nordbank that can be quantified include default risk, market risk, liquidity maturity transformation risk as a type of liquidity risk for financial risks and operational risk, which also includes legal and compliance risks, for non-financial risks. These risk types are taken into account in the calculation of the risk-bearing capacity.

In addition to insolvency risk (financial risk) as a second type of liquidity risk, other material risk types of HSH Nordbank include business strategy risk and reputation risk (NFR). Default risk is the most significant risk type due to HSH Nordbank's business model.

Determination of risk appetite and risk guidelines

The Strategic Risk Framework (SRF), which serves as the foundation of the risk culture, sets out the focus of the Bank's risk management activities and defines the objectives of risk management based on the planned development of key business activities and measures taken to achieve these objectives. The focus is on securing and allocating scarce resources taking into account risk tolerance, strategic business goals, the market environment and both the existing and planned portfolios. The SRF contains the risk strategy principles as the key guide lines for risk-conscious action and a cornerstone of a sustainable risk culture. These form the framework for the formulation of the risk appetite statement (RAS) and risk strategy. The RAS is broken down into a financial and non-financial RAS on the basis of the risk inventory and is aimed at providing a condensed description of selected risk tolerance areas in order to achieve the objectives of the overall Bank. The financial RAS consists of a catalogue of key figures and ratios, the non-financial RAS of qualitative targets regarding the risk culture. Their operationalisation is ensured via the risk strategy and limit system. whereby the risk strategy describes the management of risks based on the risk inventory in accordance with the business strategy and RAS. It provides the framework for the sub-risk strategies (counterparty default risk for performing and non-performing exposures, market risk, liquidity risk and NFR comprising reputation risk, operational and business strategy risks). The SRF serves as the basis for the business strategy and forms the central framework for the Bank's planning process.

KEY RISK INDICATORS OF THE GROUP

	31.12.2017	Limit	Guidelines
Utilisation of gone concern RBC	18.6 %	< 90 %	–
Economic capital required	€ 1,394 m	≤ € 4,900 m	–
of which for default risks[1]	€ 753 m	≤ € 2,700 m	–
for market risks	€ 399 m	< € 1,450 m	–
for liquidity risks	€ 46 m	–	< € 500 m
CET1 ratio (phase-in, same period calculation, including Pillar 2 requirement)	18.5 %	> 9.00 %	–
Liquidity coverage ratio (LCR) – actual	169 %	> 85 %	–
Net stable funding ratio (NSFR)	114 %	–	85 % – 115 %
USD proportion of overall bank exposure	15 %	–	< 30 %
USD refinancing ratio	94 %	–	> 60 %
NPE ratio	10.4 %	–	< 13 %
NLP_2 in stress case (1st – 3rd month)	Month 1: € 7.4 bn Month 2: € 7.0 bn Month 3: € 7.1 bn	> € 500 m over the 1 month maturity band, i.e. minimum (NLP SC) 1 – 30 days	–

[1] After deducting the first loss piece under the second loss guarantee of the federal states of Hamburg and Schleswig-Holstein in the amount of € 3.2 billion.

A functioning limit system requires that the risk appetite be derived on a rigorous basis. This is derived separately for the three scarce resources – regulatory and economic capital and liquidity – from the risk capacity. Starting from the risk appetite the Bank has established a system of risk limits and guidelines for all three resources, which serves to avert risks that could jeopardise its continued existence and to achieve the risk strategy objectives.

The SRF is approved by the Management Board ("tone from the top") and reviewed at least once a year. Adjustments are made where necessary. It is also fully integrated into the Bank's processes, for example by its embedding in the Bank's objectives and the definition of guidelines for the strategy process.

Organisation of risk management

The organisation of risk management at HSH Nordbank is primarily aligned to the requirements of the business model while at the same time taking regulatory requirements into account.

The Risk Committee of the Supervisory Board is in particular responsible for reviewing HSH Nordbank's current and future overall risk tolerance and strategy. In addition it advises the Supervisory Board on the current and future overall risk tolerance and strategy and supports the Supervisory Board in monitoring the implementation of this strategy by the Management Board. The Risk Committee is regularly informed of the Bank's risk position and risk management by the Management Board in meetings.

The Overall Management Board is responsible for HSH Nordbank's risk management system including the methods and procedures to be applied for measuring, managing and monitoring risk and thereby for ensuring that it is appropriate for HSH Nordbank's profile and strategy. As a member of the Management Board, the Chief Risk Officer (CRO) is responsible for the risk controlling of HSH Nordbank AG, including risk monitoring, as well as for the back office functions of the Core and Non-Core Bank. In particular, this includes the Group Risk Management, Credit Risk Management, Special Loan Management as well as Loan and Collateral Management divisions.

The Group Risk Management division develops the methods and tools for identifying, measuring, managing and monitoring risks and, by setting risk limits and risk guidelines, supports operative portfolio management, for which BU Bank Management is largely responsible.

Credit Risk Management is responsible, among other things, for credit risk analysis, including the preparation and setting of the internal rating and drafting of the credit applications for the Bank's entire lending business (Core and Non-Core Bank). Credit Risk Management is also responsible for designing the processes and rules that apply to the lending business within HSH Nordbank.

Special Loan Management is responsible for managing the reduction, workout and restructuring of loan commitments.

Loan and Collateral Management is responsible for the settlement and administration of the lending business as well as for obtaining an ongoing valuation of loan collaterals.

Trading transactions are settled in the Transaction Banking division, the risk monitoring of which is carried out in Group Risk Management.

The market and trading divisions are directly responsible for risks and income within the scope of their business activities and thereby make an active contribution to risk management in the Core Bank.

Internal Audit reviews the effectiveness, efficiency and appropriateness of risk management, the internal control system and the monitoring processes in a targeted and systematic manner. It monitors and validates the timely elimination of deficiencies identified by the Bank's own activities or external audits. As a tool used by HSH Nordbank's Overall Management Board it is an essential component of corporate governance. It regularly provides the Overall Management Board and Audit Committee of the Supervisory Board with information on the findings of its audits, which are carried out on the basis of a risk-based audit plan that is approved by the Overall Management Board on an annual basis. Internal Audit provides independent, objective and risk-based audit and advisory services that cover all business activities and processes of the Core Bank and the outsourcing arrangements and equity holdings as well as projects and changes in operational processes and structures.

The CRO makes decisions independently of the Management Board member responsible for the Market divisions and Trading and periodically informs the Overall Management Board and Risk Committee of the risk situation of the HSH Nordbank Group. In this way, the separation of functions required under the regulatory rules between the market and trading divisions on the one hand and risk controlling, settlement and control as well as back office on the other is taken into account at all levels of the Bank from an organisational perspective.

Uniform management of business areas is achieved by means of a global head principle. Based on this, the heads of the individual divisions as the respective Global Heads are responsible on a Group-wide basis for the strategy of the business areas assigned to them and have the disciplinary responsibility for the employees working in their business area. The Global Heads are supported by the head of the respective foreign branch (General Manager) in the implementation of the strategy on site in the foreign branches whilst maintaining the separation of duties in accordance with MaRisk. The General Manager is responsible for compliance with local legal and regulatory requirements. The global head principle also applies to risk controlling to ensure that a Group-wide coordinated risk controlling process is in place.

HSH Nordbank has stipulated rules in accordance with the MaRisk requirements, under which formalised audit processes are gone through prior to entering into transactions in new products or new markets (NPNM processes). This ensures that the products are properly considered under risk aspects in the relevant systems and reflected in the relevant processes and their effectiveness ensured and that transactions involving new products or on new markets are only entered into with the approval of the Management Board. There is also an NPNM review process in place under which the appropriate mapping of older products is reviewed on a regular basis.

HSH Nordbank uses an economic scope of consolidation as the basis for the Group-wide risk management. It includes those entities that are to be specifically monitored at the Group level due to material risks. The risks of other entities are fully taken into account at the aggregate level (for instance in the form of equity holding risks in the default risk management process).

Risk management by a central committee structure

The Management Board has established committees that support it in monitoring and managing all material risks. The committees comprise not only members of the Management Board, but also the heads of the risk and other departments. This ensures a regular exchange of information on issues relating to risk. Insofar as internal or external regulations do not permit delegation of decisions to the committees, such decisions are prepared by these committees for approval by the Overall Management Board.

The Overall Bank Management committee (OBM committee), which is chaired by the Chief Financial Officer (CFO) and the Chief Risk Officer (CRO), is the committee responsible for managing and allocating financial resources within the risk limits, risk guidelines and plan targets. Its duties include, inter alia, the monitoring and management of risks associated with bottleneck resources (including risk concentration, credit, liquidity as well as FX and interest rate risks), taking account of control mechanisms for all aspects (income and costs, risk, liquidity and capital). This ensures an integrated view of the key financial and risk indicators. The OBM committee also looks at market risk positions that serve the Bank's strategic goals. In order to ensure that all material risks affecting HSH Nordbank are monitored and managed and the Bank's risk-bearing capacity is maintained at all times based on its risk tolerance level, the OBM committee also looks at reports and analyses on the individual types of risk, the results of stress tests and the methodological enhancements to the risk management models. This means that the OBM committee drafts decisions on strategic guidelines, the type of management, objectives restrictions and other targets for the corporate investment portfolio. The relevant decisions are made by the Overall Management Board. The risk limits adopted by the Management Board are monitored by the units with operational responsibility. Risk limit overdrafts are escalated to the Management Board together with recommended courses of action and the implementation of measures to reduce such overdrafts is monitored. The OBM committee is also the committee responsible for drafting the decision memorandum regarding transition from or continuation of the phases defined in the recovery plan, and for the appointment and specific staffing of the teams that prepare for the implementation of courses of action and – if the Management Board has decided on their implementation – implement them.

The Scenario Steering Committee (SSC), in which the trend of market indicators is monitored and decisions made regarding simulation assumptions and scenarios (macroeconomic and segment-specific), provides significant support to the OBM committee. The simulation scenarios together with their key assumptions and an analysis of the results are also presented to the Overall Management Board in addition to the OBM committee.

The Credit Committee (CC) is an independent, decision-making body at the level of individual lending transactions, which is chaired by the head of the Credit Risk Management (CRM) division with the participation of the CRO on a case-by-case basis. The CC is responsible, among other things, for the operational management of limited resources of liquidity, economic and regulatory capital, in particular where overall bank management requires the active control of capital and liquidity requirements of the lending business. The CC is guided by the requirements for Group resource management defined in the OBM committee. The committee also performs an active portfolio management function to achieve ongoing improvements in portfolio quality (profitability, diversification, granularity) and makes individual lending decisions from a credit risk perspective.

The Business Review Meeting (BRM), chaired by the CFO and with the involvement of the Management Board member responsible for the Market divisions and selected division heads, regularly monitors the achievement of targets by the divisions with regard to new business, income and costs and discusses other general topics of strategic importance. The analysis is used as a basis for identifying any plan variances at an early stage and initiating any possible measures, such as the allocation of new income or cost targets.

Risk reporting and measurement systems

HSH Nordbank maintains a central data storage system and risk calculating methods, which takes into account internal and supervisory requirements, for the purposes of analysing, monitoring and reporting risks. Risk reporting is generally ensured by means of the management and reporting systems in the Group Risk Management division. The risk management systems ensure effective risk management and are adequate with regard to HSH Nordbank's profile and strategy.

The following key reports are prepared for the overall risk:

- The HSH management report, which as an integrated financial and risk report provides information on HSH Nordbank's overall situation with regard to the key value drivers, particularly income, costs, liquidity, capital and risk as well as on the trend of the recovery plan indicators, is submitted to the OBM committee, Management Board and also the Risk Committee (relevant extracts thereof). Adherence to the risk limits and risk guidelines relevant for managing economic capital is monitored by means of this report. The HSH management report is generally prepared on a monthly basis. In addition, it is updated on a weekly basis for selected key figures and ratios.
- The Risk Committee also receives for its quarterly meetings the trend of aggregated risk parameters of HSH Nordbank in the form of the "current risk trend" report.

The management reporting policy sets out the management requirements regarding the structure, contents, frequency, deadlines and form of the internal reporting combined in the HSH management report for the purposes of complying with BCBS 239 and ensuring the sustainability of the internal reporting.

Other overall risk reports include the Disclosure Report under Part 8 of the Capital Requirements Regulation (CRR) and the Risk Report in the Annual Report. In addition to reports on the overall risk there are reporting tools based on the risk type, which are described in the following chapters.

Internal control system

Bank-wide internal control system

The Management Board of HSH Nordbank bears the overall responsibility for ensuring that a proper business organisation is in place at the HSH Nordbank Group, including an appropriate and effective internal control system (ICS).

The ICS of HSH Nordbank is based on a bank-wide main and subprocess structure (process map), which also includes the domestic and foreign branches. A person responsible for the process is designated for all main processes. Furthermore, an ICS cycle is implemented, which is to be run regularly with the following steps:

- classification of (sub-)processes in accordance with inherent risk;
- updating/collecting the process, risk and control documentation;
- conceptual assessment of the appropriateness of the controls;
- assessment and review of the effectiveness of the controls (testing of controls);
- determination and implementation of measures to be taken with regard to the need for improvement identified in the controls;
- re-assessment and second review of the effectiveness of the control(s) after implementation of the measures (repeating the tests).

The top priority of this ICS assessment is the structured and systematic examination of potential or known process risks together with the definition of and decision on measures to be taken to mitigate them.

Furthermore, the ICS makes a significant contribution to the effectiveness of the processes by specifying uniform rules for the Bank as a whole. The ICS cycle also ensures that the ICS is continuously enhanced with respect to its correctness and functionality as well as its appropriateness and effectiveness. Central responsibility for the management and monitoring of the ICS as well as for methodology guidelines and their enhancement lies with the ICS Office in the Corporate Compliance organisational unit.

Clear roles and responsibilities are defined within the ICS cycle to ensure that the tasks are performed in a proper manner. The ICS Office is responsible for the steps to be taken in connection with the control cycle. It performs a process-independent quality assurance in particular of the testing on a random basis and centrally defines the ICS methodology. The ICS Office also ensures proper reporting to the Management Board and Supervisory Board.

In order to ensure that the system is functioning on a sustained basis, the process is closely monitored by means of continuous communication and governance throughout the Bank.

The Bank's sub-processes are defined annually for the control cycle based on the degree of risk determined and the last cycle run through. In addition, the outsourcing of material functions is reported to the Management Board on an annual basis via the ICS management process.

Furthermore, subsidiaries of HSH Nordbank are classified annually as to the materiality of their respective processes for the Bank's ICS. The processes of all subsidiaries classified as material are integrated into the ICS management processes of the Bank.

Internal control system with regard to the accounting process

The Finance division is responsible for the process of preparing the consolidated and single-entity financial statements and the correctness of the Group accounting methods. The internal control system for the accounting process should ensure compliance with the rules to be applied and generally accepted accounting principles. This should maintain a quality standard that ensures a true and fair view of net assets, financial condition and earnings situation. The written rules, including all internal instructions and regulations, form the essential basis of the ICS.

The accounting process is reviewed on a regular basis by the member of staff responsible for the process and adjusted to the current framework conditions and requirements. The focus is on the identification of material risks and the implementation of measures to prevent these. In addition the accounting process is audited by the Internal Audit division from a process-independent perspective.

The organisational structure of the Finance division supports the internal control system. A comprehensive quality assurance is performed by another organisational unit with regard to the accounting functions for lending transactions and capital market transactions in Germany and transactions in subsidiaries and foreign branches. This organisational unit is also responsible for consolidating the accounting information and preparing the annual and consolidated financial statements. In addition, this unit centrally monitors amendments to legislation concerning financial statements, in order to ensure uniform application of the standards.

Regulatory requirements

HSH Nordbank determines the amount of regulatory capital backing for default, market and operational risks as well as for risks resulting from credit valuation adjustments (CVA) of OTC derivatives made on the basis of the Capital Requirements Regulation (CRR). In this context, the so-called IRB Advanced Approach is applied for default risk, for which the supervisory authority has issued the relevant authorisation to the Bank. The Credit Risk Standardised Approach (CRSA) is used for a small part of the portfolio. This means that the Bank takes consistent parameters into account for regulatory reporting (COREP) and the internal default risk management of the IRBA portfolio. HSH Nordbank determines the amounts allocated to market risk positions in accordance with the prescribed or optional standard procedures. HSH Nordbank takes account of operational risk under the standard approach. HSH Nordbank uses the standard method for CVA.

Regulatory figures are set out in the "Net assets and financial position" section. In accordance with the requirements of Part 8 CRR in conjunction with Section 26a (1) Sentence 1 KWG, HSH Nordbank publishes material qualitative and quantitative information on equity capital and risks incurred in a separate Disclosure Report. As an institution that uses the IRB Advanced Approach for nearly the whole portfolio, particular requirements apply to HSH Nordbank in this context. The document provides more information than is disclosed in this Annual Report, which is based on the accounting principles applied, as it provides a comprehensive insight into the regulatory framework and the Bank's current risk situation based on regulatory figures. The Disclosure Report as at 31 December 2017 is available on our website, www.hsh-nordbank.de, four weeks after the publication of this Annual Report. The Disclosure Report does not form part of the Management Report. With its publication, HSH Nordbank has implemented the requirements of the the third pillar of the Basel Accord (market discipline). The requirements regarding the disclosure of risk management objectives and policies in accordance with Article 435 (1) CRR and (2) (e) CRR are implemented in this risk report. The description of the approach required in accordance with Article 438 (a) CRR, under which the institution assesses the adequacy of its internal capital to support current and future activities (capital adequacy process), is also included in this risk report. The same applies to the description of the approaches and methods adopted for determining specific and general credit risk adjustments under Article 442 (b) CRR.

Risk-bearing capacity

HSH Nordbank has integrated a capital adequacy process (ICAAP) into its risk management pursuant to MaRisk in order to monitor and safeguard its risk-bearing capacity on a sustained basis. The risk-bearing capacity is managed in the context of equity capital and risk management.

As part of the monitoring of its risk-bearing capacity, HSH Nordbank regularly compares the total economic capital required to cover all major quantifiable types of risk (overall risk) to the available amount of economic risk coverage potential and reports this to the Bank's supervisory authority. HSH Nordbank analyses its risk-bearing capacity comprehensively on a quarterly basis as well as within the framework of its annual planning process.

The primary management process for our calculation of risk-bearing capacity is a liquidation approach which focuses on protection of creditors (so-called gone concern approach). In addition to equity capital modified for economic purposes, the risk coverage potential takes into account, amongst other things, unrealised gains and losses arising on securities, equity holdings, the lending business and associated hedging transactions (line items) as well as the liabilities.

The risk coverage potential amounted to € 7.5 billion as at 31 December 2017 (31 December 2016: € 8.5 billion). The main reason for the decrease is the recognition of loan loss provisions as at 31 December 2017.

The overall risk takes into account default risk, market risk, operational risk as well as the liquidity maturity transformation risk as an element of liquidity risk. Economic capital required as an expression of unexpected losses is determined monthly for default, liquidity and market risks in a methodologically consistent manner with a confidence level of 99.9% and a risk horizon of one year. The economic capital requirements for the individual risk types are aggregated to an overall economic risk. Risk-reducing correlations are not applied for this.
Overall economic risk decreased by € 1.5 billion compared to the 2016 year end and amounted to € 1.4 billion as at the reporting date (31 December 2016: € 2.9 billion). On the one hand, this reduction compared to the previous year was due in particular to the decrease of € 1.1 billion in the default risk potential (details on the trend of the default risk potential can be found under "Default risk management") and, on the other, to lower market and liquidity risks compared to the previous year.

Utilisation of risk coverage potential amounted to 19% as at the reporting date (31 December 2016: 34%). The risk-bearing capacity was ensured at all times during the period under review.

The following table shows the economic risk coverage potential of the HSH Nordbank Group, the economic capital required for the individual risk types, the residual risk coverage potential buffer and the utilisation of risk coverage potential.

RISK-BEARING CAPACITY OF THE GROUP

(€ bn)	**31.12.2017**	31.12.2016
Economic risk coverage potential[1]	**7.5**	**8.5**
Economic capital required	**1.4**	**2.9**
of which for default risks[2]	0.8	1.9
for market risks	0.4	0.6
for liquidity risks	–	0.1
for operational risks	0.2	0.2
Risk coverage potential buffer	**6.1**	**5.6**
Utilisation of coverage potential (in %)	**19**	**34**

[1] After deducting the first loss piece under the second loss guarantee of the federal states of Hamburg and Schleswig-Holstein in the amount of € 3.2 billion.
[2] Taking the second loss guarantee into account.

Stress tests

In addition to stress tests specific to risk types, we regularly conduct stress tests across all risk types in order to be able to better estimate the effects of potential crises on key parameters such as utilisation of the risk-bearing capacity, regulatory capital ratios and liquidity and thus HSH Nordbank's overall risk position. Based on observed market developments, the Scenario Management Committee approves macroeconomic and segment-specific forecasts for the carrying out of forecast-based, dynamic stress tests. These expected and stress forecasts are incorporated in different simulation scenarios and presented quarterly to the OBM committee and Overall Management Board. The impact of macroeconomic scenarios such as a severe economic downturn or absence of the expected recovery in the shipping markets as well as a historical scenario on the Pillar I and II capital ratios and leverage ratio is calculated. The results are incorporated in HSH Nordbank's internal reporting system every quarter and analysed on a regular basis by the Management Board in terms of an action-oriented management dialogue. Besides the review of the appropriateness of the buffer available for risk coverage potential, regulatory capital and liquidity maintained to offset stress effects, this analysis is used to discuss the need for options to strengthen the financial stability of HSH Nordbank.

HSH Nordbank's recovery plan, drawn up in accordance with the Act on the Recovery and Resolution of Credit Institutions (Sanierungs- und Abwicklungsgesetz, SAG), has a comparable objective. It serves both the purpose of the early identification of any resource bottlenecks using appropriate indicators and their elimination in crisis situations by means of pre-defined options. The effectiveness of the options identified, the selected recovery plan warning indicators and related processes are reviewed and included in the recovery plan by means of specific stress scenarios.

The particular purpose of both processes is to ensure that the Bank is able to comply with the regulatory minimum requirements even under stress conditions. In addition, HSH Nordbank carries out inverse stress tests at least once a year. Scenarios that could endanger HSH Nordbank's ability to survive are identified for these. This information is also used by HSH Nordbank's Management Board as guidance for explaining and deciding upon any action required in the event of developments that threaten the Bank's existence.

In addition to stress tests across all risk types, HSH Nordbank has established procedures for the early identification of negative developments at the level of individual risk types, which are discussed in the following sections.

DEFAULT RISK

HSH Nordbank breaks down its default risk into credit, settlement, country and equity holding risk.

In addition to classical credit risk, credit risk also includes counterparty and issuer risk. Classical credit risk is the risk of complete or partial loss in the lending business as a result of deterioration in the counterparty's credit standing. Counterparty default risk refers to the risk that a counterparty defaults during the term of a transaction and HSH Nordbank can only cover itself by entering into a new contract in the market for the residual term at a market price that might be less favourable. Issuer risk denotes the risk that a loss is incurred on a financial transaction as a result of the default or deterioration in the creditworthiness of the issuer.

Settlement risk consists of clearing risk and advance performance risk. Clearing risk arises in the case of possible loss of value if delivery or acceptance claims pertaining to a transaction that is already due have not been met by both parties. Advance performance risk arises where HSH Nordbank has performed its contractual obligations but consideration from the contracting party is still outstanding.

HSH Nordbank understands country risk as the risk that agreed payments are not made or only made in part or delayed due to government-imposed restrictions on cross-border payments (transfer risk). The risk is not related to the debtor's credit rating.

The equity holding risk is the danger of financial loss due to the impairment of equity holdings.

All elements of default risk referred to are taken into account within the context of equity capital management. For risk concentrations and equity holding risks additional management measures are in place.

Organisation of default risk management

The organisational structure of HSH Nordbank reflects the functional separation of duties between market and back office departments and/or risk controlling, also at Management Board level.

Credit Risk Management is responsible for the risk analysis for the lending business, including the preparation and setting of the internal rating and drafting of the credit applications. Furthermore, the organisation of the bodies of rules for the lending business, including the related processes, is the responsibility of Credit Risk Management. The Loan Collateral Management division is responsible for the settlement of new lending business, the administration of the existing portfolio as well as the valuation and monitoring of collateral. The Special Credit Management business unit is responsible for managing restructuring and workout cases and the associated operational recovery and workout activities. If a commitment is classified as a restructuring case, it is transferred from by the market department in question to Special Credit Management and to the appropriate restructuring analysis team within Credit Risk Management. The workout commitments are processed in the restructuring analysis teams within Credit Risk Management in close collaboration with the manager from Special Credit Management. Lending decisions for normal and intensive management commitments are made jointly by the market department in question and the back office, while lending decisions on restructuring and workout loans are made jointly by Special Credit Management and Credit Risk Management. A decision against the vote made by the back office unit of Credit Risk Management is excluded in each case.

Loan loss provision management falls within the remit of Credit Risk Management.

HSH Nordbank makes use of the option to dispense with the involvement of the back office departments within the meaning of the MaRisk opening clause for lending transactions in certain types of business and below certain amounts classified as not material in terms of risk.

The trading lines for counterparty and issuer risk are monitored by the Group Risk Management division. As part of the monitoring of trading lines, the potential future exposure on currency and interest rate derivatives is recalculated daily for each client on the basis of a 95% quantile and compared to the respective trading limit. The Group Risk Management division is also responsible for the independent analysis and monitoring of risks at the portfolio level, independent reporting and management of country risk. This also includes ensuring portfolio transparency and independent business area analysis (including scenario simulations) and the operation of an early warning system at individual transaction level for identifying commitments on a timely basis that are beginning to show signs of increased risk.

The principles and regulations contained in HSH Nordbank's Credit Manual, in particular on lending competencies (definition of decision-making powers for credit decisions made by the Bank and definition of decision-making powers for entering into, changing and terminating equity holdings), on limiting and reporting the concentration of counterparty default risks, the determination of the rating, treatment of collateral, commitment monitoring and the definition of a default, form the basis for the operating activities within the lending business. Credit risks, which are recognised based on the definition of a loan under Article 389 of the Capital Requirements Regulation (CRR), are thereby considered and treated differently based on collateral, loan type, rating category and type of credit risk. The basis is HSH Nordbank Group's total exposure per group of connected clients (GCC) as defined in Article 4 (1) no. 39 CRR, whereby the bearer of the economic risk is always to be regarded as the relevant borrower.

The Bank has defined valuable collateral in order to differentiate between collateralised and non-collateralised loans. The focus is placed on meeting the requirements of the CRR (e.g. availability of a market value, ability to realise the collateral, no correlation to the collateralised loan, legal enforceability, and matching maturities). The range of approved collateral can be expanded following an assessment carried out by a team independent of the market divisions, consisting of specialists from the Credit Risk Management, Group Risk Management and Legal & Tax divisions.

Credit risk management for single risks is supplemented in particular by instructions on commitment monitoring and early identification of risks and the EAD/RWA limit monitoring based on default risk for specific portfolios (retail loans, real estate, LBO), which was approved in the SRF.

Default risk management

In line with the HSH Nordbank's business strategy focus as a "Bank for Entrepreneurs" with lending as its anchor product, default risk accounts for the largest proportion of the Bank's overall risk potential. In order to measure and manage this risk, Group Risk Management uses procedures and methods that are continually reviewed and enhanced to ensure they are appropriate.

Key default risk parameters are the expected and unexpected loss. The expected loss is equivalent to the default which is expected within one year on a given probability of default (PD), loss given default (LGD) and exposure at default (EaD) for a borrower. The EaD is the expected loan amount outstanding, taking into account a potential (partial) drawdown of commitments and contingent liabilities that will adversely impact the risk-bearing capacity in the event of a default. The maximum amount by which an actual loss can exceed the expected loss with a specified probability (99.9%) within a specified time period (one year) is described as the unexpected loss. PD, LGD and EaD are also relevant risk parameters in this context. Economic capital required is determined for internal management purposes on the basis of the calculation of the equity capital backing in accordance with CRR taking due account of any adjustments that are justified on economic grounds. In addition, institution-specific asset correlations and granularity surcharges for covering existing risk concentrations are taken into account in determining the economic capital required for default risk.

Economic capital required for default risk amounted to € 0.8 billion as at the reporting date after taking account of the second loss guarantee provided by the federal states of Hamburg and Schleswig-Holstein (31 December 2016: € 1.9 billion). This decrease in economic capital required for default risk is mainly attributable to the progress made in winding down the loan portfolio (portfolio transfer).

Non-performing exposure (NPE), which is the total of all risk positions of borrowers in default, serves as an important management indicator that has also been defined as a risk guideline in the SRF. Information on the non-performing portfolio is disclosed in the "Default risk structure by rating category" table. In addition, the coverage ratio (ratio of total loan loss provisions recognised on the non-performing exposure to the total non-performing exposure) is monitored at overall bank level as a MaSan indicator. After the portfolio transaction is executed in 2018, HSH Nordbank AG's NPE ratio would decrease significantly to that of the Group. Following this substantial improvement in the risk profile of the Bank's loan portfolios the trend of loan loss provisions and the NPE ratio would have an equivalent weight relative to to the Bank's other relevant management indicators. This also applies in particular in view of the fact that the shipping portfolio, which has hitherto been characterised by a high level of defaults, would be significantly reduced.

The syndication of lending transactions also helps to actively shape the composition of the portfolio.and align individual financing risks (so-called final takes) to the balance sheet ratios. The Bank subjects all potential new business from a certain volume limit to a market conformity review and syndication assessment performed by the credit syndication unit within the Credit Solutions department as part of the Credit Committee Pre-Check (CCPC). The CCPC/Credit Risk Management then makes a joint decision with the credit syndication unit and the deal team sales employees as to whether syndication should be arranged as part of the new business or underwriting process. The Bank's existing portfolio is also reviewed for saleability on a quarterly basis as part of the MaSan procedure (and on an ad hoc basis where appropriate).

Rating procedures, LGD and CCF

HSH Nordbank collaborates intensively with other banks in the further development and ongoing validation of various internal rating modules. This is done in the association of Landesbanks via RSU Rating Service Unit GmbH & Co. KG (RSU) and in cooperation with Sparkassen Rating und Risikosysteme GmbH (SR), a subsidiary of the German Savings Bank Association (DSGV).

HSH Nordbank uses rating modules for banks, corporates, international sub-sovereigns, country and transfer risk, insurance companies, leveraged finance, savings banks standard rating and leasing as well as for special financing for ships, real estate, projects and aircraft. Various qualitative in addition to quantitative characteristics are also used in each rating module. The result is a probability at default (PD) for each borrower and hence allocation to a concrete rating category. The Bank uses an identical rating master scale for all modules which not only allows comparison of differing portfolio segments but also mapping with external ratings.

In order to determine the expected drawdown for continent liabilities and commitments in case of possible default, so-called credit conversion factors (CCF) are calculated empirically and applied. The loan amount outstanding weighted by CCF is described as the EaD.

HSH Nordbank uses a differentiated LGD methodology to forecast the loss-given defaults (LGD). Collateral-specific recovery rates and borrower-specific recovery rates are estimated for these based on historic loss information. The respective default amount expected is determined from the EaD using the LGD.

As part of the annual validation process the predictive accuracy of the rating modules is reviewed in the reporting year with regard to the predicted probabilities of default using anonymous, aggregated data and the LGD and CCF procedures are validated in a comparable manner and continually enhanced.

Risk concentrations

Within the framework of regular business segment analyses, potential counterparty default risk concentrations, for example with regard to groups of connected clients (GCC), regions or industrial sectors in a broader sense, are identified and their trend is monitored. HSH Nordbank's material concentrations of credit risk were in the real estate portfolio, which accounted for 20% of the overall portfolio (previous year: 20%) and in the shipping portfolio, which accounted for 14% of the overall portfolio (previous year: 20%). Other concentration risks relate to the US dollar business, which accounted for 15% of the overall portfolio (previous year: 25%). The shipping loan portfolios denominated in US dollars are included in both key figures. Despite a decrease in the concentration in shipping financing and financing denominated in USD, the key capital and liquidity figures remain highly sensitive to developments on the shipping market and movements in the EUR/USD exchange rate.

There is an internal process, which ensures compliance with the regulatory requirements, for monitoring large exposure limits in accordance with Article 395 CRR. As a supplementary measure, material counterparty concentrations in the portfolio are identified by means of a risk-based parameter (risk of loss as the sum of the expected and unexpected loss) and reported quarterly to the Management Board and Risk Committee. Net rating-based upper limits are applied to new business to prevent future counterparty concentrations.

Country risk limitation is an additional management dimension within the management of risk concentrations. Country limits are set for country risk concentrations at the HSH Nordbank Group level. Utilisation of the limits is monitored continuously and centrally by country risk management. In the event that a limit is fully utilised, the decision regarding each new business transaction rests with the Overall Management Board.

Equity holding risk

For regulatory purposes, equity holdings must be consolidated, deducted from equity or backed with equity capital in the equity holdings receivable class. In this context, equity holding risk is treated as a sub-category of default risk under regulatory law. HSH Nordbank has significantly reduced its equity holding portfolio and thereby equity holding risk over recent years, thus successfully bringing it in line with the Bank's strategic realignment. New equity holdings are only acquired if they meet HSH Nordbank's strategic objectives. The opportunities and risks associated with a potential equity holding are analysed extensively prior to the conclusion of the transaction.

A regular company valuation represents an important instrument for monitoring and managing equity holding risk. At least once a year, impairment tests are performed on all equity holdings of HSH Nordbank. Important equity holdings are subject to a more detailed analysis in this context.

Furthermore, all equity holdings in the portfolio are analysed once a year, with a focus, inter alia, on the identification of risks in the individual companies. Measures are derived from the analysis in order to be able to actively counter the identified risks.

The articles of association and by-laws are formulated so as to ensure that the most intensive management possible can be exercised for the benefit of HSH Nordbank.

HSH Nordbank has issued a hard letter of comfort for three companies in the equity holdings portfolio and is therefore liable for the liabilities of these companies. These letters have so far not given rise to any liability on the part of HSH Nordbank. HSH Nordbank has concluded a profit-and-loss transfer agreement with a further two equity holdings.

Management of default risk in pricing and actual costing

HSH Nordbank applies a uniform method across the Bank for the pricing of lending transactions through calculating the present value of the expected and unexpected losses arising on default risk positions. In addition to liquidity and standard processing costs, the rating, LGD and CCF risk parameters determined internally on an individual transaction basis are incorporated in the pricing by means of the standard risk costs. In the same way, an actual costing (profit centre accounting) is made for all transactions on a monthly basis, taking the above-mentioned cost elements into account. Standard risk costs and the resulting contribution margins are determined based on the current risk parameters of the individual transactions. Furthermore, utilisation of the capital commitment set as part of the Bank's annual plan is determined regularly at the division level for the purposes of managing default risk. When bottleneck resources are overdrawn, new transactions and prolongations are subject to stricter approval requirements. The objective of this dual management of plan utilisation is to ensure that both the risk-bearing capacity and regulatory ratios are adhered to.

Default risk exposure

The figures in the following tables showing default risk exposure are based on the EaD. The EaD corresponds to the volume of loan receivables, securities, equity holdings, derivative financial instruments (positive market values after netting) and off-balance-sheet transactions (taking credit conversion factors into account). Risk-mitigating effects (such as recognition of collateral) are not included in EaD. Total EaD amounted to € 72,220 million as at 31 December 2017.

EaD broken down by internal rating categories is presented in the following table. EaD with an investment grade rating (rating category 1 to 5) accounted for 68 % of the total exposure at the Group level (31 December 2016: 59 %). The Core Bank accounted for 74 % of the investment grade commitments (31 December 2016: 69 %) and the Non-Core Bank for 10 % (31 December 2016: 16 %). 20 % of the Overall Bank portfolio is covered by the hedging effect of the second loss guarantee (31 December 2016: 34 %). 13 % of the Core Bank commitments is covered by the guarantee (31 December 2016: 20 %) and 79 % of those of the Non-Core Bank (31 December 2016: 85 %). The proportion of the guaranteed portfolio in the default categories 16 to 18 is particularly high at 78 % (31 December 2016: 87 %).

DEFAULT RISK STRUCTURE BY RATING CATEGORY[1)]

(€ m)	2017				
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**	of which guaranteed (in %)
1(AAAA) to 1 (AA+)	16,255	79	5,615	21,949	6
1 (AA) bis 1 (A–)	7,160	239	2,284	9,683	11
2 to 5	16,158	680	444	17,282	11
6 to 9	10,732	1,009	1	11,742	21
10 to 12	1,425	228	–	1,653	54
13 to 15	1,151	845	3	1,999	59
16 to 18 (default categories)	840	6,649	–	7,489	78
Other[2)]	4	88	331	423	–
Total	**53,725**	**9,818**	**8,678**	**72,220**	**20**

[1)] Mean default probabilities (in %): 1 (AAAA) bis 1 (AA+): 0,00– 0,02; 1 (AA) to 1 (A–): 0,03– 0,09; 2 to 5: 0,12– 0,39; 6 to 9: 0,59– 1,98; 10 to 12: 2,96– 6,67; 13 to 15: 10,00– 20,00; 16 to 18: 100.00
[2)] Transactions, for which there is no internal or external rating available, are reflected in the "Other" line item, such as receivables from third parties of our consolidated equity holdings.

DEFAULT RISK STRUCTURE BY RATING CATEGORY[1)]

(€ m)	2016				
	Core Bank	Non-Core Bank	Other and Consolidation	Total	of which guaranteed (in %)
1(AAAA) to 1 (AA+)	13,684	700	6,726	21,110	17
1 (AA) bis 1 (A–)	6,889	755	2,006	9,650	18
2 to 5	14,948	1,920	1,464	18,332	19
6 to 9	11,270	1,373	66	12,709	27
10 to 12	1,609	569	–	2,178	52
13 to 15	2,296	2,394	69	4,759	60
16 to 18 (default categories)	1,006	13,610	–	14,616	87
Other[2)]	–	87	186	273	–
Total	**51,703**	**21,406**	**10,517**	**83,626**	**34**

[1)] Mean default probabilities (in %): 1 (AAAA) bis 1 (AA+): 0,00– 0,02; 1 (AA) to 1 (A–): 0,03– 0,09; 2 to 5: 0,12– 0,39; 6 to 9: 0,59– 1,98; 10 to 12: 2,96– 6,67; 13 to 15: 10,00– 20,00; 16 to 18: 100.00

[2)] Transactions, for which there is no internal or external rating available, are reflected in the "Other" line item, such as receivables from third parties of our consolidated equity holdings.

EaD broken down by sectors important for HSH Nordbank is presented in the following table:

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	**2017**			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Industry	7,692	977	–	8,669
Shipping	5,056	4,170	–	9,226
Trade and transportation	3,123	322	–	3,445
Credit institutions	6,340	209	4,340	10,889
Other financial institutions	1,904	825	24	2,753
Land and buildings	9,595	2,262	–	11,857
Other services	4,686	392	542	5,620
Public sector	15,042	373	3,757	19,172
Private households	289	286	14	589
Other	–	–	–	–
Total	**53,725**	**9,818**	**8,678**	**72,220**

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	2016			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Industry	7,709	1,682	–	9,391
Shipping	6,542	9,555	42	16,139
Trade and transportation	3,428	851	–	4,279
Credit institutions	3,301	591	3,946	7,838
Other financial institutions	1,849	2,120	531	4,500
Land and buildings	10,343	3,832	29	14,204
Other services	5,377	1,121	942	7,440
Public sector	12,796	1,172	5,005	18,973
Private households	357	483	22	862
Other	–	–	–	–
Total	**51,703**	**21,406**	**10,517**	**83,626**

The following table shows EaD broken down by residual maturities:

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	2017			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Up to 3 months	12,813	2,054	525	15,393
> 3 months to 6 months	1,528	403	354	2,285
> 6 months to 1 year	3,322	955	516	4,793
> 1 year to 5 years	20,440	3,096	4,776	28,312
> 5 years to 10 years	10,399	1,773	2,132	14,304
> 10 years	5,223	1,535	374	7,132
Other	–	–	–	–
Total	**53,725**	**9,818**	**8,678**	**72,220**

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	2016			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Up to 3 months	7,474	4,189	829	12,493
> 3 months to 6 months	2,227	836	311	3,374
> 6 months to 1 year	3,384	998	572	4,954
> 1 year to 5 years	22,660	8,545	6,436	37,641
> 5 years to 10 years	9,696	3,410	1,989	15,095
> 10 years	6,262	3,429	379	10,070
Total	**51,703**	**21,406**	**10,517**	**83,626**

The following table provides an overview of the foreign exposure by region, which reached € 23.286 million as at 31 December 2017 (previous year: € 33,617 million).

FOREIGN EXPOSURE BY REGION

(€ m)	2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Eurozone	7,515	2,648	1,226	11,389
Western Europe	3,232	1,557	1,190	5,979
Eastern Europe	296	446	–	742
Africa	543	263	–	806
North America	413	385	–	798
Latin America	262	191	–	453
Middle East	38	334	–	372
Asia-Pacific region	1,210	804	–	2,014
International organisations	129	–	604	733
Total	**13,638**	**6,628**	**3,020**	**23,286**

FOREIGN EXPOSURE BY REGION

(€ m)	2016			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Eurozone	8,331	5,443	1,214	14,988
Western Europe	2,528	3,466	1,932	7,926
Eastern Europe	499	580	–	1,079
Africa	568	253	–	821
North America	1,302	1,770	52	3,124
Latin America	298	288	–	586
Middle East	44	650	–	694
Asia-Pacific region	1,307	2,399	1	3,707
International organisations	94	–	598	692
Total	**14,971**	**14,849**	**3,797**	**33,617**

The basis for the allocation of the transactions to the regions is the country of the customer relevant for transfer risk, taking account of any collateral relevant for the transfer risk. At customer level, the country relevant for transfer risk is the country from where HSH Nordbank receives the cash flows. If this cannot be clearly assigned based on the customer, the place of business where management is exercised is applied.

Due to their unfavourable fiscal and economic data, a number of European countries are subject to increased monitoring. These include in particular Croatia, Cyprus, Greece, Italy, Portugal and Spain.

As a result of economic developments and the EU sanctions, the exposure to Russia is also being monitored more closely as is the exposure to Turkey due to internal and geopolitical developments.

The following table shows the EaD of the exposures in the European countries stated. HSH Nordbank's total exposure to these countries has decreased by 39% compared to the previous year and amounted to € 3,605 million in total as at 31 December 2017 (previous year: € 5,925 million).

EXPOSURE AT DEFAULT IN SELECTED EUROPEAN COUNTRIES

(€ m)	Country		Banks		Corporates/Other		**Total**	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Greece	–	–	–	–	940	1,478	940	1,478
Italy	19	425	–	–	574	602	593	1,027
Croatia	–	–	–	–	94	101	94	101
Portugal	180	219	–	–	52	26	232	245
Russia	–	–	1	3	47	74	48	77
Spain	79	151	36	46	918	1,215	1,033	1,412
Turkey	–	–	59	31	173	379	232	410
Cyprus	–	–	–	–	434	1,175	434	1,175
Total	**278**	**795**	**96**	**80**	**3,231**	**5,050**	**3,605**	**5,925**

The previously low direct country exposure to the countries shown above was further reduced in 2017. Commitments shown under Corporates/Other sector for Greece and Cyprus relate primarily to ship financing arrangements, which do not entail the transfer of risk due to the existing collateral

Note 56 includes more information on the selected European countries.

Loan loss provisions

HSH Nordbank pays the most attention to default risk within the context of risk management. Impairments of a loan commitment are covered by the recognition of specific loan loss provisions for loans and advances and provisions for contingent liabilities in the amount of the potential loss in accordance with Group-wide standards. HSH Nordbank also recognises general loan loss provisions (GLLP) for latent default risks, which have already occurred but are not yet known to the Bank as at the balance sheet date.

All restructuring and workout commitments, as well as intensified loan management commitments with a rating greater or equal to 13, are subject every quarter to a comprehensive two-step review process. In a first step, a review is carried out on the basis of objective criteria (so-called trigger events) to determine whether the receivable could be impaired (impairment identification). If this is the case, the loans identified are reviewed in a second step to determine whether a loan loss provision is actually required and the amount thereof (impairment measurement). The amount of the loan loss provision is calculated by deducting the present value of all expected future incoming payments from the IFRS carrying amount of the receivable. The expected incoming payments comprise in particular all expected interest and redemption payments, as well as proceeds from the liquidation of collateral.

The following tables show the loan loss provision trend by segment:

CHANGES IN LOAN LOSS PROVISIONS IN THE LENDING BUSINESS1)

(€ m)	01.01.–31.12.2017							
	Specific loan loss provisions/ provisions	General loan loss provisions	**Loan loss provisions before net currency translation income and compen- sation**	Net currency translation income loan loss provisions	Compen- sation item	**Total**	Hedging effect of credit derivative second loss guarantee	LLP including hedging effect of credit derivative
Corporate clients	–47	4	–43	0	–10	–53	0	–53
Real estate clients	3	0	3	0	–1	2	0	2
Shipping	–115	159	44	5	14	63	0	63
Treasury & Markets	0	1	1	0	0	1	0	1
Total Core Bank	**–159**	**164**	**5**	**5**	**3**	**13**	**0**	**13**
Non-Core Bank	–1,512	99	–1,413	39	–731	–2,105	810	–1,295
Other and Consolida-tion	**6**	**0**	**6**	**0**	**0**	**6**	**0**	**6**
Group	**–1,665**	**263**	**–1,402**	**44**	**–728**	**–2,086**	**810**	**–1,276**

CHANGES IN LOAN LOSS PROVISIONS IN THE LENDING BUSINESS[1]

(€ m)	01.01.–31.12.2016							
	Specific loan loss provisions/ provisions	General loan loss provisions	**Loan loss provisions before net currency translation income and compensation**	Net currency translation income loan loss provisions	Compensation item	**Total**	Hedging effect of credit derivative second loss guarantee	LLP including hedging effect of credit derivative
Corporate clients	39	1	40	–	–45	–5	–	–5
Real estate clients	1	–	1	–	–1	–	–	–
Shipping	–92	63	–29	–8	89	52	–	52
Treasury & Markets	–	–	–	–	–	–	–	–
Total Core Bank	**–52**	**64**	**12**	**–8**	**43**	**47**	**–**	**47**
Non-Core Bank[1]	–1,776	182	–1,594	–66	2,241	581	–475	106
Other and Consolidation[1]	**4**	**1**	**5**	**–2**	**–**	**3**	**–**	**3**
Group	**–1,824**	**247**	**–1,577**	**–76**	**2,284**	**631**	**–475**	**156**

[1] Following the changes made to the segment structure as at 30 September 2016, the figures reported for the previous year have been adjusted accordingly.

In the past financial year, loan loss provisions were characterised on the one hand by additions for legacy commitments in line with the plan. Additional loan loss provisions were also recognised as a result of the impact of the loan portfolio transaction signed on 28 February 2018. In determining the loan loss provisions for the loans affected by the portfolio transaction the purchase price for the entire portfolio was allocated to the individual loans and assets sold based on a valuation report and this allocated portion of the purchase price representing the expected cash flow as at the intended closing date was discounted to the balance sheet date using the original effective interest rate. A closing date by the end of the third quarter was assumed for this purpose. Further loan loss provisions were recognised primarily for legacy positions in the shipping portfolio. However, the risk trend in the other segments remained insignificant.

Loan loss provision expense before taking into account the compensation effect of the guarantee and before currency translation income amounted in total to € –1,402 million as at the reporting date (previous year: € –1,577 million). It is therefore significantly below that of the previous year and in line with expectations.

The loan loss provisions recognised were no longer fully compensated for due to the full balance sheet utilisation of the second loss guarantee in the first quarter of 2017. After taking account of the hedging effect of € 810 million under the credit derivative (same period in the previous year: € –475 million) and including currency effects and after compensation, total loan loss provision expense amounted to € –1,276 million (same period in the previous year: income of € 156 million) and had a significant adverse impact on the Group results.

The second loss guarantee of € 10 billion has been fully utilised in balance sheet terms as at the reporting date. Losses submitted for settlement amounted to € 0.4 billion. In view of the termination agreement reached between HSH Nordbank AG and HSH Finanzfonds AöR the guarantee will be terminated prematurely on the closing date of the loan portfolio transaction and settled in full (for details, see the "Sale of HSH Nordbank on 28 February 2018)" section in this Management Report.

The loss ratio in the Group was 4.31 % in the reporting year (previous year: 3.63 %). The loss ratio is calculated based on the actually realised defaults as a ratio of the credit risk exposure. The total amount of defaults in 2017 was € 3,114 million (previous year: € 3,046 million), the credit risk exposure € 72,313 million (previous year: € 83,969 million). The credit risk exposure includes all balance sheet and off-balance sheet assets taking into account both specific and general loan loss provisions recognised on loans and advances to customers and banks subject to default risk.

The individual elements of loan loss provisions are shown in the following table:

TOTAL LOAN LOSS PROVISIONS

(€ m)	**2017**	2016
Loans and advances to customers	39,174	50,910
Loans and advances to banks	3,838	4,192
Volume of impaired loans	6,813	10,541
Non-current assets held for sale and discontinued operations (IFRS 5)	139	1,382
Total loan loss provisions (SLLP) for loans and advances to customers	– 4,355	– 6,336
Total loan loss provisions (GLLP) for loans and advances to customers	– 138	– 375
Total loan loss provisions (SLLP) for loans and advances to banks	–	0
Total loan loss provisions (GLLP) for loans and advances to banks	– 1	– 1
Total loan loss provisions for balance sheet items	**– 4,494**	**– 6,712**
Provisions for individual risks in the lending business	– 60	– 67
Provisions for portfolio risks in the lending business	– 7	– 43
Total loan loss provisions for off-balance sheet items	**– 67**	**– 110**
Total loan loss provisions (before compensation item)	**– 4,561**	**– 6,822**
Compensation item	5,181	7,854
Total loan loss provisions (including compensation item)	**620**	**1,032**

Total loan loss provisions for the Group amounted to € 620 million as at 31 December 2017 after compensation under the second loss guarantee (previous year: € 1,032 million). The reason why the compensation item exceeds the loan loss provisions is that the compensation item also includes the hedging effect for other transactions covered by the guarantee (e.g. securities). In such cases, any related impairments are not disclosed under loan loss provisions but in other P&L line items (e.g. net income from financial investments).

Total specific loan loss provisions comprise SLLP of € – 4,355 million for loans and advances to customers and banks (previous year: € – 6.336 million), SLLP of € – 39 million for contingent liabilities and irrevocable loan commitments (previous year: € – 65 million) and SLLP of € – 21 million for other off-balance sheet transactions (previous year: € – 2 million) and amounted in total to € – 4,415 million (previous year: € – 6,403 million).

GLLP totalled € – 146 million (previous year: € – 419 million) and were composed of GLLP of € – 139 million (previous year: € – 376 million) for loans and advances to banks and customers and € – 7 million (previous year: € – 43 million) for contingent liabilities and irrevocable loan commitments.

Details regarding the total loan loss provisions are presented in Notes 14, 26 and 42.

Planning for loan loss provisions

Loan loss provisions are planned as part of the annual Bank plan under the plan assumptions specified therein and include the annual changes in the amounts of the specific and general loan loss provisions including new business.

In planning additions to as well as utilisations and reversals of loan loss provisions, HSH Nordbank mainly relies on models that simulate the expected loss at the individual transaction level over the planning period, based on parameters specific to the transaction. Scenario analyses based on cash flows and historical data regarding changes in loan loss provisions based on the expected loss are also taken into account. Furthermore, the loan portfolio transaction signed on 28 February 2018 was also reflected in the planning for loan loss provisions.

Due to its full balance sheet utilisation and planned termination in 2018 and the planning assumption of the full payment of the hedging effect by the guarantor. the second loss guarantee has no impact on the planned loan loss provision results. Further information on the hedging effect of the second loss guarantee is presented in Note 3 to the Group financial statements.

An important driver of the amount recognised for loan loss provisions is the breakdown of non-performing loan commitments into “capable of recovery” (and therefore recognition of a SLLP based on the assumption of the continuation of the borrower’s business) or “not capable of recovery” (and therefore recognition of a SLLP based on the assumption of a workout). The estimates made for loan loss provisions are based on the assumption of the continuation of the stabilisation process started in 2017 and the recovery of the shipping markets, in particular in container shipping, as well as the continuation of the current recovery strategy.

Further information on the loan loss provision forecast and uncertainties associated with the long-term loan loss provision plan is set out in the Forecast, opportunities and risks report section.

Reports on default risk

The Management Board and Risk Committee are regularly informed regarding the risk content and trend in individual asset classes and sub-portfolios and risk concentrations as well as recommended measures by means of regular reports.

The HSH Management Report also includes reports on problem loans and new business in addition to information on the trend of the relevant key default risk figures, structural analyses on business areas and conspicuous individual commitments. It also includes the profit centre accounting, rating validation results and rating migration development as well as information on the monitoring and management of country risk.

MARKET RISK

Market risk represents the potential loss that can arise as a result of adverse changes in market values on positions held in our trading and banking book. Market movements relevant to the Bank are changes in interest rates and credit spreads (interest rate risk), exchange rates (foreign exchange risk) as well as share prices, indices and fund prices (equity risk) including their volatilities.

Organisation of market risk management

The Management Board determines the methods and processes for measuring, limiting and steering market risk, and budgets an overall limit percentage for market risks. Against the background of this upper loss limit, the risks of all business bearing market risk are limited by a dynamic system of loss and risk limits.

Market risk was actively managed in the Treasury & Markets division in the reporting year. The Bank Management division performs the central management function for interest rate and foreign exchange risks in the banking book. The Overall Management Board is responsible for selected strategic positions exposed to market risk.

An organisational separation between market risk controlling, financial controlling as well as settlement and control on the one hand and the trading divisions responsible for positions on the other is ensured at all levels in accordance with MaRisk. All major methodological and operational risk measurement and monitoring functions are consolidated in the Group Risk Management division.

Market risk management

Market risk measurement and limitation

Our system for measuring and managing market risk is based, on the one hand, on the economic daily profit and loss and, on the other, on a value-at-risk approach. The economic profit and loss is calculated from the change in present values compared to the end of the previous year. The market risk of a position represents the loss in value (in euros) which will not be exceeded until the position is hedged or realised within a predetermined period with a predetermined probability. In the context of the value-at-risk approach, the interest VaR in the banking book is also determined and limits are explicitly set for interest rate risk in the banking book. The present value basis used in the measurement of market risk was expanded by an earnings-oriented perspective, in which the change in average interest income is simulated in different scenarios over a 5 year time horizon.

The value-at-risk (VaR) is determined by HSH Nordbank using the historical simulation method. It is calculated for the entire Group based on a confidence level of 99.0 % and a holding period of one day for a historical observation period of 250 equally weighted trading days.

The material market risks at HSH Nordbank are interest rate risk (including credit spread risk) and foreign exchange risk. In addition to these risk types, the VaR of HSH Nordbank also covers equity risk for both the trading book and banking book. The basis risk is also taken into account in determining the VaR. The basis risk constitutes the risk of a potential loss or profit resulting from changes in the proportion of prices or interest rates on similar financial products within a portfolio. The individual market risk types are not restricted by separate limits. Limits are set within the VaR limit for the overall market risk of the Bank. Limits are set for the VaR for the different reporting units for the purposes of managing market risk, whereas losses incurred are restricted through stop loss limits. There are clearly defined processes for limit adjustments and overdrafts.

Where necessary, HSH Nordbank enters into hedging transactions to manage or reduce market risk in order to offset the impact of unfavourable market movements (e.g. with regard to interest rates, exchange rates) on its own positions. Derivative financial instruments in particular, such as interest rate and cross-currency interest rate swaps, for example, are used as hedging instruments. The effects of the hedging transactions entered into are included in the VaR disclosed. Further information on this and the type and categories of the hedging instruments and hedging relationships entered into by HSH Nordbank as well as the type of risks hedged is presented in the Notes. In particular, we refer to Section I. F) of Note 7 Accounting policies, Note 10 Result from hedging, Note 27 Positive fair values of hedging derivatives, Note 40 Negative fair values of hedging derivatives and Note 61 Report on business in derivatives.

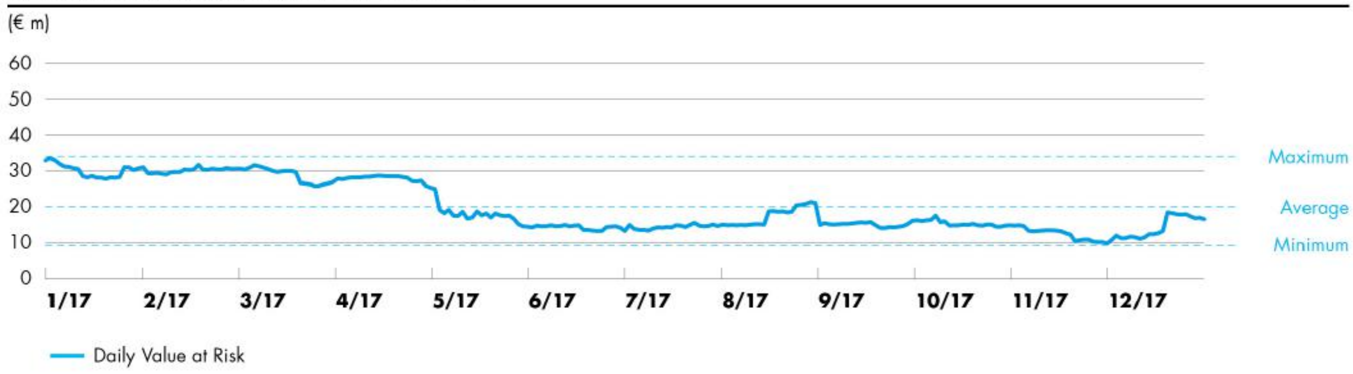
Market risks arising from the lending business and liabilities of the Bank are transferred to the trading divisions and taken into account in the corresponding risk positions. There they are managed as part of a proactive portfolio management process and hedged through external transactions.

The VaR model used and continuously enhanced by HSH Nordbank contains all of the Bank's significant market risks in an adequate form.

Daily value-at-risk during the year under review

The following chart shows the movement in the daily VaR for the total trading and banking book positions of HSH Nordbank over the course of 2017.

DAILY VALUE-AT-RISK IN THE COURSE OF 2017



Market risk fluctuated between € 9.9 million and € 33.7 million. It decreased from € 34.5 million to € 16.7 million on a year-end comparison. The main drivers of this reduction in the overall VaR were the winding down of the divestment portfolio and lower market volatility compared to the previous year. The VaR of the trading book positions amounted to € 0.3 million as at 31 December 2017, while that of the banking book transactions amounted to € 16.6 million.

The overall VaR, which cannot be derived from adding the VaR of the trading and banking book positions due to risk-mitigating correlation effects, amounted to € 16.7 million as at the reporting date. This resulted in a limit utilisation of 24 % based on a VaR limit of € 70 million.

The following table shows the change in overall VaR by individual market risk type. The maximum and minimum represent the range over which the respective risk amount moved in the course of the year under review.

DAILY VALUE-AT-RISK OF THE GROUP

(€ m)	Interest rate risk[1]		Credit spread risk[1]		Foreign exchange risk		Equity risk		Commodity risk		Total[2]	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016
Average	5.2	9.7	15.6	25.1	11.1	18.1	1.2	2.0	–	–	20.0	41.8
Maximum	9.7	19.9	26.7	27.1	20.8	25.8	1.6	4.1	–	–	33.7	49.9
Minimum	2.9	4.6	8.1	21.6	0.8	9.1	0.8	0.9	–	–	9.9	30.2
Period end amount	5.3	12.3	9.1	22.9	14.5	18.3	1.5	1.4	–	–	16.7	34.5

[1] Credit spread risk is a sub-type of interest rate risk. It is not disclosed as part of interest rate risk but as a separate item due to its significance for HSH Nordbank.
[2] Due to correlations the VaR does not result from adding up individual values.

With regard to the risk types there was a significant decrease in both interest rate and FX risk as well as in credit spread risk. Due to the accelerated winding down of the divestment portfolio the sharpest decrease was in credit spread risk.

Commodity risk is no longer disclosed as the commodity business has been discontinued and the last positions were wound down by the end of 2016.

As the market risk of the Core Bank (as at the 2017 year end: € 15.6 million) is primarily characterised by interest rate and foreign exchange risk arising from the lending business, funding and the trading book, which predominantly contains positions resulting from trading in interest rate and currency derivatives with customers as well as bond trading. Market risk also includes credit spread risk on securities held in the liquidity buffer and cover pool portfolios that have good credit quality.

The market risk (as at the 2017 year end: € 3 million) of the Non-Core Bank arises predominantly from the residual balances of the credit substitute business in the banking book. Accordingly, credit spread risk is the dominant factor here.

Backtesting

HSH Nordbank performs regular backtests to review the appropriateness of its VaR forecasts. On the assumption of unchanged positions, the daily profit and loss achieved in theory due to the market developments observed are compared with the VaR values of the previous day, which were forecast using historical simulation. Based on the assumption of a confidence level of 99.0% applied by HSH Nordbank, up to four outliers indicate that the forecasting quality for market risks is satisfactory. This threshold was always maintained at the HSH Nordbank Group level in 2017.

Stress tests

In addition to the limit-based management of the daily VaR, at least weekly stress tests are performed that analyse the effects of unusual market fluctuations on the net present value of the Bank's positions.

When it comes to market risk, HSH Nordbank makes a distinction between standardised, historical and hypothetical stress scenarios. Whereas standardised scenarios are defined for specific risk types (e.g. shift in or rotation of the interest rate curve), historical and hypothetical stress tests apply to several market risk factors at the same time. In this regard, historical scenarios actually map correlations between risk factors that occurred in the past, whereas hypothetical scenarios are based on fictitious changes in risk factors. With regard to the hypothetical scenarios, it is also distinguished between economic scenarios that simulate a downturn in the macroeconomic environment and portfolio-specific scenarios that can represent a potential threat for the value of individual sub-portfolios of HSH Nordbank. The hypothetical scenarios are periodically reviewed and adjusted where necessary depending on changes in the market environment.

Instruments for managing market risk as part of the accounting for hedging relationships

The Financial Market's division also uses derivative financial instruments to manage market risk arising from loans and advances and liabilities as well as securities. Interest rate swaps and other interest rate or currency swaps are used to hedge the interest rate and foreign exchange risk arising from the underlying transactions. Market risks can be hedged at the micro, portfolio and macro level.

Changes in the value of derivatives are always recognised through profit or loss due to the HFT classification. If underlying transactions held in the AFS, LAR or LIA categories are hedged by derivatives, this gives rise to a distortion in the income statement that is not consistent with the economic facts. These distortions can be avoided by the use of fair value hedge accounting. Under fair value hedge accounting the changes in value of the underlying transactions to be attributed to the hedged risk are also recognised through profit or loss. In so doing, the Bank only takes account of hedges of the fair value against interest rate risk. Fixed-interest rate loans, issued instruments and securities positions are designated as underlying transactions (hedged items), while only external interest rate and interest rate currency swaps are designated as hedging instruments. In general, HSH Nordbank recognises appropriate hedges of underlying transactions by external derivatives under portfolio fair value hedge accounting, insofar as the requirements of IAS 39 are met.

Reports on market risk

The Management Board is informed on a daily basis with regard to the trend in market risk and results as well as limit utilisations. In addition, weekly and monthly reports are submitted to the Overall Bank Management Committee.

LIQUIDITY RISK

HSH Nordbank divides its liquidity risk into risk of insolvency and liquidity maturity transformation risk.

Insolvency risk refers to the risk that present or future payment obligations cannot be met in part or in full. This is referred to as liquidity risk in the narrower sense. The key driver of this liquidity risk is the cash flow structure in the liquidity development report, which is determined by the assets (maturity/currency structure) and liabilities (funding structure by maturity/currency/investor). In this regard, the market liquidity risk, i.e. the danger, that transactions cannot be sold or only at unfavourable conditions because of a lack of market depth, is reflected in the liquidity development report as a component of the insolvency risk. Another component of insolvency risk is the refinancing risk, i.e. the danger, of not being able to obtain liquidity or not at the expected conditions if required. The refinancing risk is determined by the refinancing structure. Information on the refinancing structure can be found in Note 53 "Residual maturity breakdown of financial instruments" to the Group financial statements.

Liquidity maturity transformation risk is also a component of the risk-bearing capacity concept and refers to the risk that a loss will result from a mismatch in the contractual maturities of assets and liabilities, the so-called liquidity maturity transformation position, and from the change in the Bank's refinancing surcharge.

Organisation of liquidity risk management

Strategic liquidity management is the responsibility of the Bank Management division. The objective of liquidity management is to ensure the solvency of HSH Nordbank at all times, at all locations and in all currencies, to adhere to the regulatory liquidity ratios, to manage the marketability of the liquid assets of the liquidity buffer and to avoid concentration risks in the refinancing structure. The Treasury & Markets division is operationally responsible for funding and marketing.

The Group Risk Management division is responsible for the methods used to measure and limit liquidity risk within the Group and performs daily risk measurement and limit monitoring. Bank Management uses the risk measurement results to support it in managing liquidity for all maturity bands and enable it to counter possible risks at an early stage.

The Overall Bank Management Committee is the central committee responsible for managing the resource liquidity and is assisted by the Credit Committee in this task by means of an active portfolio management at the material individual transaction level.

HSH Nordbank has a liquidity contingency plan and regulated procedures and responsibilities in place in the event of a liquidity crisis. Institution-specific, risk-based and capital market-oriented early warning indicators are also taken into account as part of the contingency process in order to avert a liquidity emergency. The liquidity contingency plan is closely linked to the Recovery Plan as defined in SAG.

Liquidity risk management

Measurement and limitation of liquidity risk

The transactions in the Group impacting liquidity are presented as cash flows and the resultant inflows and outflows allocated to maturity bands (liquidity development report) for the purposes of measuring insolvency risk or funding requirements. The difference between inflows and outflows represents a liquidity surplus or deficit (gap) in the relevant maturity bands. The gaps are shown on a cumulative basis from day one to twelve months in order to map future liquidity requirements. They are compared to the respective liquidity potential which is applied to close the cumulative gaps of the individual maturity bands and consequently represents the respective limit for insolvency risk. Utilisation of this limit is monitored daily. The net liquidity position, which shows the extent of the insolvency risk, is determined as the net amount from the gaps and the respective liquidity potential. The measures used in the normal market phases to generate liquidity are already included in the net liquidity position.

In addition to all on-balance sheet business, loan commitments already granted, guarantees, transactions with forward value dates and other off-balance sheet transactions are incorporated in the liquidity development report. Maturity scenarios are used for a number of positions to map economic maturities more effectively. In doing so, any possible minimum levels of deposits as well as liquidation periods and realisation amounts of assets, for example, are modelled conservatively as a matter of principle. The modelling assumptions used are periodically reviewed, which is also required under MaRisk.

The liquidity potential available to close gaps is composed of a securities portfolio held as a precaution in the event of a crisis (liquidity buffer), other highly liquid and liquid securities according to how liquid they are and industrial loans eligible for refinancing with central banks. Most of the portfolio of securities is invested in liquid markets and can be liquidated via the refinancing channels, namely central banks, Eurex repo market, bilateral repo market or the cash market.

The components of the liquidity potential – such as the liquidity buffer required under MaRisk for example – are monitored continuously and validated in accordance with internal and external minimum requirements. Safety buffers and risk discounts are incorporated into the limits in order to keep the probability of full utilisation or overdrawing the limits as low as possible. These discounts are, for example, haircuts or other safety margins that reflect the uncertainty about the future development of the respective component of liquidity potential. Permanent market access to the funding sources relevant for HSH Nordbank is also monitored on a regular basis. This is achieved firstly through the ongoing market observation of all funding sources by the Bank's divisions. Secondly, Group Risk Management reviews the funding potential on a daily basis based on the expected prolongation ratios for short-term deposits. The Bank Management division also prepares actual/plan analyses regarding long-term funding.

The liquidity-value-at-risk (LVaR) as a reflection of liquidity maturity transformation risk is calculated monthly through historical simulation (confidence level 99.9%) of the liquidity spread and their present value effects on transactions, which would be theoretically necessary to immediately close the current maturity transformation position. It is assumed for this purpose that these hypothetical close-out transactions could actually be executed in the market and that full funding is therefore possible. LVaR limits are set at Group level and are a part of the risk-bearing capacity concept.

Liquidity management

The short-term liquidity base and regulatory liquidity ratios are operationally managed by the Bank Management division based on general parameters specified by the Treasury & Markets division. In addition to the regulatory requirements the liquidity development report is relevant amongst other things for determining these general parameters. The definition of or change to individual parameters or the framework is decided by the OBM committee or the Management Board. This places HSH Nordbank in the position to react flexibly to market developments.

HSH Nordbank uses the so-called expected case liquidity development report and stress case forecast, which contain expected cash flows and are prepared for a period extending beyond the current financial year, as the basis for managing the medium-term liquidity base. This tool is used to forecast how the worst stress case scenario and/or stress case liquidity development report develops over time.

In 2017, the maturity mismatch liquidity development report was introduced to obtain a long-term view of the risk of insolvency. It shows the pure maturity mismatches in the base case. The base case scenario maps the normal, expected business operations, taking account of fluctuations in cash flows usual in normal market phases and defined by regulation. The benefit lies in the setting of a limit on the liquidity maturity transformation in order to limit future risks of insolvency.

The collateral pool of HSH Nordbank consisting of cash balances, securities and loan receivables that are eligible for funding is coordinated by ALM in order to be able to utilise the potential for secured funding in the best possible manner.

Stress tests

The selection of our stress tests is the result of an analysis of historical events and hypothetical scenarios. The selection is reviewed on an annual basis and adapted to current developments where necessary.

Within the different stress modelling processes, additional market-specific scenarios (e.g. Market liquidity crisis, severe economic downturn) and institution-specific scenarios (e.g. rating downgrade of HSH Nordbank AG, capital market rumours) are assessed for insolvency risk on a monthly basis in addition to the daily preparation of the stress case liquidity development report. A stressed US dollar (gradual appreciation) is taken into account in the scenarios market liquidity crisis and severe economic downturn.

In addition, the Bank performs a monthly US dollar stress test which is based on the normal case liquidity development report and simulates an immediate as well as a gradual appreciation in the US dollar affecting the US dollar cash flows and the cash collateral for US dollar derivatives. The stress factor for the appreciation is determined based on an analysis of the historical movement of the EUR/USD exchange rate.

Within the framework of a stress test for the liquidity maturity transformation risk, an analysis is carried out to determine how the LVaR changes on increasing liquidity spreads and stressed liquidity gaps. The stress LVaR serves as an indicator for the sensitivity of the LVaR to an increase in the spread/liquidity costs or liquidity gap and constitutes an additional piece of management information.

Furthermore, events that could have a critical impact on HSH Nordbank's solvency were analysed in the reporting year within the framework of the periodic implementation of inverse stress tests.

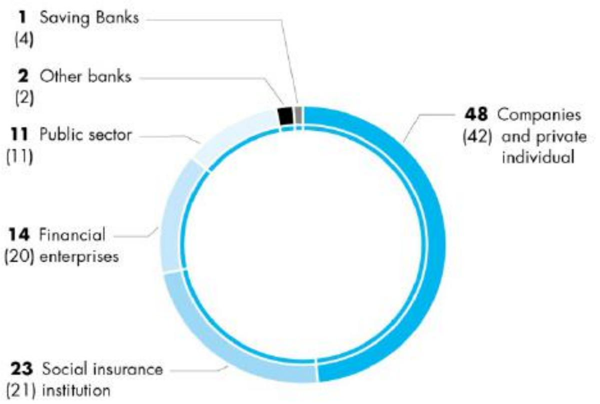
Risk concentrations

HSH Nordbank has established a monitoring system for managing concentrations of both asset and liability instruments. Special emphasis is placed on deposits that are analysed and reported on with regard to the depositor structure (investor, sectors), maturities (original and residual maturities). The deposit structure is characterised by a high level of concentration relating to a small number of large institutional investors that place deposits based on interest rates and ratings. The ten largest depositors account for around 29% of total deposits. Furthermore, a high proportion (more than 44%) of total deposits comprises overnight deposits.

The following chart shows the structure of our deposits by sector:

DEPOSITOR STRUCTURE AS AT 31 DECEMBER 2017[1)]

(in %, previous year figures in brackets[2)])



[1)] In addition to call an term deposits this illustration also includes demand deposits for the first time.
[2)] The figures reported for the prior year have been adjusted to the new structure of our deposits by sector.

Quantitative measures are calculated for the purposes of analysing existing risk concentrations. Furthermore, an analysis is performed not only on the structure but especially on the risk content, in order to be able to derive according control impulses from the quantitative measures in combination with a qualitative discussion.

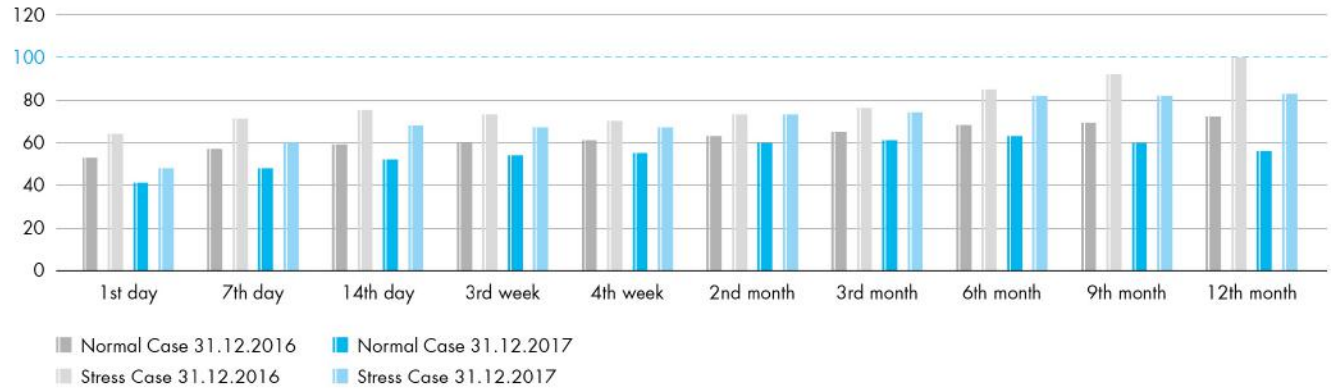
In addition to the analysis of the depositor structure with regard to existing depositor concentrations, risk concentrations are examined with regard to the US dollar asset/liability position. This shows the dependency of the liquidity situation on the movement in the US dollar exchange rate, which, although it has decreased in 2017 due to the overall reduction in US dollar assets, is still relevant. This is, inter alia, due to the large amount of US dollar assets that are refinanced through EUR/USD basis swaps. A decrease in the EUR/USD exchange rate will increase the cash collateral to be provided on foreign currency derivatives, representing a burden on liquidity. For the purposes of analysing the dependency on the US dollar, a US dollar liquidity development report is prepared and sensitivity analyses and a US dollar stress test of the liquidity development report are performed.

Quantification of liquidity risk

The following chart shows the relative utilisation levels of the liquidity potential for individual cumulative liquidity gaps in the normal case and stress case liquidity development reports as at 31 December 2017 as well as at the 2016 year end. Utilisation represents the ratio of the cumulative gap to the total liquidity potential, which also includes the liquidity buffer required under supervisory law.

LIMIT ON CUMULATIVE LIQUIDITY GAPS

(Utilisation of liquidity potential in %)



HSH Nordbank's risk tolerance with regard to liquidity risk is reflected, amongst other things, in the definition of a minimum survival period, which describes how long a utilisation of a liquidity potential lower than 100% is to be maintained under the normal and stress cases for insolvency risk.

The liquidity potential had a peak utilisation of 63% in the sixth month as at the reporting date in the normal case assessment, which is based on the assumption of business development in an ordinary market environment. All limits within the minimum survival period of twelve months defined by the Bank were thereby adhered to. The stress case liquidity development report (combined scenario – economic downturn and rating downgrade – based on the assumption of a gradual increase in the US dollar amongst other things) shows that the liquidity potential was also not exceeded within the minimum survival period of one month established taking the Minimum Requirements for Risk Management (MaRisk) into account. In fact, the limits as at the end of 2017 are even adhered to for a period of twelve months. Compared to the 2016 year end, utilisation levels have decreased in the normal case and stress case in virtually all maturity bands. This improvement is primarily attributable to the planned sale and already implemented winding down of loan and securities portfolios. Critical limit utilisation levels were not reported in either in the normal case or in the stress case liquidity development report in the course of the period under review.

The results of the market-specific and Bank-specific stress scenarios determined in addition to the stress case liquidity development report show that, as at December 2017, HSH Nordbank's liquidity requirement was covered by the liquidity potential over twelve months in all scenarios despite the worst-case assumptions. A minimum survival period of one month is thereby maintained in all scenarios. The results show that HSH Nordbank is prepared accordingly for the crisis scenarios assessed.

In the year under review, the LVaR as an expression of the liquidity maturity transformation risk decreased to € 46 million (31 December 2016: € 83 million). This decrease is attributable to a new relevant scenario, in which deposit volatilities have declined.

Regulatory liquidity ratios

The regulatory management parameter for liquidity risks is the liquidity ratio defined by the German Liquidity Regulation (LiqV). With values between 1.69 and 1.95, HSH Nordbank's liquidity ratio remained above the regulatory minimum value at all times throughout the reporting year. The average value for 2017 was 1.83 (previous year: 1.78), and the ratio was 1.79 as at the reporting date (31 December 2016: 1.92).

Under Basel III and the CRR Delegated Regulation (EU) 2015/61 the liquidity coverage ratio (LCR) was specified as an additional liquidity ratio to ensure liquidity in an acute stress phase of 30 days. When calculating the LCR the amount of highly liquid assets is compared to the net outflows over the next 30 days. The ratio is to be complied with from the entry into force of the Delegated Regulation (EU) 2015/61 on 1 October 2015, whereby the compliance rate increases from an initial 60 % to 100 % in 2018. Under the SREP requirements for 2018 a LCR ratio of 110 % is to be maintained at the sub-consolidated level. As at the reporting date, the LCR was 169 % (determined on an internal sub-consolidation basis) in the survey carried out under the Delegated Regulation (EU) 2015/61 (previous year: 172 %) and was therefore above the future minimum threshold.

The net stable funding ratio (NSFR), which must be adhered to from 2020 at the earliest, is calculated as the ratio of available funding resources across all maturities to the funding required and must also be at least 100 % after full implementation. As at 31 December 2017 the NSFR amounted to 114 % under the QIS (Basel framework) (previous year: 111 %).

Refinancing situation

The implementation of the funding strategy was successfully driven forward during the course of the financial year thereby improving the Bank's liquidity profile. The measures stepped up in the year to date to reduce risk positions, thereby releasing liquidity, had a positive impact. The liquidity position was also improved by the accelerated settlement of losses under the second loss guarantee. Besides the issuing activities, a stable level of deposits contributed to the refinancing of the business. However, there is no unrestricted access to the capital markets.

Future funding and HSH Nordbank's rating continue to be key challenges in the context of its privatisation. In the reporting year, HSH Nordbank accelerated the winding down of legacy portfolios, particularly in the US dollar area, to reduce the effect of changes in exchange rates on, inter alia, the Bank's liquidity. Further information on HSH Nordbank's refinancing situation is set out in the Earnings, net assets and financial position and Forecast, opportunities and risks report sections.

Reports on liquidity risk

The CRO and divisions concerned are informed daily of the change in insolvency risk in the normal case and stress case. In addition, the OBM committee and Overall Management Board receive a liquidity risk report at least every month. This includes, in addition to the analysis of insolvency risk and maturity transformation risk in the normal case and stress case, an analysis of other stress scenarios, of liquidity risk arising on US dollar positions and depositor concentration risk.

OPERATIONAL RISK

HSH Nordbank defines operational risk (OpRisk) as the risk of direct or indirect losses caused by the inappropriateness or failure of the internal infrastructure, internal procedures or staff or as a result of external factors (risk categories). This definition includes the risk of loss resulting from legal risk and compliance risk.

Operational risks are determined in accordance with the modified regulatory standardised approach for the purposes of managing the risk-bearing capacity. The corresponding economic capital required amounted to € 0.2 billion as at 31 December 2017 (31 December 2016: € 0.2 billion).

Organisation of operational risk management

The management of operational risk at HSH Nordbank is organised in a decentralised manner. The risks are identified and managed directly in the individual organisational units of the Bank. Accordingly, the division heads are responsible for the management of operational risk and the quality of such management in their respective areas of responsibility. The operational implementation is supported by OpRisk officers in the individual divisions.

The OpRisk Controlling department in the Group Risk Management division defines the basic principles of operational risk management applicable throughout the Bank and develops the central methods and instruments to be used in the identification, measurement, management and monitoring of operational risk.

As a Bank-wide steering committee for operational and other risks in the Group, the OpRisk Committee convenes every quarter and provides support to the Overall Management Board in the implementation of the OpRisk strategy under the chairmanship of the head of Group Risk Management. The objective of the interdisciplinary OpRisk Steering Committee is to promote dialogue between the persons involved at all hierarchy levels and to determine appropriate measures for reducing operational risk.

Operational risk management

The identification, analysis, evaluation and monitoring of operational risk and the promotion of a corresponding risk culture in the Group represents an important success factor for HSH Nordbank. Different procedures and instruments are used in this process.

Loss event database

Loss events arising from operational risk are consolidated into a central loss event database for HSH Nordbank and relevant subsidiaries. The loss events are recorded locally by the divisions affected and forwarded to OpRisk Controlling. The results of the analyses of actual loss events provide a starting point to eliminate existing weaknesses. The OpRisk Steering Committee is informed on a quarterly basis of loss events and measures taken. The Management Board is immediately informed of material operational risk events.

The loss event database includes all loss events with a gross loss of at least € 2,500 and all material near-loss events.

In the reporting year 53% (previous year: 38%) of the operational loss events reported were incurred in the employee risk category. This risk category includes, for example, processing errors or unauthorised actions. The proportion of operational loss events reported under the Internal processes risk category amounted to 15% (previous year: 26%). These include, for example, deficient or missing processes. The proportion of operational loss events reported under the External influences category (e.g. criminal acts, regulatory and statutory requirements) amounted to 28% (previous year: 35%). The proportion of loss events reported under the Internal infrastructure category (e.g. system failures, functionality or security) amounted to 4% (previous year: 1%).

HSH Nordbank participates in the exchange of operational loss event data as part of the operational risk data pool (DakOR). Thus, HSH Nordbank obtains a more comprehensive database for the evaluation of risk scenarios and external comparisons.

Risk inventory

HSH Nordbank performs a risk inventory for operational risk each year for the whole Group. Information about the risk situation of the divisions gained from this inventory supplements the reporting and serves the purpose of preventive management and monitoring of operational risk. The Bank takes the risk inventory based on defined scenarios, which take into account both actual and potential loss events.

Controlling of measures

Based on an analysis of the causes of significant loss events and the results of the risk inventory, suitable measures are established in order to avoid future losses as far as possible. The measures identified are to be appropriate under cost-benefit aspects. In doing this, the instruments of risk mitigation consist above all of a large number of organisational safeguarding and control measures which are also applied in the context of the internal control system. OpRisk Controlling monitors the actual implementation of the measures determined using the measures controlling procedures.

Risk indicators

Risk indicators are collected on a quarterly basis and incorporated in the OpRisk reporting. The indicators are selected based on the estimated risk situation and are periodically reviewed to ensure that they are up-to-date. The aim is to identify risks at an early stage and prevent their causes by the use of ongoing and comparative analysis of loss events and risk indicators.

In addition to the methods mentioned above, specific procedures and responsibilities have been instituted within HSH Nordbank for the operational risk elements listed below.

Management of personnel risks

Personnel risk refers to the risk of losses that may occur as a result of the unplanned departure of key personnel of HSH Nordbank, shortage of skilled staff or poor motivation of employees. This risk could materialise particularly in light of the current reduction in staff. The Human Resources division is therefore focusing increasingly on measures to reduce personnel risk. A large number of personnel management tools for employee retention are used to prevent the unscheduled departure of key personnel. In addition, succession planning is performed and regularly reviewed for relevant positions.

IT risk management

The IT division is responsible for IT risk management. In the IT strategy it has defined as the primary objective of IT risk management to identify IT risks at an early stage and assess them based on protection needs in order to avert or reduce particularly severe losses on the basis of clear responsibilities.

IT-specific risk tools are used by means of which risks are actively managed in projects and in the line functions and reduced by a monitored implementation of measures.

Business continuity management

HSH Nordbank is exposed to risks arising from unforeseeable events that may lead to an interruption of business operations and, as a result, losses and additional costs. Group Risk Management has established, with the involvement of the relevant divisions, processes to limit the risks arising from the fact that the information technology fails or service providers or employees are unavailable. The objective of the business continuity plans to be prepared and periodically reviewed by each division is to ensure the functional capability of critical business processes and activities, even in the event of an emergency.

Internal control system

Operational risk is closely linked to HSH Nordbank's internal control system (ICS). A major objective of the ICS is to optimise the internal bank processes in order to avoid losses that may arise as a result of, for example, processing errors. Detailed information on the ICS is set out in the Risk management system section.

Management of legal risk

Legal risks also fall under operational risk. Legal risks include economic risks arising as a result of non-compliance or incomplete compliance with regulations or with the framework defined by case law, in particular commercial law, tax law and company law. In case any of these risks materialise, this may lead to a greater financial burden than planned.

The Legal and Taxes divisions are responsible for managing these risks. In order to reduce, limit or prevent risk all divisions are given comprehensive legal advice by regularly trained staff and where appropriate by external consultants.

HSH Nordbank recognised provisions of € 98 million (previous year: € 34 million) for litigation risks as at the reporting date. In addition, there are contingent liabilities of € 32 million arising from legal disputes (previous year: € 32 million).

HSH Nordbank takes a number of factors into consideration to determine for which claim a loss is likely to be incurred and to estimate the possible payment obligation. This includes the type of claim and underlying facts, the status of the individual proceedings, (preliminary) decisions of courts and arbitration boards, experience of HSH Nordbank and third parties in similar cases (insofar as they are known to the Bank), previous settlement discussions as well as expert reports and assessments of internal and external legal advisers and other experts.

A major portion of the provisions for litigation risks relates to the legal proceedings mentioned below. The provision amounts are not disclosed individually in order not to influence the outcome of the respective proceedings. The current status of the proceedings and expected outcome of the proceedings are taken into account in recognising these amounts. Utilisation can differ from the amounts provided depending on the actual outcomes of the proceedings:

Since 2005, HSH Nordbank AG has been involved in legal proceedings with a Turkish shipping group and previously had to pay a total amount of US$ 54 million in the year 2013 due to decisions made by Turkish courts. The plaintiffs have asserted further claims under which damages are asserted based on loss of profit and third party liabilities in connection with measures taken to realise the Bank's collateral for a loan.

Furthermore, HSH Nordbank is being sued by a former borrower for payment of a total amount of € 197 million plus interest. The plaintiff is asserting various claims, particularly claims for payment of damages and claims for unjust enrichment in connection with measures taken by the Bank regarding a problem loan. Material aspects of the underlying facts of this legal action have already been the subject of several lawsuits in the past, in which the Bank has always succeeded before different courts with the exception of relatively small amounts.

Furthermore, claims in connection with different legal opinions on the interpretation of the contract regarding certain financial instruments on the liability side are also being asserted against the Bank in legal actions.

As a component of legal risk, tax risks mainly result from the fact that the binding interpretation of rules that can be interpreted in specific cases may only be known after several years due to the long period between tax audits. The tax audits have been finalised for the years 2003–2007 and appropriate provisions have been recognised on the balance sheet. The tax audits have not yet been finalised for the years starting from 2008.

HSH Nordbank recognised provisions and liabilities (including interest) totalling € 44 million (previous year: € 86 million) for tax risks as at the reporting date. A major portion of this relates to tax audit risks (in connection with internal cost allocations to foreign entities, structured transactions, reimbursement of value-added tax on inputs, and risks resulting from the tax treatment of investment income).

Management of compliance risk

Compliance risk arises as a result of non-compliance with legal regulations and requirements that may lead to sanctions being imposed by the legislator or supervisory authorities, financial losses or to a negative impact on the Bank's reputation.

The Compliance division is responsible for compliance risk management. Compliance with the different legal requirements is also ensured by the respective divisions concerned. Compliance monitors adherence to codes of conduct with respect to the topics of capital markets compliance, prevention of money laundering, terrorism financing and other criminal offences in accordance with Section 25h KWG as well as compliance with financial sanctions and embargoes. In addition, the division performs the compliance function as defined in AT 4.4.2 MaRisk and in this context strives to ensure that the essential legal regulations and standards are implemented at HSH Nordbank and complied with.

The Code of Conduct summarises the requirements of different legal sources and internal guidelines. It applies to all employees as well as the Management Board of HSH Nordbank AG and is a mandatory part of the Overall Bank's objectives. The specific code of conduct requirements of the Compliance division are set out in detail in internal instructions.

The Bank's staff is regularly trained in compliance-relevant topics. The objective of the training is to firmly anchor compliance as part of the corporate culture, to disseminate relevant standards and changes thereto, and to enable new staff to quickly become familiar with corporate practices and to ensure compliance with such legal requirements in this way.

The Bank receives notification of suspicious cases of misconduct via internal reporting channels and the so-called "whistle-blowing office", and forwards these to the responsible bodies. The whistle-blowing office is staffed by independent ombudsmen from BDO Deutsche Warentreuhand Aktiengesellschaft Wirtschaftsprüfungsgesellschaft and enables anonymous reporting of suspicious cases both by employees of the Bank and external third parties.

Reports on operational risk

The OpRisk Steering Committee receives a quarterly report regarding the development of the risk position, material loss events and management measures addressed. The Overall Management Board is informed once a year regarding the capital required, the loss event trend and material loss events and loss potential, as well as any measures required.

OTHER MATERIAL RISKS

Amongst other material risk types of HSH Nordbank are strategic risk and reputation risk.

Business strategy risk

Business strategy risk refers to the risk of financial damage being incurred due to long-term strategic decisions based on incorrect assumptions. Should HSH Nordbank not be successful in identifying changes in markets relevant for it on a timely basis, this could have a negative impact on its competitiveness. Changes to laws and regulations or new regulatory requirements for instance could also jeopardise the implementation of HSH Nordbank's business model.

This risk is managed via the regular review and updating of the business strategy by the Strategy & Management Board Office division and the closely related overall bank planning process established in the Bank. The responsibility for the strategy of HSH Nordbank rests with the Overall Management Board, while the Strategy & Management Board Office division is responsible for the process. An action-oriented management dialogue, including on the strategic business objectives, is conducted during the year in the business review meeting held on a monthly basis.

Reputation risk

Reputation risk is the risk of a direct or indirect loss caused by damage to the reputation of the company. Damage to reputation means a public loss of confidence in HSH Nordbank or a loss of esteem of the Bank from the viewpoint of individual stakeholder groups (e.g. capital markets, clients, shareholders, investors, the general public, employees).

Damage to reputation can be directly caused by the behaviour of internal staff, external stakeholders or by the social environment as a whole or indirectly in connection with another risk type. HSH Nordbank can suffer adverse consequences in both cases, for instance due to a loss of clients.

HSH Nordbank manages reputation risk particularly by means of preventive measures via the review of specific transactions, on the one hand, and via process-related rules, on the other, in order to prevent the occurrence of reputational damage if possible. The reputation risk strategy that is adopted every year defines the bank-wide principles for managing reputation risk as a supplement to the existing regulations and instructions, such as the Code of Conduct.

SUMMARY OF RISK ASSESSMENT AND OUTLOOK

The 2017 financial year was characterised by the continuing winding down of high-risk, non-strategic lending and capital markets transactions held in the Non-Core Bank's portfolios as well as by the progress made in implementing the business model as the key strategic steps on the path to a successful change in owners. In addition to various transactions and activities entered into during the course of the 2017 financial year to wind down the portfolio, HSH Nordbank AG at the same time entered into, upon the successful conclusion of the share purchase agreement, an agreement regarding the sale of a predominantly impaired loan portfolio (consisting mainly of large ship financing amounts) to an acquisition vehicle of the investor group. This transaction serves, inter alia, to sustainably strengthen the regulatory capital ratios, improve the Bank's external ratings by increasing the asset quality and reduce the stress sensitivity.

The risk-bearing capacity of HSH Nordbank was maintained at all times during the year under review with a maximum utilisation of the risk coverage potential of 36%. The guarantee facility and ongoing winding down of risk positions made a positive contribution in this regard.

Based on the restructuring progress made in the past financial year together with the overall satisfactory operating performance, the Bank expects to be able to drive forward the initiated transformation process in line with the plan in the 2018 financial year. The privatisation process can be brought to a successful conclusion by fulfilling the closing conditions. Operating measures aimed at realigning a future risk-optimised and agile corporate structure are to be defined for this and implemented as quickly as possible. The Bank's realignment activities are combined in a bank-wide transformation project. The key focuses of the project include the development of profitable and risk-oriented growth strategies and associated implementation projects. The Bank's operating business model will be realigned in this connection.

The accompanying aim is to reduce the complexity in processes and products, enabling an organisational structure freed of legacy assets and the guarantee structure.

Within this transformation process a highly effective and efficient CRO division aligned to the future strategy and targets must be developed based on the risk organisation and the Bank must be further stabilised. This is accomplished in particular by being able to ensure the risk-bearing capacity and an adequate capital and liquidity base at all times.

For information on further key challenges regarding the realignment and risks associated with maintaining appropriate capital and liquidity resources, we refer to the statements made in the Forecast, opportunities and risks report.

The implementation of the new supervisory requirements will be a further focus of our activities in 2018. For example, extensive requirements of the EBA/ECB resulting from the "Supervisory Review and Evaluation Process" (SREP) and expected update of the “SSM Guides on ICAAP and ILAAP”, which are still in the consultation phase, have to be met.

The risk and bank management systems described in this report are aligned to take account of risk on a systematic basis. This also applies to our expectations regarding future market and business developments. We believe that we have appropriately presented the overall risk profile of HSH Nordbank Group as well as the opportunities and risks inherent in the future development of our business activities in the Forecast, opportunities and risks report section and in this Risk report in an appropriate and comprehensive manner.

Hamburg/Kiel, 17 April 2018

Stefan Ermisch Oliver Gatzke

Ulrik Lackschewitz Torsten Temp

GROUP FINANC

CIAL STATEMENTS

GROUP STATEMENT OF INCOME
FOR THE PERIOD 1 JANUARY TO 31 DECEMBER 2017

(€ m)	Note	**2017**	2016	Change in %
Interest income		3,086	3,466	– 11
Negative interest on cash investments and derivatives		– 305	– 191	60
Interest expenses		– 2,202	– 2,733	– 19
Positive interest on borrowings and derivatives		296	183	62
Net loss from hybrid financial instruments		304	– 118	> 100
Net interest income	(8)	**1,179**	**607**	**94**
Net commission income	(9)	65	87	– 25
Result from hedging	(10)	– 18	– 4	> – 100
Net trading income	(11)	254	88	> 100
Net income from financial investments	(12)	90	140	– 36
Net income from financial investments accounted for under the equity method	(13)	2	3	– 33
Total income		**1,572**	**921**	**71**
Loan loss provisions in the lending business	(14)	– 2,086	631	> – 100
Hedging effect of credit derivative under the second loss guarantee	(3)	810	– 475	> 100
Administrative expenses	(15)	– 515	– 634	– 19
Other operating income	(16)	22	58	– 62
Expenses for bank levy and deposit guarantee fund	(17)	– 41	– 56	– 27
Net income before restructuring and privatisation		**– 238**	**445**	**> – 100**
Net income from restructuring and privatisation	(18)	– 66	– 110	40
Expenses for government guarantees	(19)	– 149	– 214	– 30
Net income before taxes		**– 453**	**121**	**> – 100**
Income tax expense	(20)	– 75	– 52	44
Group net result		**– 528**	**69**	**> – 100**
Group net result attributable to non-controlling interests		7	2	> 100
Group net result attributable to HSH Nordbank shareholders		– 535	67	> – 100

EARNINGS PER SHARE

(€)	Note	**2017**	2016
Undiluted	(22)	– 1.77	0.22
Diluted	(22)	– 177	0.22
Number of shares (millions)		**302**	**302**

GROUP STATEMENT OF COMPREHENSIVE INCOME
FOR THE PERIOD 1 JANUARY TO 31 DECEMBER 2017

RECONCILIATION WITH TOTAL COMPREHENSIVE INCOME/LOSS

(€ m)	**2017**	2016
Group net result	**-528**	**69**
Income and expense that have been reclassified to the statement of income or may be reclassified at a later date		
Changes in fair value of AfS financial instruments		
Unrealised gains and losses (before taxes)	-26	67
Gains and losses (before taxes) reclassified to the statement of income	1	-36
of which from exchange rate effects	-17	–
Income taxes recognised	7	-7
	-18	**24**
Differences resulting from currency translation	-57	18
	-57	**18**
Subtotal	**-75**	**42**
Income and expenses that will not be reclassified to the statement of income at a later date		
Credit risk-induced changes in the value of liabilities designated at fair value (before taxes)	-3	–
Income taxes recognised	1	–
	-2	–
Changes resulting from the revaluation of net defined benefit liabilities (before taxes)	46	-88
Income taxes recognised	-18	28
	28	**-60**
Subtotal	**26**	**-60**
Other comprehensive income for the period	**-49**	**-18**
Total comprehensive income	**-577**	**51**
Total comprehensive income attributable to non-controlling interests	8	2
Total comprehensive income attributable to HSH Nordbank shareholders	-585	49

GROUP STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2017

ASSETS

(€ m)	Note	**2017**	2016	Change in %
Cash reserve	(23)	6,625	3,491	90
Loans and advances to banks	(24)	3,838	4,192	– 8
Loans and advances to customers	(25)	39,174	50,910	– 23
Loan loss provisions	(26)	687	1,142	– 40
Credit derivative under the second loss guarantee	(3)	1,014	199	> 100
Positive fair value of hedging derivatives	(27)	264	508	– 48
Positive adjustment item from portfolio fair value hedges		255	403	– 37
Trading assets	(28)	3,641	5,433	– 33
Financial investments	(29)	13,647	15,493	– 12
Financial investments accounted for under the equity method	(30)	–	13	– 100
Intangible assets	(31)	10	14	– 29
Property, plant and equipment	(32)	232	236	– 2
Investment property	(32)	13	12	8
Non-current assets held for sale and disposal groups	(33)	139	1,382	– 90
Current tax assets	(34)	46	65	– 29
Deferred tax assets	(35)	723	767	– 6
Other assets	(36)	74	105	– 30
Total assets		**70,382**	**84,365**	**– 17**

LIABILITIES

(€ m)	Note	2017	2016	Change in %
Liabilities to banks	(37)	8,271	9,501	– 13
Liabilities to customers	(38)	36,205	40,172	– 10
Securitised liabilities	(39)	12,444	16,624	– 25
Negative fair values of hedging derivatives	(40)	163	290	– 44
Negative adjustment item from portfolio fair value hedges		553	786	– 30
Trading liabilities	(41)	3,875	5,981	– 35
Provisions	(42)	1,438	1,521	– 5
Liabilities relating to disposal groups	(44)	47	65	– 28
Current tax liabilities	(45)	103	87	18
Deferred tax liabilities	(46)	–	7	– 100
Other liabilities	(47)	658	845	– 22
Subordinated capital	(48)	2,252	3,536	– 36
Equity	(49)	4,373	4,950	– 12
Share capital		3,018	3,018	–
Capital reserve		75	75	–
Retained earnings		1,701	1,617	5
Revaluation reserve		117	127	– 8
Currency conversion reserve		2	60	– 97
Group net result		– 535	67	>– 100
Total before non-controlling interests		4,378	4,964	– 12
Non-controlling interests		– 5	– 14	– 64
Total equity and liabilities		**70,382**	**84,365**	**– 17**

GROUP STATEMENT OF CHANGES IN EQUITY

(€ m)	Note	Share capital	Capital reserve
As at 1 January 2016		**3,018**	**175**
Group net result		–	–
Changes resulting from the revaluation of net defined benefit liabilities		–	–
Changes in fair value of AfS financial instruments		–	–
Exchange rate changes			
thereof resulting from currency translation		–	–
thereof resulting from changes in scope of consolidation		–	–
Other comprehensive income		–	–
Comprehensive income as at 31 December 2016		**–**	**–**
Compensation for the Group net loss for the previous year		–	– 100
Changes in the scope of consolidation		–	–
As at 31 December 2016		**3,018**	**75**
As at 1 January 2017		**3,018**	**75**
Change due to early application of IFRS 9.5.7.7 in conjunction with IAS 1.7 (f)		–	–
Adjusted amount as at 1 January 2017		**3,018**	**75**
Group net result		–	–
Changes resulting from the revaluation of net defined benefit liabilities		–	–
Changes in fair value of AfS financial instruments		–	–
Credit risk-induced changes in the value of liabilities designated at fair value[1]		–	–
Exchange rate changes			
thereof resulting from currency translation		–	–
thereof resulting from changes in scope of consolidation		–	–
Other comprehensive income		–	–
Comprehensive income as at 31 December 2017		**–**	**–**
Addition of the Group retained earnings for the previous year		–	–
Reclassifications		–	–
As at 31 December 2017	(49)	**3,018**	**75**

[1] The reclassification of the credit risk-induced changes in the value of liabilities designated at fair value to retained earnings is due to the repurchase of issues/promissory note loans.

Retained earnings	Currency conversion reserve	Revaluation reserve	Group net result	Total before non-controllinginterests	Non-controllinginterests	**Total**
1,464	**42**	**103**	**99**	**4,901**	**– 16**	**4,885**
–	–	–	67	67	2	69
– 60	–	–	–	– 60	–	– 60
–	–	24	–	24	–	24
–	17	–	–	17	–	17
–	1	–	–	1	–	1
– 60	18	24	–	– 18	–	– 18
– 60	**18**	**24**	**67**	**49**	**2**	**51**
199	–	–	– 99	–	–	–
14	–	–	–	14	–	14
1,617	**60**	**127**	**67**	**4,964**	**– 14**	**4,950**
1,617	**60**	**127**	**67**	**4,964**	**– 14**	**4,950**
– 9	–	9	–	–	–	–
1,608	**60**	**136**	**67**	**4,964**	**– 14**	**4,950**
–	–	–	– 535	– 535	7	– 528
28	–	–	–	28	–	28
–	–	– 18	–	– 18	–	– 18
– 1	–	– 1	–	– 2	–	– 2
–	– 54	–	–	– 54	1	– 53
–	– 4	–	–	– 4	–	– 4
27	– 58	– 19	–	– 50	1	– 49
27	**– 58**	**– 19**	**– 535**	**– 585**	**8**	**– 577**
67	–	–	– 67	–	–	–
– 1	–	–	–	– 1	1	–
1,701	**2**	**117**	**– 535**	**4,378**	**– 5**	**4,373**

GROUP CASH FLOW STATEMENT

CASH FLOW STATEMENT

(€ m)	2017		2016	
Net result for the period		–528		69
Reconciliation with cash flow from operating activities				
Depreciation, impairments and write-ups on loans and advances, property, plant and equipment, financial investments, intangible assets and investment property		1,517		1,656
a) Loans and advances to customers and banks	1,456	–	1,586	–
b) Financial investments	19	–	–30	–
c) Property, plant and equipment/intangible assets/investment property	42	–	100	–
Changes in provisions		1		164
Other non-cash expenses/income		–1,036		–2,308
Profit/loss from disposal of financial investments and property, plant and equipment/investment property		–125		–153
a) Financial investments	–124		–152	
b) Property, plant and equipment/investment property	–1	–	–1	–
Other adjustments		–1,126		–562
Subtotal		**–1,297**		**–1,134**
Changes in loans and advances		10,108		7,973
a) to banks	349	–	1,385	–
b) to customers	9,759	–	6,588	–
Changes in trading assets		2,184		2,630
Changes in other assets from continuing operations		1,954		1,631
Changes in liabilities		–5,204		–9,265
a) to banks	–1,229	–	–4,889	–
b) to customers	–3,975	–	–4,376	–
Changes in securitised liabilities		–3,979		–2,020
Changes in trading liabilities		–2,285		–1,148
Changes in other liabilities from continuing operations		–302		–302
Interest and dividends received		2,946		3,212
Interest paid		–2,143		–2,733
Income tax payments		15		–104
Cash flow from operating activities		**1,997**		**–1,260**
Receipts from disposals of		4,226		2,483
a) securities	3,667	–	2,430	–
b) interests in affiliated companies and equity holdings	78	–	10	–
c) property, plant and equipment	481	–	43	–
Purchases of		–2,133		–1,126
a) securities	–2,111	–	–1,059	–
b) interests in affiliated companies and equity holdings	–16	–	–22	–
c) property, plant and equipment	–6	–	–45	–
Change resulting from sale/purchase of consolidated subsidiaries	**–**	**75**	**–**	**–**
Cash flow from investing activities		**2,168**		**1,357**

CASH FLOW STATEMENT

(€ m)	2017	2016
Payments made (–) from subordinated capital	– 1,031	–
Cash flow from financing activities	**– 1,031**	**–**
Cash and cash equivalents at the beginning of the period	**3,491**	**3,394**
Cash flow from operating activities	1,997	– 1,260
Cash flow from investing activities	2,168	1,357
Cash flow from financing activities	– 1,031	–
Cash and cash equivalents at the end of the period	**6,625**	**3,491**

Cash and cash equivalents are equivalent to the Cash reserve item in the statement of financial position and comprise cash on hand, balances at central banks, treasury bills, discounted treasury notes and similar debt instruments issued by public-sector bodies and bills of exchange.

The cash flow from operating activities is calculated using the indirect method, whereby the Group net income/loss for the year is adjusted for non-cash expenses (increased) and non-cash income (reduced) and for cash changes in assets and liabilities used in operating activities.

The following cash flows resulted from the obtaining or loss of control over subsidiaries during the financial year:

CASH FLOW

(€ m)	Obtaining control	Loss of control
Amounts paid/received	–	74
of which cash and cash equivalents	–	74
Amount of cash and cash equivalents	1	–

Assets and liabilities of subsidiaries, over which control was obtained or lost during the financial year, comprise the following:

ASSETS

(€ m)	Obtaining control	Loss of control
Non-current assets held for sale and disposal groups	480	77
Other assets	4	–

LIABILITIES

(€ m)	Obtaining control	Loss of control
Liabilities to customers	30	–
Liabilities relating to disposal groups	–	1
Other liabilities	2	–

The table below shows a reconciliation of balance sheet values to cash flow from financing activities.

(€ m)	Other subordinated capital	Hidden contributions	Profit-sharing rights
Balance sheet value as at 1 January 2017	**2,110**	**1,412**	**14**
Cash changes			–
Payments made	– 1,017	–	– 14
Other changes – interest paid	– 13	–	–
Non-cash changes	–	–	–
Changes due to exchange rate fluctuations	–	– 45	–
Change in fair value	– 19	– 175	–
Other changes	– 1	–	–
Balance sheet value as at 31 December 2017	**1,060**	**1,192**	**-**

GROUP EXPLANATORY NOTES

GENERAL INFORMATION

1. ACCOUNTING PRINCIPLES

HSH Beteiligungs Management GmbH, Hamburg, is the parent company and, at the same time, the top-level parent company of HSH Nordbank AG, which prepares Group financial statements.

HSH Nordbank AG has issued debt instruments as defined in Section 2 (1) sentence 1 of the German Securities Trading Act (WpHG) on an organised market as defined in Section 2 (11) WpHG and is thus obliged, as a publicly traded company as defined in Regulation (EC) 1606/2002 (IAS Regulation) of the European Parliament and of the Council of 19 July 2002 in conjunction with Section 315e (1) of the German Commercial Code (HGB) to draw up its Group financial statements in accordance with the International Financial Reporting Standards. International accounting standards, hereinafter IFRS or standards, refer to the International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS) and the associated interpretations by the Standing Interpretations Committee (SIC) and the International Financial Reporting Interpretations Committee (IFRIC), published by the International Accounting Standards Board (IASB) and adopted under the IAS Regulation as part of the EU endorsement.

The supplementary provisions of Section 315e HGB are taken into account and are shown individually in Notes 65 and 68.

The Group financial statements are prepared in accordance with IFRS as published by the IASB and adopted as European law by the European Union (EU).

The Group financial statements of HSH Nordbank are prepared in line with IFRS 10 according to uniform Group-wide measurement and accounting policies. In accordance with IAS 1, the Group financial statements consist of the statement of income, the statement of comprehensive income, the statement of financial position, the statement of changes in equity, the cash flow statement and the explanatory notes, including segment reporting. In addition to the Group financial statements a Group management report in accordance with Section 315 HGB was prepared.

Group income and expenses are accrued on a pro rata temporis basis. They are recognised and disclosed in the period to which they must be assigned economically. Accounting for assets, liabilities, income and expenses takes place on a consistent basis. Deviations are only made in justified exceptional cases which are explained separately in the Notes on the relevant items in the HSH Nordbank Group financial statements.

Unless explicitly stated otherwise, all amounts are in millions of euros (€ m).

The reporting year corresponds to the 2017 calendar year.

IFRS 7.31 et seqq. contains rules on presenting risks arising from financial instruments. IFRS 7.B6 allows for the possibility of disclosing risk in a suitable medium separate from the Group financial statements. Availing itself of this option, HSH Nordbank has published disclosures about financial instruments as permitted by IFRS 7.31 et seqq. predominantly in the Group risk report within the Group management report. Specifically, this relates to the overall qualitative and quantitative risk information disclosed under IFRS 7.33 et seqq. and the total market risk reporting under IFRS 7.40–42 as well as the description of how liquidity risk is managed as required by IFRS 7.39 (c).

In addition, as part of the supplementary German commercial regulations the Group observed the following German Accounting Standards (GAS) in preparing these Group financial statements and this Group management report:

- GAS 20 Group Management Report
- GAS 17 Reporting on the Remuneration of Members of Governing Bodies.

Apart from the new standards and interpretations stated below, which may have a significant influence on the Group financial statements, a number of additional standards and interpretations were adopted which, however, are expected not to have any influence on the Group financial statements.

During the current financial year, the following accounting standards need to be applied for the first time as a matter of principle:

Amendments to IAS 7 – Disclosure Initiative

The amendment improves the information on changes in the company's debt. The company provides information on the changes in those financial liabilities whose inflows and outflows are shown under cash flow from financing activities in the cash flow statement. Corresponding financial assets are also included in the disclosures (e.g. assets from hedging transactions).

Information is provided on cash changes, changes arising from the acquisition or disposal of companies, changes relating to foreign exchange rates, changes in fair values and other changes.

The information is provided in the form of a reconciliation between the opening and closing balances in the statement of financial position.

Amendments to IAS 12 – Recognition of Deferred Tax Assets for Unrealised Losses

The amendments clarify the recognition of deferred tax assets for unrealised losses that are related to debt instruments measured at fair value.

Improvements to IFRS 2014–2016

The Annual Improvements to IFRS (2014–2016) amended three IFRSs, of which only the following amendment was to be applied during 2017:

In IFRS 12, the amendments clarify the scope of the standard by specifying that the disclosure requirements in IFRS 12, except for those in IFRS 12.B10-B16 (financial information), also apply to an entity's interests in subsidiaries, joint ventures or associates that are classified as held for sale in accordance with IFRS 5.

The above-mentioned Standards, which are to be applied for the first time in the current financial year, do not materially affect the Group financial statements of HSH Nordbank.

HSH Nordbank is not planning the early application of the following new or amended Standards or Interpretations for which application is only mandatory in later financial years, with the exception of the disclosure requirements under IFRS 9 for financial liabilities designated for measurement at fair value through profit or loss. To the extent not indicated otherwise, all effects on the financial statements of HSH Nordbank are currently under review.

Already endorsed by the EU:

IFRS 9 – Financial Instruments

The final version of IFRS 9, published in July 2014, replaces the existing guidelines contained in IAS 39 on the recognition and measurement of financial instruments with regard to classification and measurement, impairments and hedge accounting.

IFRS 9 is to be applied for the first time, as a mandatory requirement, in financial years beginning on or after 1 January 2018. Early application is permitted. HSH Nordbank will be applying IFRS 9 as of 1 January 2018. IFRS 9 permits the isolated early application of the financial liabilities designated for measurement at fair value through profit or loss before the date of mandatory initial application of the Standard. HSH Nordbank has made use of this option and, since 1 January 2017, has been reporting the credit risk-induced fair value changes in its own liabilities for which the fair value option was exercised (see Note 7), in Other comprehensive income (OCI), i.e. not through profit or loss. Application was retrospective within the framework of the categorisation provisions set out in the valid IAS 39. As a result of the early application of the recognition provision as per 1 January 2017, the effect from the credit risk-induced valuation of the Bank's own liabilities, which was recognised in the income statement in the past, in the amount of € 13 million before taxes, or € 9 million after taxes (in cumulative terms from the previous years in retained earnings) was reclassified from retained earnings to the revaluation reserve (thereof credit risk-induced changes in the value of liabilities designated at fair value) within equity. This means that, as of 1 January 2017, credit risk-induced valuation effects are no longer recognised in the income statement, but rather in other comprehensive income, i.e. not through profit or loss; accumulated contributions to earnings recognised in other comprehensive income will be recognised in equity in the revaluation reserve (thereof credit risk-induced changes in the value of liabilities designated at fair value). The valuation results from the Bank's own credit risk recognised in equity via the other comprehensive income will not be recognised through profit or loss via the income statement at any time, i.e. not even upon repayment or repurchase. In the 2017 reporting year, a credit risk-induced change in value in the amount of € –3 million (before taxes, €–2 million after taxes) was recognised in other comprehensive income.

The changes resulting from IFRS 9 are generally to be applied retrospectively - with the exception of the new hedge accounting requirements. HSH Nordbank will, however, be making use of the option of not adjusting the prior-period figures. In addition, and by way of derogation from the principle of retrospective application, the following classification requirements are to be assessed based on the circumstances at the time of initial application on 1 January 2018:

- the determination of the business model in which the financial asset is held,
- the designation/revocation of the fair value designation of financial assets and liabilities.

The new regulations set out in IFRS 9 will result in valuation effects to be recognised in equity in the opening balance sheet in retained earnings/the revaluation reserve at the time of initial application. HSH Nordbank estimates that, at the time of initial application on 1 January 2018, IFRS 9 will result in an increase in equity of approx. € 109 million before taxes and € 79 million after taxes. The actual effect, based on the first interim financial statements including the time of initial application, is still subject to uncertainty, first of all because definitive verifications of certain parameters and models (e.g. PD and LGD) used in the calculation of loan loss provisions and fair value are still outstanding. Second, the process associated with the quality assurance of the opening balance sheet data that has been prepared has not yet been completed in full. HSH Nordbank estimates that, on the basis of the remaining uncertainties, the above value of the change in equity may yet fluctuate around € +/– 10 million before tax.

The main drivers of the estimated initial application effect include the increase in general loan loss provisions due to the new loan loss provision model (levels 1 and 2 in the new loan loss provisions model) and effects from the fair value measurement of certain loans and securities resulting from the new classification provisions.

The increase in general loan loss provisions is attributable to the increase in loan loss provisions on the lifetime expected loss (level 2) or the full 12-month expected loss (level 1), respectively. HSH Nordbank estimates that the increase in general loan loss provisions will reduce equity in an amount ranging from approx. € 136 million to € 156 million before taxes.

Concerning the above effects of the fair value measurement of certain loans and securities, the reclassification of financial assets from the amortised cost (AC) measurement category to the fair value through other comprehensive income (FVOCI) category is a main driver. These financial assets relate to promissory note loans and securities based on the "Hold and sell" business model under IFRS 9. This recategorisation results in an increase in equity of approx. € 165 million before taxes. Another main driver of the fair value effect relates to reclassifications of financial assets from the amortised cost (AC) measurement category to the fair value through profit & loss (FVPL) category. This relates, in particular, to a portfolio in the lending business of the Non-Core Bank that is allocated to the "Other" business model within the meaning of IFRS 9 and whose sale was agreed on 28 February 2018. For details, reference is made to the information set out in Note 2 Events after the reporting date. The reclassification of this portfolio increases equity at the time of initial application in the amount of € 61 million before taxes (net after the reversal of loan loss provisions).

The effects of the initial application of IFRS 9 also have an impact on regulatory figures. HSH Nordbank estimates that, at the time of initial application on 1 January 2018, IFRS 9 will result in an improvement in the core Tier 1 capital ratio (in-period CET1 ratio) of between approx. 1.0 and 1.2 percentage points. In the context of the analysis of the pro forma CET1 ratio, HSH Nordbank expects to see an effect within a range of +/– 0.1 percentage points. "Pro forma CET1 ratio" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements. Further information on the impact of IFRS 9 on the future capital ratios can be found in the Group management report in the section entitled "Forecast, opportunities and risks report".

In connection with the introduction of IFRS 9, the new CRR Article 473a came into force with effect from 1 January 2018 via EU Regulation 2017/2395 of 12 December 2017. This Article introduces the option allowing certain initial application effects to be distributed over a transitional period of 5 years. HSH Nordbank AG will opt not to apply the transitional provisions pursuant to Article 473a CRR until further notice.The following sections compare the main changes resulting from the application of IFRS 9 compared with IAS 39. In addition, information is provided on significant specific effects for the Bank and the use of options.

A) Classification and measurement

IFRS 9 introduces a new categorisation model for financial assets. They are classified into measurement categories on the basis of the business model (portfolio level) or the contractual terms or cash flow characteristics (instrument level). A distinction is made between the amortised cost (AC), fair value through other comprehensive income (FVOCI, measurement at fair value directly in equity) and fair value through profit or loss (FVPL, measurement at fair value through profit or loss) measurement categories.

IFRS 9 makes a distinction between three business models:

- "Hold to collect": In this business model, the aim is to hold the financial assets in the portfolio in order to collect contractual cash flows from them. The financial assets are classified as AC as long as the contractual cash flow characteristics criterion (for information on the contractual cash flow characteristics criterion, please refer to the section below) is met.
- "Hold and sell": The aim of this business model is achieved both by collecting the contractual cash flows and by selling the financial assets. The financial assets are classified as FVOCI as long as the contractual cash flow characteristics criterion is met.
- Other: Other business models that cannot be allocated to the two other business models. This category also includes portfolios that are held for trading or portfolios in which the cash flows are to be generated by selling the financial assets. The financial assets are then classified as FVPL.

The contractual cash flow characteristics criterion under IFRS 9 is considered to be met if the contractual terms only provide for payments on specified dates that are solely payments of principal and interest on the principal amount outstanding (basic lending arrangement). If a financial asset does not meet the contractual cash flow characteristics criterion, then it must be measured at FVPL irrespective of the business model.

In derogation from the principles described above, the following options apply:

- Upon the initial recognition of an equity instrument that falls under the scope of IFRS 9 and is not held for trading, there is the option of measuring the instrument at FVOCI (FVOCI option).
- Financial assets can be designated for measurement at FVPL to eliminate or significantly reduce a measurement or recognition inconsistency (accounting mismatch) (FVPL option).

The new IFRS 9 categorisation model will result in different valuation categories compared with IAS 39 for certain portfolios/individual transactions involving financial assets within HSH Nordbank's portfolio. This will expand the scope of instruments to be valued at FVPL/FVOCI.

The business model condition results in the following material effects at the time of initial application:

Within the securities portfolio (capital markets business incl. promissory note loans), a large part of the portfolio that is not held for trading and is allocated to the LaR category under IAS 39 (AC valuation category) has been reclassified to the FVOCI category under IFRS 9, as the business model is a "Hold and sell" business model. This affects a portfolio with a carrying amount of approx. € 1,548 million as at 31 December 2017.

The "Hold to collect" business model generally applies to the Core Bank's loan portfolio (lending business). No receivables sales are planned as a general rule. An exception applies to syndication shares from new business syndication, which are allocated to a separate portfolio (see below). As an exception, sales not planned ex ante can be consistent with the "Hold to collect" business model. IFRS 9 cites sales resulting from an increase in the loan default risk associated with an asset as an example. In order to operationalise the definition of an increased loan default risk, HSH Nordbank has defined both an absolute threshold value (rating threshold based on credit standards) and a relative threshold value (level allocation 2 pursuant to loan loss provision model). As an exception, sales are still consistent with the "Hold to collect" business model under IFRS 9 if they are implemented shortly prior to the final maturity of the financial asset and if the proceeds from the sale correspond roughly to the outstanding contractual cash flows. HSH Nordbank defines "shortly prior to final maturity" as follows:

– residual maturity of less than 90 days or
– residual maturity of greater than or equal to 90 days and less than or equal to 10 % of the overall term of the financial asset and proceeds from the sale correspond roughly to the contractual cash flows that are still outstanding.

Sales for other reasons can also be consistent with the "Hold to collect" business model if they are executed infrequently/erratically or are of an insignificant value either individually or in the aggregate, even if they occur frequently/regularly. In order to monitor the abovementioned restrictions in the "Hold to collect" business model, HSH Nordbank has defined a process which assesses and monitors the reasons for the sales in connection with the application for the receivables sale, meaning that receivables sales (that are unplanned ex ante) that are not covered by the exceptions do not exceed certain materiality thresholds or are to be classed as infrequent/erratic.

The materiality thresholds relate both to a balance sheet assessment based on the carrying amount, and to an income statement-based assessment based on the loss/gain on disposal (individually and in the aggregate). For the purposes of the balance sheet assessment, the gross carrying amounts of the sold financial assets are expressed in relation to the gross carrying amount of the portfolio at the start of the period, both individually and in the aggregate. For the purposes of the income statement-based assessment, the absolute loss/gain on the disposal of the sold financial assets are expressed in relation to the gross interest income of the portfolio during the period, both individually and in the aggregate. If the average term of a portfolio lies outside of a range, then this is reflected accordingly in special materiality thresholds that take the special average term into account accordingly.

The allocation of the Core Bank's lending business to the "Hold to collect" business model results in measurement at AC in the same way as under IAS 39 – if the financial instrument also meets the contractual cash flow characteristics criterion.

By way of derogation from the principle of the "Hold to collect" classification of the loan portfolio (lending business) of the Core Bank, syndication shares from new business syndication are allocated to a separate portfolio that is to be measured at FVPL.

The Non-Core Bank's lending business is split into two portfolios: one portfolio that is allocated to the "Hold to collect" business model and another portfolio that is allocated to the "Other" business model. The "Hold to collect" portfolio bundles the business that is not to be wound down by way of receivables sales/syndication. The run-down of the "Hold to collect" portfolio is to be achieved using measures that are not harmful to the "Hold to collect" business model, e.g. "letting loan exposures expire", restructuring, realisation of collateral to repay the loan. The Other portfolio bundles the transactions that the Bank also plans to wind down. The run-down for this business is to be implemented using receivables sales (individual and portfolio sales) or syndication. This portfolio particularly relates to the disposal of a credit portfolio signed on 28 February 2018. This is referred to in detail in the commentary in Note 2 Events after the balance sheet date.

As the "Other" portfolio has the "Other" business model, the loan portfolio in question is to be reclassified, at the time of initial application, from the IAS 39 category LaR (AC measurement category) to the IFRS 9 category FVPL. This affects a portfolio with a carrying amount of approx. € 5,923 million as at 31 December 2017.

The contractual cash flow characteristics criterion results in the following material effects at the time of initial application of IFRS 9:

The vast majority of the securities portfolio (capital market business incl. promissory note loans) meets the criterion relating to the cash flow condition. At the time of initial application, there are structured holdings that are not allocated to the "Other" business model, that do not meet the contractual cash flow characteristics criterion and that are reclassified from the IAS 39 category LaR (AC measurement category) to the IFRS 9 category FVPL with a carrying amount of approx. € 18 million as at 31 December 2017.

As far as the loan portfolio (lending business) is concerned, the overwhelming majority of the instruments are to be classed as basic lending arrangements within the meaning of IFRS 9, i.e. the contractual terms of these transactions satisfy the cash flow condition. In addition, there are loans that breach the contractual cash flow characteristics criterion. The breach of the contractual cash flow characteristics criterion is due to certain detrimental side agreements (e.g. profit participation agreed in the loan agreement) or non-recourse financing. This non-recourse financing involves a substantial property or project risk on the commitment date, i.e. a primary investment risk (asset risk) that constitutes a business risk, meaning that the payments depend, in economic terms, to a considerable degree on the property or project being financed. By way of example, the non-recourse financing of a single-property company is deemed to carry a substantial property risk if, at the time of initial recognition, the loan amount is very high in relation to the value of the property (high loan-to-value ratio), the property company only has limited capital resources available for potential loss absorption and, in addition, there are no mitigating factors such as recoverable third-party collateral in favour of the lender.

As at 31 December 2017, there is a loan portfolio with a carrying amount of approx. € 328 million which is not allocated to the "Other" business model at the time of initial application, but is to be reclassified from the IAS 39 category LaR (AC measurement category) to the IFRS 9 category FVPL because the contractual cash flow characteristics criterion is not met.

For financial assets with a carrying amount of approx. € 1,052 million which are designated for measurement at FVPL under IAS 39 to avoid an accounting mismatch, the FVPL option under IFRS 9 is not exercised despite the criteria being met (revocation of the FVPL option). These assets are allocated to the "Hold and sell" business model under IFRS 9, meaning that they are categorised as FVOCI. At the time of initial application of IFRS 9, this results in a one-off transfer within equity from retained earnings to the revaluation reserve in the amount of € 291 million.

At the time of initial application, HSH Nordbank will not be making use of the option relating to the FVOCI categorisation of equity instruments (FVOCI option) within the scope of IFRS 9.

The provisions governing the classification and measurement of financial liabilities remain largely unchanged compared with IAS 39. There are, however, changes to disclosures for financial liabilities designated at fair value. As far as these liabilities are concerned, fair value changes resulting from the Bank's own credit risk are no longer to be disclosed through profit or loss in the income statement, but rather directly in equity in Other comprehensive income (OCI) as a general rule (cf. also the comments made on the early isolated application of this recognition provision at the beginning of this section and the impact in the statement of comprehensive income and statement of changes in equity).

Under IFRS 9, the separation rules for embedded derivatives will only apply for host contracts that are financial liabilities or not of a financial nature.

B) Impairment

The introduction of IFRS 9 will replace the current model used to calculate loan loss provisions or impairments under IAS 39, which is based on incurred losses, with a model based on the expected credit losses. The scope of the new model consistently includes all financial instruments that are recognised at amortised cost or at fair value through other comprehensive income, irrevocable loan commitments and financial guarantees that are not recognised at fair value through profit or loss, leasing receivables and contract assets.

The calculation of loan loss provisions under the new impairment model will involve making a distinction between three provisioning levels. Allocation to a provisioning level is based on whether the loan default risk associated with a financial instrument has increased significantly since it was first added to the portfolio (level 2) and/or whether the financial instrument has an impaired credit rating, i.e. is credit-impaired (level 3). At the time of initial recognition of a financial instrument, all financial instruments – irrespective of their initial loan default risk – are initially allocated to level 1 as a general rule. This is associated with the recognition of loan loss provisions in the amount of the 12-month expected loss through profit or loss. If the loan default risk associated with a financial instrument has increased significantly since it was first added to the portfolio and/or it is credit-impaired, then the loan loss provisions set up correspond to the lifetime expected loss (level 2/3). One exception to the application of this general (3-level) approach relates to financial instruments that are already purchased or originated credit impaired. These are subject to a separate calculation method (known as the POCI approach) on a permanent basis (until their derecognition in the balance sheet), which involves recognising the change in the lifetime expected loss as loan loss provisions through profit or loss.

HSH Nordbank calculates expected credit losses at levels 1 and 2 based on the following credit risk parameters:

- Probability of default (PD)
- Loss given default (LGD)
- Exposure at default (EAD)

The internal credit risk models which – where necessary – are adjusted for the purposes of IFRS 9 are taken as a basis in this regard. The rating models used by HSH Nordbank have been developed based on the definition of "default" set out in Art. 178 CRR and are validated in this respect on a regular basis. The definition of default is used as standard for internal Credit Risk Management and for supervisory law and IFRS 9 purposes.

Any necessary adjustments/expansions of the existing models relate primarily to the use of methods for multiannual estimates. Within this context, HSH Nordbank uses PD profiles based on migration matrices for its multiannual estimates. These reflect the observed rating migrations from debtors within a year and are calculated based on an extensive cross-economic historical observation period. The forward projection of the LGD over the multiannual period is based primarily on the expected collateralisation ratio of the financial instrument, which comprises the expected collateral value and the expected amount of the receivable. EAD modelling for the on-balance sheet business is used to project the gross carrying amount forward over the multiannual period, taking amortisation and repayment effects into account. Within this context, fixed cash flows that have been contractually agreed and expectations regarding the exercise of options and their impact on the cash flows are taken into account in the modelling. For off-balance sheet business, the estimate of the expected future drawdown is based on the borrower's expected drawing behaviour over a multiannual period.

In addition, the credit risk parameters are expanded to include additional macroeconomic information relating to the future – if necessary. HSH Nordbank uses the same economic forecasts for planning, internal control and calculating loan loss provisions. As at each quarter end date, forecasts for selected parameters are prepared in three scenarios: base, downside and upside. The forecast horizon comprises the current reporting year-end and the next two years. The base scenario reflects the development that is deemed most likely to occur. This can be both an economic upswing and an economic downturn. The other scenarios reflect more optimistic (upside) or more pessimistic (downside) developments in relation to the base scenario. In addition, expectations regarding extreme events are taken into account using an additional scenario if necessary, i.e. if these have not already been included in the existing scenarios.

The scenario estimates are based on internal Bank economic forecasts which are prepared within the affected areas, taking into account the forecasts of the Bundesbank and the ECB, as well as Bloomberg consensus estimates. Segment-specific parameters are added to these scenarios.

The estimated parameters cover forward-looking information in the following areas, among others:

- Economy (gross domestic product and inflation rate for various regions)
- Direction of interest rates
- Movement in exchange rates
- Bond markets (in particular, corporate spreads)
- Oil prices
- Share prices
- Shipping (in particular charter rates and second-hand prices)
- Real estate prices (broken down by location and type of property)
- Aviation.

The impact of this forward-looking information on the credit risk parameters PD and LGD is determined using statistical procedures and is taken into account when calculating the expected credit losses. Within this context, PD and LGD are adjusted to reflect base scenario forecasts where necessary. Regular checks are also performed to see whether other scenarios have a material non-linear impact on the amount of loan loss provisions. In such cases, the loan loss provisions are corrected by making a management adjustment, including the various scenarios weighted by probability.

The 12-month expected loss is calculated by multiplying the (one-year) credit risk parameters. The lifetime expected loss is calculated as the sum product of the period-specific credit risk parameters determined during the term. Discounting to the balance sheet date is based on the effective interest rate in each case.

The loan loss provisions are generally calculated at the level of the individual financial instrument. This means that there is generally no grouping of financial instruments with risk features in common at HSH Nordbank. One exception relates to securities for which joint level allocation and loan loss provision calculation is applied to different purchases of the same security. This involves dividing the purchases in terms of similar credit quality at the time of initial recognition (rating) – where necessary.

In order to assess a significant increase in the loan default risk of a financial instrument, HSH Nordbank uses internal ratings as the main characteristic. The extent giving rise to a significant deterioration in credit quality is determined for each portfolio or rating category segment in a manner that is specific to the initial rating and on the basis of a statistical quantile assessment. The outcome shows rating changes as of which the loan default risk is deemed to have deteriorated significantly (significance thresholds). The internal rating expected at the time the financial instrument was added for the balance sheet date in question serves as a benchmark in this regard. This expected rating is compared with the current rating to determine whether the relevant change in rating that is defined as significant is exceeded. In connection with the use of ratings as the main characteristic for assessing the significant increase in the loan default risk, HSH Nordbank furnishes proof that the relevant change in rating and corresponding change in the 12-month PD takes the main risk drivers into account that lead to the relevant change in the lifetime PD, meaning that changes in rating constitute a suitable assessment criterion for the level allocation. Key risk drivers over the term of a transaction that are not adequately addressed by ratings can relate to macroeconomic effects. In order to assess whether this is the case, the macroeconomic forecasts for the scenarios are analysed on an ongoing basis in a tolerance area test developed for this purpose. Depending on the results of the analysis, the defined significance thresholds are then adjusted in order to take the macroeconomic impact into account in the level allocation accordingly.

In addition, financial instruments are allocated to level 2 at the latest if forbearance measures (e.g. interest payment deferrals due to financial difficulties faced by the debtor) have been applied to the financial instrument or if the default has lasted more than 30 days.

A financial instrument is transferred (back) from level 2 to level 1 if the loan default risk is no longer significantly increased based on the rating. In cases involving modified financial instruments, however, a good conduct period is set, during which the financial instrument remains in level 2. This corresponds to the good conduct period for forbearance.

The Bank does not make use of the option set out in IFRS 9.5.5.10, which allows financial instruments with a low risk of loan default to be assigned to level 1. Nor does it make use of the option provided for in IFRS 9.5.5.15 on the constant recognition of loan loss provisions in the amount of the lifetime expected loss for trade receivables or contract assets that include a material financing component, or for leasing receivables.

Defining level 3 of the impairment model involves assessing, on each balance sheet date, whether there are objective indications of an impairment that could have a detrimental impact on the expected future cash flows from the financial instrument. The criteria for impairment are consistent with those that apply to supervisory law default and include 90-day default and indications that, based on current information, interest payments cannot be made and an improvement in the financial situation cannot be demonstrated.

The default risk resulting from loans and securities with objective evidence of impairment is accounted for by setting up specific loan loss provisions for the receivable in question. To calculate the amount of the specific loan loss provisions, the net present value of the anticipated cash flows arising from the loan or advance – that is, achievable amount – is compared to its gross carrying amount. The anticipated cash flows may comprise capital repayments, interest payments or the proceeds from disposal of collateral less liquidation costs. The realisable amount is calculated using various scenarios and compared against the gross carrying amount. If the gross carrying amount is higher than the realisable amount for the scenario in question, then this scenario results in a potential loss in the amount of the difference. The specific loan loss provision is set up in the amount of the probability-weighted average losses from among the various scenarios.

In the subsequent periods, loan loss provisions are adjusted to reflect changes in the estimates for the expected cash flows and changes in the gross carrying amount. Changes in the gross carrying amount result not only from incoming payments that reduce the gross carrying amount, but also from interest claims. These claims increase the gross carrying amount and, as a result, the loan loss provisions. This increase is to be recognised with no effect on profit and loss. The collection of the interest for credit-impaired instruments, which is recognised through profit or loss, is based on the net carrying amount, as under IAS 39.

Compared to the existing model under IAS 39, the new impairment model results in loan loss provisions being recognised earlier and in a higher amount. HSH Nordbank also expects the loan loss provisions pursuant to IFRS 9 to be more volatile.

As well as the new provisions governing impairment, IFRS 9 also contains new requirements governing how contractual modifications are taken into account. In cases involving substantial modifications resulting in derecognition of the financial instrument in the balance sheet, the provisions continue to apply unchanged as against the IAS 39 provisions. In cases involving modifications not classed as substantial that do not result in derecognition of the asset in the balance sheet, the gross carrying amount of the asset is adjusted. The new gross carrying amount is given by the present value of the modified cash flows using the financial instrument's original effective interest rate for discounting.

The adjustment of the gross carrying amount results in a modification gain or loss that has to be recognised through profit or loss. Non-substantial modifications in the lending business result in receivables correction amounts, i.e. a reduction/increase in the gross carrying amount based on the effective interest rate present value of the cash flows following the contractual modification. The receivables corrections lead, in loan loss provision level 3, to a reduction in the loan loss provisions set up (negative receivables correction) or in an increase in the loan loss provisions set up (positive receivables correction). In loan loss provision levels 1 and 2, the impact on loan loss provisions is relatively minor.

C) Hedge accounting

IFRS 9 includes various changes to hedge accounting rules compared to IAS 39. However, new rules for the recognition of (dynamic) portfolio or macro hedges respectively are not included in IFRS 9. As a result, options apply allowing for the continued application of existing IAS 39 provisions. HSH Nordbank will make use of the option provided for in IFRS 9.6.1.3 to apply the hedge accounting provisions set out in IAS 39 to portfolio fair value hedges on interest rate change risks.

IFRS 15 – Revenue from Contracts with Customers and Clarifications to IFRS 15

IFRS 15 Revenue from Contracts with Customers sets out a comprehensive framework for determining whether, at what level and when revenue is recognised. It replaces existing guidelines on recognising revenue, including IAS 18 Revenue, IAS 11 Construction Contracts and IFRIC 13 Customer Loyalty Programmes.

IFRS 15 is to be applied for the first time in financial years beginning on or after 1 January 2018.

The application of IFRS 15 does not materially affect the Group financial statements of HSH Nordbank with regard to the recognition of revenue from client contracts compared with the previous practice under IAS 18.

IFRS 16 Leases

IFRS 16 provides a single model regarding how lessees are to recognise leases in their balance sheets. A lessee recognises a right-of-use asset, representing its right to use the underlying asset, and a lease liability, representing its obligation to make lease payments. Exceptions apply to short-term leases and leases for low-value assets. Accounting at the level of the lessor is comparable to the current standard – i.e. the lessor continues to classify leases as finance or operating leases.

IFRS 16 replaces the existing guidelines on leases, including IAS 17 Leases, IFRIC 4 Determining Whether an Arrangement Contains a Lease, SIC-15 Operating Leases – Incentives and SIC-27 Evaluating the Substance of Transactions in the Legal Form of a Lease.

IFRS 16 needs to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2019. Early application is permitted for companies that apply IFRS 15 Revenue from Contracts with Customers at the time of the initial application of IFRS 16 or before.

HSH Nordbank has started to assess the potential impact of the application of IFRS 16 on its Group financial statements without being able to quantify this impact reliably at the present point in time. In particular, the balance sheet extension resulting from the recognition of rights of use and leasing liabilities, as well as the reduction in the ongoing administrative expenses and the increase in current interest expenses in the same amount are considered negligible. The reduction in administrative expenses and increase in interest expense are due to the splitting of leasing expenses into an interest and a depreciation component.

No decision on which transitional method is to be applied has been made as yet.

Amendments to IFRS 9 Prepayment Features with Negative Compensation

The adjustments relate to a minor adjustment to the assessment criteria relevant to the classification of financial assets. Financial assets with a negative prepayment penalty (“prepayment feature with negative compensation”) can be recognised, subject to certain requirements, at amortised cost or at fair value through other comprehensive income, instead of at fair value through profit or loss.

The amendments need to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2019.

Amendments to IAS 40 – Transfers of Investment Property

The amendment to IAS 40 serves to clarify the cases in which properties start/stop being classified as an “investment property” if they are under construction or development. The previous exhaustive list in IAS 40.57 did not set out clear provisions on the classification of properties that had not yet been completed. The list is now explicitly designated as non-exhaustive, meaning that properties that have not yet been completed now also fall under the scope of the provisions.

The amendment needs to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2018.

IFRIC 22 Foreign Currency Transactions and Advance Consideration

IFRIC 22 addresses a question relating to the application of IAS 21 The Effects of Changes in Foreign Exchange Rates. The Interpretation clarifies the time at which the exchange rate is to be calculated for the translation of foreign currency transactions that include the receipt or payment of advance consideration. According to the Standard, the decisive date for the purpose of determining the exchange rate for the underlying asset, income or expense, is the date of initial recognition of the asset or liability resulting from the advance consideration. The interpretation needs to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2018.

Improvements to IFRS 2014–2016

The Annual Improvements to IFRS (2014–2016) amended three IFRSs, of which the following two amendments are only to be applied in 2018:

IAS 28 clarifies that the election to measure an investment in an associate or a joint venture that is held by an entity that is a venture capital organisation, or other qualifying entity, can be exercised differently for each investment.

The short-term exemptions in IFRS 1 Appendix E (IFRS 1.E3 – E7) were also deleted for entities applying the IFRS for the first time.

The changes do not have any material impact on the Group financial statements of HSH Nordbank.

EU endorsement still pending:

The above-mentioned Standards do not materially affect the Group financial statements of HSH Nordbank.

Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture

The amendments address a known inconsistency between the provisions in IFRS 10 and those in IAS 28 (2011) in the event of the sale of assets to an associate or joint venture and/or the contribution of assets to an associate or joint venture.

Under IFRS 10, a parent must recognise total profit or loss from the sale of a subsidiary on the statement of income when control is lost. In contrast, the currently applicable IAS 28.28 requires that the sale proceeds in the case of sales transactions between an investor and an equity holding measured at equity – whether it is an associate or a joint venture – are only recognised in the amount of the share of the other shareholders in this entity.

In future, the entire profit or loss on a transaction is only to be recognised if the sold or received assets constitute a business operation as defined in IFRS 3. This applies regardless of whether the transaction is structured as a share or asset deal. Conversely, if the assets do not constitute a business operation, it is only permissible to recognise proportionate net income.

Initial application of the amendments has been postponed for an indefinite period of time by the IASB.

Amendments to IAS 19 Plan Amendment, Curtailment or Settlement

The amendments to IAS 19 relate to plan amendment, curtailment or settlement. In accordance with IAS 19.99, the net defined benefit liability has to be remeasured in such cases taking current actuarial assumptions into account. In accordance with the amendments, the current service cost and the net interest for the period after the remeasurement also have to be determined based on the updated actuarial assumptions. In addition, the remeasured net liability (taking into account the adjusted benefits resulting from the intervention) is to be used to determine the net interest expense after the intervention.

Subject to the still-pending adoption into EU law, the amendments need to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2019. Early application is permitted.

Amendments to IAS 28 Long-term Interests in Associates and Joint Ventures

The amendments clarify that IFRS 9 is to apply to long-term interests in associates and joint ventures to which the equity method is not applied.

Subject to the still-pending adoption into EU law, the amendments need to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2019.

IFRIC 23 Uncertainty over Income Tax Treatments

The tax treatment of certain scenarios and transactions may depend on future recognition by the tax authorities or fiscal courts. IAS 12 Income Taxes sets out provisions governing how actual and deferred taxes are to be recognised. IFRIC 23 supplements the provisions set out in IAS 12 regarding how to deal with uncertainty surrounding the income tax treatment of scenarios and transactions.

Subject to the still-pending adoption into EU law, the Interpretation needs to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2019. Early application is permitted.

Improvements to IFRS 2015–2017

The Annual Improvements to IFRS 2015–2017 amended four IFRSs.

IFRS 3 clarifies that, when an entity obtains control over a business operation in which it previously held an interest as part of a joint operation, the principles governing successive business combinations are to be applied. The interest previously held by the acquirer is to be remeasured.

IFRS 11 states that a company does not remeasure its previously held interest in a joint operation when it obtains joint control of the business.

IAS 12 is amended in such a way that a company is to account for all income tax consequences of dividend payments in the same way as the income on which the dividends are based.

Finally, IAS 23 states that, in connection with the calculation of the capitalisation rate, if a company has generally borrowed funds to purchase qualifying assets, the costs associated with debt taken out specifically in connection with the qualifying assets is not to be included until the asset is completed.

Subject to the still-pending adoption into EU law, the amendments need to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2019. Early application is permitted.

Going concern assumption

Accounting and measurement are based on the assumption that the Bank is a going concern. The Bank's corporate planning forms the basis for the going concern assumption.

Assessments, the basis for the corporate planning and in particular the planning for the movement in loan loss provisions take information available to us at this point in time into account. These assessments are dependent on factors that are mostly outside the control of the Bank and are therefore subject to a significant degree of uncertainty. By way of example, material uncertainty factors with regard to the development of loan loss provisions include the development of the relevant market parameters such as freight and charter rates, ship values, the US dollar exchange rate and changes regarding macroeconomic trends.

One key assumption used in corporate planning in view of the ongoing sale process of HSH Nordbank AG is that the outstanding conditions for the closing of the privatisation transaction are fulfilled and that the privatisation process is completed successfully as a result.

Simultaneously with the successful conclusion of the share purchase agreement, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio consisting largely of non-performing loans (in particular ship financing) to a special-purpose entity from the sphere of the investors (the portfolio transaction). The closing of the portfolio transaction is subject, first of all, to the approval of the German Federal Cartel Office (*Bundeskartellamt*) and also depends on the closing of the share purchase agreement.

The successful execution of this portfolio transaction and the associated reduction in the NPE ratio are key assumptions used in the Bank's corporate planning over and above successful privatisation.

A further significant assumption with regard to corporate planning is the termination of the Sunrise guarantee. In light of the privatisation, HSH Nordbank AG and HSH Beteiligungs Management GmbH reached an agreement with HSH Finanzfonds AöR on the premature termination of the agreement on the provision of a guarantee facility in return for a compensation payment made by HSH Nordbank AG to HSH Finanzfonds AöR in an amount of € 100 million (cancellation agreement). As a result, the corporate planning assumes that, taking into account the settlement procedures set out in the cancellation agreement, the entire guarantee facility of €10 billion will be drawn down by HSH Nordbank AG and paid by the guarantor to HSH Nordbank AG. The implementation of the cancellation agreement is also subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

As it is not, however, possible to objectively predict the course and outcome of the privatisation process, the privatisation process involving HSH Nordbank AG creates significant uncertainty regarding the implementation of the corporate planning, as well as accounting and measurement, based on the assumption that the business activities are continued. Additional assumptions, uncertainties, opportunities and risks of corporate planning are discussed in the Group Management Report in the section Forecast, opportunities and risks report.

The assumption of the Bank as a going concern for accounting and measurement purposes and the assumption of the continued going concern of HSH Nordbank AG and significant group companies is based, in particular, on the share purchase agreement concluded on 28 February 2018, in which HSH Beteiligungs Management GmbH sold 94.9% of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG (hereinafter referred to as the "bidders") being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) grants the necessary approvals,
- the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank AG can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

It is further required that acceptance by market participants and other relevant stakeholders necessary for the successful implementation of HSH Nordbank AG's future business model is maintained or gained.

2. EVENTS AFTER THE REPORTING DATE

In its decision of 2 May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings in favour of HSH Nordbank AG. One essential commitment related, among other things, to the sale of HSH Nordbank by 28 February 2018. Within this context, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other.

The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing) at least until the end of 2021. The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

In addition, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of € 10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management GmbH and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million, which will put pressure on the statement of income in the first quarter of 2018.

At the same time, HSH Finanzfonds AöR will make a payment to HSH Nordbank to compensate for the losses that have not yet been settled based on a separate settlement procedure. The signed cancellation agreement is subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

3. PROVISION OF A GUARANTEE FACILITY

I. Second loss guarantee of HSH Finanzfonds AöR

Basics of the effect of the second loss guarantee

On 2 June 2009, the Federal State of Schleswig Holstein and the Free and Hanseatic City of Hamburg granted HSH Nordbank AG a guarantee facility in the amount of € 10 billion via the HSH Finanzfonds AöR as the guarantor in order to secure the future of the Bank. This agreement on the provision of a guarantee facility as well as a related recapitalisation of the Bank are subject to approval by the European Commission in accordance with the law regarding state aid. The EU Commission concluded these state aid proceedings at the end of September 2011 and entered into an agreement on commitments with all the parties involved and imposed conditions. The guarantee of the federal states is split into two partial guarantees for financial reporting purposes. Partial guarantee One is recognised in the Group financial statements as a financial guarantee contract in accordance with IAS 39.9. Partial guarantee Two is recognised as a credit derivative. For example, certain assets no longer meet the requirements for a financial guarantee after recovery and restructuring measures, and are therefore covered by partial guarantee Two. Transfers to partial guarantee two are also made for commitments in respect of which HSH Nordbank cannot establish legal maturity for various reasons.

The guarantor guarantees actual rating-related defaults on financial instruments selected based on certain defined criteria that form part of the assets of HSH Nordbank AG.

The amount of default on a specific commitment is determined by the amount outstanding, taking into account the specific loan loss provision existing as at 31 March 2009. The amount outstanding is at the most the amount repayable as at 31 March 2009, plus all interest owed and other ancillary payments. Losses may only be allocated under the guarantee once the guarantee case has been examined and approved by the guarantor.

In 2011, the guarantee was reduced by a total of € 3 billion to € 7 billion. The guarantee facility was replenished as at 30 June 2013 by € 3 billion to the original amount of € 10 billion. The guarantee agreement was adjusted by way of an appropriate amendment agreement. Under this agreement the fee provisions for the replenished guarantee remain essentially unchanged.

As long as and insofar as a cash drawdown of the guarantee had not yet taken place through the invoicing of losses that in total exceed the first loss piece of € 3.2 billion to be borne by the Bank, a claim for compensation against HSH Finanzfonds AöR could not be recognised. Against this background the hedging effect of partial guarantee One recognised in the balance sheet is accounted for on a net basis. The Bank initially determines specific and general loan loss provisions without taking the hedging effect of the second loss guarantee into account and then records the balance sheet hedging effect through the use of a compensation item that reduces the loan loss provision amount disclosed on the balance sheet accordingly. The specific and general loan loss provisions recognised are not changed by the accounting applied to the hedging effect. The hedging effect of partial guarantee Two is not disclosed separately as a compensation item in Loan loss provisions but in a separate line item in the statement of financial position and the statement of income within the framework of accounting for the credit derivative at fair value.

If, during the restructuring and workout programme, measures consistent with the guarantee are implemented in respect of hedged commitments that conflict with recognition of the hedging instrument in the financial statements as a financial guarantee under IAS 39.9, commitments may be transferred to the partial guarantee Two under the framework agreement that falls under the definition of a credit derivative under IFRS, subject to approval from the trustee appointed by the guarantor. The maximum guarantee amount is not altered by the revival of partial guarantee Two and the respective partial amounts offset each other.

Decision made by the European Commission in the EU state aid proceedings

On 2 May 2016 the EU Commission issued a formal decision in the EU state aid proceedings and thereby approved the replenishment of the second loss guarantee provided by the federal states from € 7.0 billion to € 10 billion. Within this context, HSH Nordbank AG was relieved of significant guarantee premiums by a newly formed holding company (HSH Beteiligungs Management GmbH).

In exchange for the guarantee, HSH Nordbank AG has been paying a contractually agreed base premium of 2.2 % p.a. since 1 January 2016 on the guarantee volume that has not yet been drawn down. The recurring base premium payable is recognised through profit or loss on an accrual basis in the Expenses for government guarantees line item. The guarantee premium expense that is attributable to partial guarantee Two (credit derivative) is taken into account when calculating the market value of the credit derivative. The other fee components of the guarantee (base premium on the utilised portion of the guarantee, base premium of 1.8 % p.a. on the nominal amount of the guarantee, additional premium) were assumed by HSH Beteiligungs Management GmbH.

Accounting impact of the second loss guarantee in the 2017 financial year

The hedging effect of the financial guarantee granted by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein via HSH Finanzfonds AöR, which was reported on the face of the balance sheet for the first time as at 31 December 2010, amounted to € 5,181 million as at 31 December 2017 (previous year: € 7,854 million).

As at 31 December 2017 a compensation item disclosed on the balance sheet of € 5,181 million (31 December 2016: € 7,854 million) results from the hedging effect of partial guarantee One which is offset under the loan loss provisions item. An expense of € –728 million (previous year: € 2,284 million) has been taken into account under loan loss provisions in the statement of income which can be traced to a reduced hedging effect of partial guarantee One through changes in the allocation of transactions from partial guarantee One (financial guarantee) to partial guarantee Two (credit derivative).

The compensation item on the balance sheet includes compensation claims of HSH Nordbank AG vis-à-vis the guarantor in the total amount of € 319 million. This means that HSH Nordbank AG now has a contractual entitlement to loss compensation with regard to the main claims in default and the interest accrued. The payments already made amount to € 3.8 billion as at 31 December 2017.

The partial guarantee Two is disclosed as a credit derivative under the “Credit derivative under the second loss guarantee” line item. Changes in the measurement of the credit derivative are disclosed under the “Hedging effect of the credit derivative second loss guarantee” line item in the statement of income. The fair value of the partial guarantee Two was € 1,014 million as at 31 December 2017 (previous year: € 199 million). Income of € 810 million (previous year: expense of € –475 million) has been recognised under the “Hedging effect of credit derivative under the second loss guarantee” line item in the statement of income. The increase in the market value of the credit derivative is due to changes in the allocation of transactions in the transaction portfolio which was sold on 28 February 2018 from partial guarantee One (financial guarantee) to partial guarantee two (credit derivative). The transactions in question no longer meet the requirements for the accounting of the hedging effect under the financial guarantee.

Insofar as the reference commitments so far associated with partial guarantee One are now included under the hedging effect of partial guarantee Two, the compensation item up to now accounted for on a net basis (hedging effect before guarantee expenses) was derecognised in the loan loss provisions in the amount of € 809 million. Additionally a compensatory claim under partial guarantee Two was recognised vis-à-vis the guarantor in the compensation item in the balance sheet in the amount of € 47 million.

Payments were already made under partial guarantee Two from settled losses in the amount of € 904 million (previous year: € 739 million).

HEDGING EFFECT OF THE SECOND LOSS GUARANTEE

(€ m)	**2017**		2016		**2017**		2016	
	Balance sheet		Balance sheet		**Statement of income**		Statement of income	
	Loan loss provisions	**Credit derivative**	Loan loss provisions	Credit derivative	**Loan loss provisions**	**Hedging effect credit derivative**	Loan loss provisions	Hedging effect credit derivative
Hedging effect before guarantee costs	5,181	–	7,854	–	–2,673	–	432	–
Compensation under the second loss guarantee	**5,181**	**–**	**7,854**	**–**	**–2,673**	**–**	**432**	**–**
Payments to HSH Finanzfonds AöR	–	–	–	–	1,945	–	1,852	–
Fair valuecredit derivative	–	1,014	–	199	–	810	–	–475
Hedging effect of the guarantee	**5,181**	**1,014**	**7,854**	**199**	**–728**	**810**	**2,284**	**–475**

Taking into account the compensation payments of HSH Finanzfonds AöR already received for credit losses in the hedged portfolio of € 3,797 million (of which in the previous year: € 1,852 million) and the hedging effect resulting from the credit derivative measured on the reporting date in the amount of € 1,022 million, the utilisation of the guarantee as at 31 December 2017 comes to € 10,000 million (previous year: € 9,911 million). Since the 2009 reporting year the Bank has recorded premium expense totalling € 3,860 million for the provision of the second loss guarantee. € 3,825 million has been paid to date, of which € 2,790 million is attributable to the current base premium and € 1,035 million to one-off payments (thereof € 260 million to HSH Beteiligungs Management GmbH).

Privatisation of the Bank

As part of the privatisation of the Bank, an agreement was reached between HSH Nordbank AG, the guarantor and HSH Beteiligungs Management GmbH on 28 February 2018 on the premature termination of the agreement on the provision of a guarantee facility. This means that, on the date on which the cancellation takes effect, HSH Nordbank AG will no longer be under any obligation to pay guarantee fees, and the guarantor will make a compensation payment to HSH Nordbank AG to compensate for the loss facility that has not yet been settled/disbursed. In addition, HSH Nordbank AG is to make a one-off payment of € 100 million to the guarantor to compensate for the monetary benefits associated with the early termination of the guarantee, as well as the premature liquidity effect, in particular state aid law advantages resulting from the fact that premium payments are no longer to be made. This will put pressure on the statement of income in 2018. Losses from guarantee cases that have not yet been definitively confirmed at the time of the signing of this agreement will be assessed based on a separate settlement procedure and compensated for within the context of the compensatory payment. The cancellation of the guarantee, remuneration and compensation payment, i.e. the guarantee cancellation agreement, depends on the closing of the purchase agreement on the shares in HSH Nordbank AG (share purchase agreement), corresponding notification sent to the parties to the agreement on the sale of an extensive credit portfolio (portfolio transaction) on 28 February 2018 and, as a result, on the closing of the portfolio transaction.

II. Synthetic securitisation transaction

In the fourth quarter of 2016, largely for capital management reasons, HSH Nordbank AG securitised loan receivables from the Corporate Clients and Real Estate Clients areas accounting for a volume of € 3 billion in total. By way of a financial guarantee, this involves the transfer of the default risk associated with a mezzanine tranche (with an initial and current amount of € 235 million) to an unconsolidated structured entity in Luxembourg (Horizon 2016 S.A.), which has, in turn, passed the default risk on to an investor. The financial resources that the investor received from the structured entity were deposited as cash collateral for the guarantee at HSH Nordbank AG. HSH Nordbank AG in turn provides the structured entity with securities as collateral for this cash deposit.

A vertical tranche approach is used in accordance with Art. 405 (1a) CRR. This means that loan receivables are included in the reference portfolio at a maximum of 95 % of their nominal value. The resulting first loss piece of at least 5 % is not treated as an additional retained tranche, but rather as unsecuritised outside of the Horizon transaction and as ranking pari passu with the securitised share regarding the allocation of losses.

The use of the financial guarantee allows the risk weighting of the secured loan portfolio to be reduced. This allows the two following objectives to be achieved:

- Risk management (reduction of credit risks in the portfolio)
- Relief on equity capital (reduction in regulatory equity capital requirements)

HSH Nordbank AG pays an annual premium on the respective outstanding mezzanine tranche. The premium to be paid in each case is determined primarily by the extent to which the guarantee has actually been utilised. The premium is recognised through profit or loss in commission expense. In 2017, the Bank incurred premium expense totalling around € 25.9 million. In 2018, the Bank expects to incur premium expense totalling a maximum of around € 25.9 million. The contractual term of the guarantee is nine years (starting from the time at which the guarantee agreement was concluded in the fourth quarter of 2016).

As long as and insofar as the cash drawdown of the guarantee is not yet made through the invoicing of losses that in total exceed the first loss piece to be borne by HSH Nordbank AG (on the securitised portfolio) in an initial and current amount of € 30 million (the aforementioned first loss piece comprises a first loss tranche of € 22.5 million and an initial excess spread, i.e. a loss buffer to be determined on an annual basis, of € 7.5 million), then there is no claim for compensation against the guarantor that is eligible for capitalisation. Against this background the hedging effect of the financial guarantee recognised in the balance sheet is accounted for on a net basis. The Bank initially determines specific and general loan loss provisions without taking the hedging effect of the financial guarantee into account and then records the hedging effect (if the first loss piece is exceeded by the specific and general loan loss provisions) on the face of the balance sheet through the use of a compensation item, which reduces the amount recognised under loan loss provisions in the lending business in the balance sheet accordingly. The specific and general loan loss provisions recognised are not changed by the accounting applied to the hedging effect. At the end of the year, no compensation item was recognised because the specific and general loan loss provisions did not exceed the first loss piece of € 30 million. The maximum possible hedging/compensation effect of the guarantee is limited to the volume of the mezzanine tranche in the amount of € 235 million.

4. CONSOLIDATION PRINCIPLES

The Group financial statements present the parent company HSH Nordbank AG together with the consolidated subsidiaries as an economic unit. Subsidiaries also include structured entities that are controlled by HSH Nordbank. Structured entities are entities in which voting rights and similar rights do not constitute the dominant factor in assessing control. These also include entities whose relevant activities are predetermined by a narrow objective defined in the articles of association/partnership agreement or in other contractual agreements or in which there is a lasting restriction of the decision-making powers of the management. HSH Nordbank mainly includes ABS conduits and other securitisation and refinancing vehicles as well as investment funds (including private equity funds) within structured entities. Structured entities are included in the scope of consolidation if they are subsidiaries and are material to the presentation of the net assets, financial condition and earnings or to the assessment of the risk situation of the HSH Nordbank Group. Disclosures of the nature of the risks in connection with shares in consolidated structured entities are included in Note 5. Reference is made to Note 59 with regard to unconsolidated structured entities.

Control over a subsidiary prevails when HSH Nordbank is exposed to variable incoming cash flows from the exposure to this entity or has rights to such cash flows and is able to influence the cash flows through its decision-making power over the entity. HSH Nordbank possesses decision-making power over an entity if it has rights that confer on it, either directly or indirectly via third parties, the current possibility of controlling the entity's relevant activities. Relevant activities are deemed to be those which materially affect the entity's incoming cash flows depending on the nature and purpose of the entity. Variable incoming cash flows are all those which can vary depending on the entity's performance. Incoming cash flows from the exposure to another entity may accordingly be positive as well as negative. Variable incoming cash flows include dividends, fixed and variable interest, remuneration and fees, fluctuations in the value of investments and other financial advantages.

The assessment as to whether decision-making power exists is made on the basis of the relevant activities of the entity and the powers of HSH Nordbank to influence them. Voting rights as well as other contractual rights are considered in reviewing the control of relevant activities provided there are no economic or other obstacles to the exercise of the existing rights and HSH Nordbank would benefit from exercising those rights. The Bank has decision-making power based on voting rights if as a result of equity instruments or contractual agreements HSH Nordbank holds more than 50% of the voting rights and this proportion of the voting rights is allied to a substantial decision-making right with regard to the relevant activities.

Other contractual rights that may facilitate a controlling influence are primarily rights to appoint members of executive bodies, recall them, to liquidate and to make other decisions. HSH Nordbank controls a subsidiary if based on the total contractual rights it has the possibility to control the relevant activities of the entity.

A subsidiary is also controlled by HSH Nordbank if the decision-making power is exercised by third parties in the interests of and for the benefit of HSH Nordbank. Whether such delegated decision-making power exists is judged by considering the existing powers to appoint members of executive bodies, the legal and de facto scope for making decisions and the structure of the economic incentives. HSH Nordbank itself does not exercise any delegated powers to make decisions that would benefit third parties.

Due to agreements ceding control and insolvency proceedings currently pending, HSH Nordbank in individual cases holds equity interests in companies exceeding 50% which are not tied to any corresponding voting rights and therefore do not result in any controlling influence. In such cases, for purposes of defining the scope of consolidation as well as for purposes of preparing the list of shareholdings, the voting rights ratios were adjusted to the extent deemed reasonable under the special circumstances described above. Conversely, HSH Nordbank possesses a controlling influence in individual cases based on contractual rights, although it holds less than 50% of the voting rights.

Shares held by third parties in the equity of the subsidiary are shown as non-controlling interests in Group equity, provided these are not shares of external shareholders in consolidated commercial partnerships. Non-controlling interests are that part of the net results for the period and net assets of a subsidiary related to shares not directly held by the parent company or by a Group subsidiary. Non-controlling equity shares in subsidiaries and the resulting profit or loss as well as summarised financial information on subsidiaries with material non-controlling shares are presented in Note 5. Shares of external shareholders in consolidated commercial partnerships constitute puttable financial instruments, which are to be classified as debt in the Group financial statements under IAS 32 and disclosed under Other liabilities. Changes in value are recognised in Other operating income/expenses in the consolidated statement of income.

Subsidiaries are included by way of full consolidation in the Group financial statements of HSH Nordbank. In consolidating the capital the carrying amount of the equity holding in each subsidiary is set off against the share of HSH Nordbank in the subsidiary's equity capital. Goodwill connected to this is accounted for using the acquisition method in accordance with IFRS 3. Intra-Group receivables, liabilities and income are eliminated within the framework of debt and/or expense and income consolidation for the purpose of the Group financial statements. Expenses and gains arising from the transfer of assets within the Group are eliminated as well.

Shares in subsidiaries which were not consolidated because of their subordinate importance for HSH Nordbank Group's net assets, financial condition and earnings are accounted for as available for sale (AfS) financial instruments using the recognition and measurement guidelines of IAS 39.

Structured entities within the meaning of IFRS 12 are entities designed so that voting rights or similar rights do not represent the dominant factor in terms of assessing whether control is being exercised. Voting rights in such entities only relate to contractually specified administrative functions. Similar rights would refer, for example, to potential voting rights such as options on voting rights. Structured entities like securitisation vehicles are controlled by HSH Nordbank and included as subsidiaries in the Group financial statements if HSH Nordbank has decision-making power over the relevant activities and is subject to variable return flows from these activities.

HSH Nordbank does not classify single asset companies and project companies as structured entities, because as a rule they are not designed to ensure that holding voting rights is only for the purpose of performing contractually governed administrative functions. Structured entities are also characterised by a narrowly defined business purpose, a limited field of activity and comparatively low equity capital. If a company is not controlled by voting rights but by means of contractual rights, it is classified as a structured entity.

Joint arrangements are based on contractual agreements under which two or more partners establish an economic activity under shared management. Joint management is present if the partners have to cooperate in order to steer the relevant activities of the joint arrangement and decisions require unanimous approval from the participating partners. Such a joint arrangement is a joint venture if the partners who exercise joint management hold rights and obligations to the net assets of the arrangement. If, conversely, the partners have direct rights to the assets or liabilities attributable to the joint arrangement for their debts, the arrangement is a joint operation. If a joint arrangement is embodied in a legally independent partnership or corporation with its own assets, so that HSH Nordbank only has a proportionate claim to the net assets of the company based on its shares in the company, this entity is normally a joint venture. In order to determine whether a joint venture or a joint operation is concerned in the case of joint arrangements, the contractual provisions and the purpose of the joint arrangement are used in addition. If neither the legal form nor the contractual provisions or other facts and circumstances provide an indication that HSH Nordbank has direct rights to the assets and/or obligations for the debts of the joint arrangement, it is a joint venture.

Associates are companies where the HSH Nordbank AG can exercise a significant but not controlling influence directly or indirectly via subsidiaries. Significant influence refers to the possibility of influencing decisions affecting the financial and business policy of another entity but not controlling it. Significant influence is found in principle if HSH Nordbank as an investor directly or indirectly holds 20% or more of the voting rights through subsidiaries. It may also be an associate if HSH Nordbank has less than 20% of the voting rights but because of other factors has the possibility of influencing the company's decisions concerning financial and business policy. This in particular includes the representation of HSH Nordbank in the entity's decision-making body and contractual rights to manage or dispose of assets including investment decisions in the case of investment funds. If HSH Nordbank only holds rights to approve, agree or veto, significant influence is not presumed to exist.

Interests in joint ventures and associates that are material to the proper presentation of the Group's net assets, financial position and results of operations are consolidated under the equity method. In doing so, the Group's interest in a joint venture/share in an associate is initially measured at cost of acquisition and thereafter increased or decreased depending on the Group's share in the joint venture's/associate's profit or loss. The relevant shares are stated in the statement of financial position under a separate line item. Details of the risks associated with the shares of HSH Nordbank in joint ventures and associates as well as summarised financial information on these entities are presented in Note 5. With regard to joint ventures and associates that in themselves are not material, the summarised financial information is presented in aggregate form in Note 29.

Interest in joint ventures and associates, respectively, which were not consolidated under the equity method because of their subordinate importance for HSH Nordbank Group's net assets, financial condition and earnings have been accounted for as financial instruments of the category AfS using the reporting and measurement guidelines of IAS 39 and are disclosed under financial investments. Where HSH Nordbank has no information as of the reporting date which would allow for the fair value of these interests to be reliably determined, measurement is based on acquisition cost.

5. SCOPE OF CONSOLIDATION

In addition to the parent company, HSH Nordbank AG, Hamburg/Kiel, the scope of consolidation includes 53 fully consolidated subsidiaries (previous year: 57).

No associate or joint venture consolidated under the equity method is included in the Group financial statements as at the balance sheet date (previous year: one associate and one joint venture).

The following subsidiaries are included in the Group financial statements of HSH Nordbank:

CONSOLIDATED COMPANIES

Subsidiaries in which HSH Nordbank AG directly or indirectly holds 100 % of the equity interests	Registered office	**2017 Share of equity capital in %**	2016 Share of equity capital in %
1. Avia Management S.à.r.l.	Luxembourg	100.0	100.0
2. BINNENALSTER-Beteiligungsgesellschaft mbH	Hamburg	100.0	100.0
3. Bu Wi Beteiligungsholding GmbH	Hamburg	100.0	100.0
4. CAPCELLENCE Dritte Fondsbeteiligung GmbH [4]	Hamburg	100.0	100.0
5. CAPCELLENCE Erste Fondsbeteiligung GmbH [3]	Hamburg	100.0	100.0
6. CAPCELLENCE Holding GmbH & Co. KG [9]	Hamburg	100.0	100.0
7. CAPCELLENCE Zweite Fondsbeteiligung GmbH [4]	Hamburg	100.0	100.0
8. FSL Asset Management Pte. Ltd. [6) 12]	Singapore	100.0	100.0
9. FSL Holdings Pte. Ltd. [7) 12]	Singapore	100.0	100.0
10. FSL Trust Management Pte. Ltd. [5) 12]	Singapore	100.0	100.0
11. GODAN GmbH	Hamburg	100.0	100.0
12. HSH Auffang- und Holdinggesellschaft mbH & Co. KG	Hamburg	100.0	100.0
13. HSH Facility Management GmbH	Hamburg	100.0	100.0
14. HSH Gastro+Event GmbH [8]	Hamburg	100.0	100.0
15. HSH N Finance (Guernsey) Limited	St. Peter Port	100.0	100.0
16. HSH N Residual Value Ltd.	Hamilton	100.0	100.0
17. HSH Nordbank Securities S.A.	Luxembourg	100.0	100.0
18. HSH Private Equity GmbH	Hamburg	100.0	100.0
19. Ilex Integra GmbH [1]	Hamburg	100.0	100.0
20. ISM Agency LLC [10]	New York	100.0	100.0
21. Neptune Finance Partner S.à.r.l.	Luxembourg	100.0	100.0
22. Neptune Finance Partner II S.à.r.l.	Luxembourg	100.0	100.0
23. 2200 Victory LLC	Dover	100.0	100.0

CONSOLIDATED COMPANIES

Subsidiaries with non-controlling interests	Registered office	**2017 Share of equity capital in %**	2016 Share of equity capital in %
24. Adessa Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG [11]	Mainz	–	–
25. Amentum Aircraft Leasing No. Five Limited [11]	Dublin	49.0	49.0
26. Amentum Aircraft Leasing No. Seven Limited [11]	Dublin	49.0	49.0
27. Amentum Aircraft Leasing No. Six Limited [11]	Dublin	49.0	49.0
28. Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG [2]	Hamburg	83.3	83.3
29. Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG [2]	Hamburg	90.9	83.3
30. CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG [2]	Hamburg	83.3	83.3
31. CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG [2]	Hamburg	90.9	83.3
32. CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG [2]	Hamburg	83.3	83.3
33. Castellum ABF S.A. [11]	Luxembourg	–	–
34. Chasms Navigation Limited [11]	Douglas	100.0	–
35. Cregneash Navigation Limited [11]	Douglas	100.0	–
36. Curragh Navigation Limited [11]	Douglas	100.0	–
37. GmbH Altstadt Grundstücksgesellschaft [11]	Mainz	50.0	50.0
38. HSH Care+Clean GmbH [8]	Hamburg	51.0	51.0
39. HSH Move+More GmbH [8]	Kiel	51.0	51.0
40. HSH N Funding II [11]	George Town	56.3	56.3
41. Life Insurance Fund Elite LLC [11]	New York	–	–
42. Life Insurance Fund Elite Trust [11]	Minneapolis	–	–
43. Mooragh Navigation Limited [11]	Douglas	100.0	–
44. Next Generation Aircraft Finance 2 S.à.r.l. [11]	Findel	49.0	49.0
45. Next Generation Aircraft Finance 3 S.à.r.l. [11]	Findel	49.0	49.0
46. OCEAN Funding 2013 GmbH [11]	Frankfurt a.M.	–	–
47. RDM Limited [11]	George Town	–	–
48. RESPARCS Funding Limited Partnership I [11]	Hong Kong	0.0	0.0
49. RESPARCS Funding II Limited Partnership [11]	St. Helier	0.0	0.0
50. Senior Assured Investment S.A. [11]	Luxembourg	–	–
51. Senior Preferred Investments S.A. [11]	Luxembourg	–	–
52. Soderick Navigation Limited [11]	Douglas	100.0	–
53. Stratus ABF S.A. [11]	Luxembourg	–	–

[1] Subsidiary of Bu Wi Beteiligungsholding GmbH.
[2] Subsidiary of CAPCELLENCE Holding GmbH & Co. KG.
[3] Subsidiary of Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG.
[4] Subsidiary of Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG.
[5] Subsidiary of FSL Asset Management Pte. Ltd.
[6] Subsidiary of FSL Holdings Pte. Ltd.
[7] Subsidiary of GODAN GmbH.
[8] Subsidiary of HSH Facility Management GmbH.
[9] Subsidiary of HSH Private Equity GmbH.
[10] Subsidiary of Life Insurance Fund Elite LLC.
[11] Structured entity.
[12] A disposal plan within the meaning of IFRS 5.8A is in place.

I. Information on subsidiaries – changes to the scope of consolidation

A) Additions

The following companies were included for the first time in the scope of consolidation on a fully consolidated basis:

- CAPCELLENCE Vintage Year 17 Beteiligungen GmbH & Co. KG, Hamburg (also derecognition in the reporting year by way of a collapse merger)
- Chasms Navigation Limited, Douglas
- Cregneash Navigation Limited, Douglas
- Curragh Navigation Limited, Douglas
- Mooragh Navigation Limited, Douglas
- Soderick Navigation Limited, Douglas

On 1 June 2017, HSH Nordbank gained control over the following companies: Chasms Navigation Limited, Cregneash Navigation Limited, Curragh Navigation Limited, Mooragh Navigation Limited and Soderick Navigation Limited.

The above-mentioned single-ship companies (hereinafter referred to as the "Navigation Group") based on the Isle of Man at the time of obtaining control each held one container vessel which was leased to generate charter income until 2020 or 2021 as their material asset. The transaction was refinanced largely using loans of HSH Nordbank AG. In order to limit the interest rate risk arising from these loans, the single-ship companies had concluded swaps with HSH Nordbank AG.

HSH Nordbank AG realised collateral in its capacity as the creditor on 1 June 2017. In the context of this realisation of collateral, it transferred the shares in the five single-ship companies that had been pledged to it to another party which holds the shares for HSH Nordbank AG on a fiduciary basis. This fiduciary relationship allows HSH Nordbank to exercise control over the single-ship companies.

The business combinations mean that pre-existing business relationships, within the meaning of IFRS 3, between HSH Nordbank and the Navigation Group are deemed to have ended. The termination of the above-mentioned loan and swap relationships at fair value results in income totalling € 7 million in the reporting period. The income is disclosed under Other operating income. The fair value of the loan receivables and the swaps totalling € 426 million was derecognised as consideration for the business combinations. No cash consideration was paid in connection with the transaction. The business combinations do not result in any difference overall.

The material assets of the Navigation Group were the above-mentioned container vessels at the time of initial consolidation. At the time of initial consolidation, the vessels were stated at their market value less costs to sell in the amount of € 450 million in total. The acquired net assets also include a loan liability to a dockyard. This liability is reported under Other liabilities and had a fair value of € 28 million at the time of initial consolidation. The other assumed assets and liabilities of the Navigation Group are insignificant. The container ships were sold in the third quarter of 2017.

The results of the Navigation Group included in the Group financial statements as at 31 December 2017 amount to € –5 million. The revenue of the Navigation Group included in the Group financial statements from the time of initial consolidation until 31 December 2017 amounts to € 17 million and largely relates to income from ship chartering. It is reported under Other operating income. The revenue of the Navigation Group in the period from 1 January to 31 December 2017 amounts to € 76 million. A comparison with the revenue included in the Group financial statements is only possible to a limited extent.

The company CAPCELLENCE Vintage Year 17 Beteiligungen GmbH & Co. KG, which was set up on 5 April 2017 and in which HSH Nordbank AG held the majority of voting rights, was included in the scope of consolidation on a fully consolidated basis during the year. With economic effect from 30 November 2017, this company was incorporated into CAPCELLENCE Holding GmbH & Co. KG by way of accrual. The entry in the commercial register was made on 11 December 2017.

B) Disposals

Contrary to the inclusion as at 31 December 2016, the following companies are no longer included in the scope of fully consolidated companies:

- DEERS Green Power Development Company S.L., Madrid
- Mitco Real Estate A. S.à.r.l., Canach
- Mitco Resolution 1 S.à.r.l., Canach
- Mitco Resolution 2 S.à.r.l., Canach
- Mitco Resolution 3 S.à.r.l., Canach
- Mitco Resolution 4 S.à.r.l., Canach
- Mitco Resolution 5 S.à.r.l., Canach
- Solar Holdings S.à.r.l., Luxembourg
- Unterstützungs-Gesellschaft der Hamburgischen Landesbank mit beschränkter Haftung, Hamburg

With effect from 23 June 2017, HSH Nordbank AG sold its shares in Solar Holdings S.à.r.l. as part of the market portfolio transaction (energy sub-portfolio), meaning that it lost control over this company. This sale means that DEERS Green Power Development Company S.L., whose shares are held in full by Solar Holdings S.à.r.l., was also been excluded from the scope of consolidation. A total loss of € 3 million resulted from the deconsolidation of these two companies and is recognised under the item Other operating result.

The companies in the Mitco Group were borrowers of HSH Nordbank AG in which HSH Nordbank held neither capital shares nor voting rights. The control over these companies and, as a result their classification as subsidiaries was based on the fact that third parties exercised decision-making powers in the interests and for the benefit of HSH Nordbank. With effect from 3 March 2017, HSH Nordbank AG sold its loan receivables as part of the market portfolio transaction. The sale of the loan receivable means that HSH Nordbank has lost control over the companies in the Mitco Group, as it will not be exposed to any variable returns from a link with these companies in the future. A profit in the amount of € 1 million resulted from the deconsolidation of the Mitco Group, which is recognised under the item Other operating income.

Unterstützungs-Gesellschaft der Hamburgischen Landesbank mit beschränkter Haftung was not included in the scope of consolidation due to its liquidation on 31 July 2017. The deconsolidation did not have any material effect on income.

II. Details of subsidiaries with material non-controlling shares

There are no subsidiaries with non-controlling shares material to HSH Nordbank as of the reporting date.

III. Information on shares held in associates and joint ventures accounted for under the equity method

A) General information

The following companies included in the scope of consolidation as at 31 December 2016 will no longer be consolidated under the equity method:

- Kontora Family Office GmbH, Hamburg
- First Ship Lease Trust, Singapore

All shares held in Kontora Family Office GmbH were sold as at 22 March 2017. The associated deconsolidation did not have any material effect on income.

The shares in First Ship Lease Trust (Non-Core Bank segment) previously accounted for under the equity method were classified as held for sale as at 14 December 2017 and have since been reported and recognised separately in accordance with IFRS 5. The shares were sold on 28 February 2018.

The last inclusion of First Ship Lease Trust under the equity method and the subsequent measurement in accordance with IFRS 5 are based on financial statements prepared by the Trust as at 30 September 2017. It is not possible to obtain the financial information relating to the Trust as at 31 December 2017 before the preparation of the Group financial statements of HSH Nordbank. There is no information suggesting that material business transactions or other material events between this cut-off date for the financial statements and the balance sheet date of the HSH Nordbank Group would have to be taken into account.

As at the reporting date and the prior-year reporting date, HSH Nordbank did not hold any shares in material associates and joint ventures accounted for under the equity method.

B) Summarised financial information

The section below sets out the summarised financial information for associates and joint ventures included in the Group financial statements under the equity method that are not material taken in isolation and as a whole for HSH Nordbank.

OTHER SHARES HELD IN ASSOCIATES ACCOUNTED FOR UNDER THE EQUITY METHOD

€ m	2017	2016
Share of the following attributable to HSH Nordbank:		
Net income/loss for the year	2	3
Other comprehensive income	–	–
Total comprehensive income	2	3
Cumulative carrying amount	**–**	**12**

OTHER SHARES HELD IN JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD

€ m	2017	2016
Share of the following attributable to HSH Nordbank:		
Net income/loss for the year	–	–
Other comprehensive income	–	–
Total comprehensive income	–	–
Cumulative carrying amount	**–**	**1**

C) Risks and restrictions

In connection with its shares in First Ship Lease Trust (which are measured in accordance with IFRS 5), HSH Nordbank is neither exposed to risks from unrecognised obligations to this company nor are there any restrictions within the meaning of IFRS 12.22 vis-à-vis his company.

Additional information on companies accounted for under the equity method may be found under Notes 13 and 30.

IV. Information on consolidated structured entities

HSH Nordbank's scope of consolidation includes 23 fully-consolidated structured entities. These companies are controlled due to contractual rights and/or principal-agent relationships. The HSH Nordbank Group also holds the majority of the voting rights for three of these companies.

The following disclosures represent the type of risks in connection with business relationships with consolidated structured entities:

HSH Nordbank AG is the sponsor of a consolidated structured entity and benefits from this company through the expanded funding volume. For this asset-based funding transaction, HSH Nordbank AG has transferred claims to the company for which, because of the opportunities and risks remaining with HSH Nordbank AG there has been no derecognition of the assets on the balance sheet. The structured entity was funded exclusively by the granting of a junior loan by HSH Nordbank AG which was repaid in the reporting year. An original senior promissory note bond that served to fund the company had already been repaid in the 2016 reporting year.

HSH Nordbank AG is the sponsor of securitisation vehicles whose business purpose is the issuance of securities on the capital market and the investment of the resulting funds in silent participations at HSH Nordbank AG. HSH Nordbank has provided these consolidated structured entities with a guarantee facility. This guarantee facility serves to hedge the payment obligations of the structured entities in respect of the holders of the securities. These payment obligations arise if payment claims result for the structured entities against HSH Nordbank AG from the Silent Participations held by them.

HSH Nordbank AG has granted liquidity and credit facilities to consolidated structured entities. In terms of the amounts, these are of minor significance for the Group's financial position.

HSH Nordbank AG has a contractual obligation to bear the operating expenses for three consolidated structured entities.

During the reporting year, HSH Nordbank did not provide consolidated or unconsolidated structured entities with any non-contractual support.

As of the balance sheet date there is no current intention to provide a consolidated structured entity any financial or other support within the definition of IFRS 12.17.

6. MANAGEMENT ESTIMATES AND DISCRETIONARY DECISIONS

As permitted, estimates and assumptions for the measurement of assets and liabilities have been incorporated into the Group financial statements of HSH Nordbank. All estimates and judgments necessary for accounting and measurement according to IFRS were undertaken in accordance with the appropriate standard in each case, are continuously reassessed and are based on past experience and other factors including expectations of future events which appear reasonable under the circumstances. Specifically, the determination of the loan loss provisions taking into account the effects of the guarantee (see Note 7.I.C.), determination of impairment losses in order to sell non-current assets held for sale and disposal groups (see Note 33 and Note 26, respectively), future cash flows of hybrid financial instruments (see Note 7.I.E.), deferred taxes (see Note 7.III.6), the determination of fair values (see Note 7.I.D.), provisions for pensions and similar obligations and other provisions (see Note 7.III.5) are affected by uncertainty.

In February 2018, HSH Beteiligungs Management GmbH concluded a share purchase agreement on the sale of its shares in HSH Nordbank AG to independent funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC., GoldenTree Asset Management L.P. and Centaurus Capital LP, as well as BAWAG P.S.K. AG (signing). The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the EU Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing). The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

In addition, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement.

When calculating the loan loss provisions for the affected loans, the purchase price for the entire portfolio was allocated, among other things, based on a valuation report on the individual loans and assets sold, and the purchase price share that was attributed in each case was discounted to the balance sheet date as an expected cash flow on the expected closing date based on the original effective interest rate (see Note 26). A closing date of 30 September 2018 was assumed.

The composition of the loan portfolio sold can also still change for various reasons (among other things, due to certain exclusion rights of the contracting parties). As a result, the required loan loss provisions can also change.

For information on further significant uncertainties relating to estimates used to calculate loan loss provisions, reference is made to the comments below and to the comments in the Group management report in the section entitled "Opportunities and risks in the forecast for loan loss provisions".

Where there is greater uncertainty regarding estimates relating to other aspects, the underlying assumptions are presented in greater detail in the relevant note.

With the exception of estimates, major discretionary decisions by management in the application of accounting and measurement methods include:
- use of the fair value option for financial instruments (see Note 7.I.A);
- not classifying financial instruments as held to maturity (HtM);
- applying the current reclassification rules under IAS 39 (see Note 52);
- deciding whether non-current assets and disposal groups are highly likely to be sold within the twelve months after the balance sheet date (see Note 33);
- determining fair values for certain financial instruments, including a judgement regarding the existence of an active or inactive market;
- assessing whether HSH Nordbank controls another entity.

7. ACCOUNTING POLICIES

I. Financial instruments

A) Categorisation of financial assets and liabilities

A financial instrument is an agreement which simultaneously creates a financial asset for one company and a financial liability or equity instrument for the other company. Under IAS 39 all financial assets and liabilities including financial derivatives must be stated in the statement of financial position and measured according to the category to which they are assigned.

Financial assets and liabilities are stated in the statement of financial position if HSH Nordbank is counterparty under the contract for the corresponding financial instrument. Expected future transactions or contracts are not recognised.

Provided that they fulfil the criteria of IAS 39, pending transactions in the form of derivatives must always be stated in the statement of financial position as financial assets or liabilities and measured at fair value on the trading date. Spot transactions in non-derivative financial assets (so-called regular way contracts) are recognised as of the settlement date. The change in fair value between the trading date and settlement date is recognised according to the measurement rules for the category of asset. This means that changes in value of financial instruments in the category available for sale must be recognised in the revaluation reserve, while changes in value for the categories designated at fair value and held for trading are recognised in the statement of income in Net trading income. For financial liabilities designated at fair value through profit or loss, for which under IFRS 9.7.1.2 an early application of IFRS 9 is made, the credit risk-induced value changes are recognised directly in equity in the revaluation reserve.

Other non-derivative financial assets which do not result from spot transactions, for example loans granted, are recognised as of the settlement date.

Non-derivative financial liabilities are recognised if one of the two parties to the contract has fulfilled the contract (settlement date).

Initial recognition is measured at fair value, which generally corresponds to the acquisition cost of the financial instrument.

Derecognition of a financial asset takes place on the settlement date. In the case of derivatives, derecognition takes place on the trading date.

Subsequent measurement of financial assets and liabilities depends on which IAS 39 category they were assigned to at the time of acquisition. The following distinctions are made here:

1. Financial assets and liabilities which are financial instruments at fair value recognised in profit or loss include both instruments held for trading (HfT) as well as instruments which are voluntarily and irrevocably designated at fair value (DFV) at the time of first recognition:

   a. All financial instruments held for trading and derivatives which are not part of a hedge accounting transaction are classified as held for trading (HfT).

      They are initially and subsequently measured at fair value. Transaction costs are recognised through profit or loss on acquisition date. In accordance with IAS 39.43, transaction costs are only included in the initial recognition in the case of financial assets or liabilities not measured at fair value and recognised in profit or loss. Where a market price exists in the form of an exchange quotation, this is used for the purposes of measurement. In other cases, the market price of comparable instruments or recognised measurement models, especially net present value methods and option pricing models, are used to determine fair value.

      These trading instruments and derivatives are stated under Trading assets or Trading liabilities on the statement of financial position. Ongoing measurement gains and losses and realised gains and losses on these financial instruments are incorporated into Net trading income. Interest income and expenses as well as dividends arising from HfT transactions are recorded under Net interest income.

   b. In addition, certain complex structures arising from issued instruments and assets that contain derivatives requiring separation, as well as certain financial instruments which are a component of an economic hedge without satisfying the requirements of IAS 39 for hedge accounting, are also classified as designated at fair value (DFV). Furthermore, the fair value option may be applied at HSH Nordbank to portfolios whose management and performance measurement is done on a fair value basis in accordance with the documented risk management strategy. This is possible, for example, with special funds and similar assets to be consolidated.

The designation at HSH Nordbank serves to avoid or reduce accounting mismatches from securities and loans hedged with interest rate derivatives. In addition, the fair value option is generally applied to any structures otherwise required to be segregated.

Financial assets designated as DFV primarily relate to bonds. Financial liabilities designated as DFV specifically comprise structured registered and bearer instruments with embedded interest, currency, equity and other risks.

Financial instruments in the fair value option are stated at fair value. These financial instruments are stated under Loans and advances to banks, Loans and advances to customers, Financial investments and Liabilities to banks, Liabilities to customers, Securitised liabilities and Subordinated capital. Gains or losses arising from ongoing measurement and realised gains or losses are generally stated under Net trading income, whereas gains or losses arising from ongoing measurement and realised gains or losses relating to liabilities in the DFV category are stated in the revaluation reserve if credit risk-induced (on IFRS 9 initial recognition refer to Note 1). Interest income and expenses for these financial instruments are stated under Net interest income. To the extent dividend income is received, it is disclosed under Net interest income.

2. Loans and receivables, which are stated in the statement of financial position at amortised cost:

   Non-derivative financial assets with fixed or determinable payments not traded on an active market when first recognised are shown under IAS 39.9 as loans and receivables (LaR). Exceptionally, this category also includes financial instruments which originally complied with the classification requirements as LaR and which have been reclassified from AfS category in accordance with the changes in IAS 39 (rev. 2008) because there was no longer any active market and there is an intention and ability to hold the financial asset for the foreseeable future or to maturity.

   An active market exists when quoted prices are regularly provided, e.g. by an exchange or a broker, and these prices are representative of actual transactions between arms-length third parties.

   Financial instruments in this category are stated at cost of acquisition, equivalent to fair value at the time of initial recognition and taking transaction costs into account.

   They are measured subsequently at amortised cost; whereby premiums or discounts are amortised according to the effective interest method over the term and recognised in Net interest income. Financial instruments in the LAR category are shown under Cash reserves, Loans and advances to banks and Loans and advances to customers, Financial investments, Non-current assets held for sale and disposal groups or Other assets.

3. Financial assets available for sale (AfS) recognised at fair value under OCI and not taken through the statement of income:

   The category available for sale (AfS) encompasses all non-derivative assets which cannot be assigned to any of the other categories. The Group's AfS holdings relate primarily to marketable fixed income securities, investment fund units and equity instruments such as interests in affiliated companies and equity holdings which are recognised in accordance with IAS 39. They are recognised under Cash reserves, Loans and advances to banks, Loans and advances to customers, Financial investments, Non-current assets held for sale and disposal groups or Other assets.

   The initial measurement of financial assets available for sale is at the fair value at the time of acquisition plus transaction costs. Fair value at the time of acquisition generally corresponds to the transaction price. Subsequently, AfS financial instruments are measured at fair value in accordance with IAS 39.46. This also applies generally for equity instruments which are not listed. Subsequent measurement at cost in accordance with IAS 39.46 (c) in conjunction with IAS 39.A81 only takes place to an insignificant extent in this regard and only insofar as the fair value also cannot be determined reliably using other methods.

   Insofar as changes in value of AfS instruments measured at fair value are not attributable to impairment, they are recognised as Changes in fair value of AfS financial instruments under Other comprehensive income (OCI), taking deferred taxes into account, without affecting net income. By contrast, where hedged AfS instruments are concerned, the fluctuation relating to the hedged risk is recognised in the statement of income under Result from hedging and is separately disclosed as an adjustment item arising from the portfolio fair value hedge.

   When an asset is sold or impaired, the revaluation reserve is released through the statement of income so that the profit or loss is reflected in the statement of income. Any write-ups required after impairment are recognised directly in equity in Other comprehensive income (OCI) for equity securities and recognised in profit or loss for debt securities.

Amortisation of the difference between costs of acquisition and repayment amount for interest-bearing securities is stated under Net interest income, using the effective interest method.

4. Other liabilities (LIA):

   Other liabilities (LIA) include liabilities which are neither part of the trading portfolio nor classified as DFV.

   Financial liabilities are recognised at fair value at the time of issue plus transaction costs. Fair value at the time of acquisition generally corresponds to the transaction price. In subsequent periods, they are measured at amortised cost using the effective interest method.

B) Classification of financial instruments

The classification of financial instruments required for reporting by IFRS 7.6 is similar to the categorisation of financial instruments according to IAS 39 (IFRS 9 for financial liabilities designated at fair value) for the items in the statement of financial position, in order to ensure a uniform and clear picture of the financial position and performance. The table below shows the classes of financial instruments at HSH Nordbank:

Measurement method	Classes	
	IAS 39 category	Statement of financial position item/sub-item
Financial instruments measured at amortised cost	Loans and Receivables (LaR)	Cash reserve
		Loans and advances to banks
		Loans and advances to customers
		Financial investments
		Non-current assets held for sale and disposal groups
		Other assets
	Other liabilities (LIA)	Liabilities to banks
		Liabilities to customers
		Securitised liabilities
		Liabilities relating to disposal groups
		Subordinated capital
		Other liabilities
Financial instruments measured at cost	Available for sale (AfS)	Financial investments
		Non-current assets held for sale and disposal groups
		Other assets
Financial instruments measured at fair value	Held for Trading (HfT)	Trading assets
		Credit derivative under the second loss guarantee
		Non-current assets held for sale and disposal groups
		Trading liabilities
		Liabilities relating to disposal groups
	Designated at fair value (DFV)	Loans and advances to banks
		Loans and advances to customers
		Financial investments
		Non-current assets held for sale and disposal groups
	Available for sale (AfS)	Cash reserve
		Loans and advances to banks
		Loans and advances to customers
		Financial investments
		Non-current assets held for sale and disposal groups
	n/a	Positive fair value of hedging derivatives
		Negative fair values of hedging derivatives
Financial instruments measured on the basis of other standards	n/a	Receivables under finance leases
Off-balance-sheet transactions	n/a	Contingent liabilities
		Irrevocable loan commitments
		Other obligations
	IFRS 9 category	
Financial instruments measured at fair value	Designated FVPL (FVPL DFP)	Liabilities to banks
		Liabilities to customers
		Securitised liabilities
		Liabilities relating to disposal groups
		Subordinated capital

In addition to the holding categories, a distinction is made with regard to the substance, characteristics and risk of the financial instruments for the classification of line items and sub-items in the statement of financial position as listed above that fall within the scope of IFRS 13 for disclosures under IFRS 13. These are defined in each case for non-derivative instruments and derivatives and comprise the following:

Non-derivative financial instruments	Debt instruments
	Contractually linked instruments
	Equity and near-equity instruments
	Other trading portfolios
Derivatives	Interest rate derivatives
	Cross-currency interest rate derivatives
	Currency derivatives
	Credit derivatives
	Structured derivatives
	Other derivatives

Debt instruments are classified as follows for quantitative disclosures under IFRS 13 relating to financial instruments classified as loans and receivables in the Loans and advances to banks and Loans and advances to customers balance sheet line items.

Statement of financial position item/sub-item	IAS 39 category	Classes
Loans and advances to banks	Loans and Receivables (LaR)	Debt instruments Payable on demand
		Debt instruments Other loans and advances
Loans and advances to customers	Loans and Receivables (LaR)	Debt instruments
		Retail customers
		Corporate clients
		Public authorities

C) Loan loss provision and impairment of financial instruments

At every reporting date, a check is performed to establish whether there is objective evidence for the impairment of a financial asset which is not measured at fair value recognised in profit or loss.

An impairment test is performed if, after initial recognition of a financial instrument, there is objective evidence of an impairment which would have an impact on the anticipated future cash flows from the financial instrument.

Criteria for impairment are essentially major financial difficulties for the borrower and indications that, based on current information, interest payments cannot be made and an improvement in the financial situation cannot be demonstrated. These also particularly include deferrals of interest and/or principal payments, concessions such as the granting of restructuring loans in particular for the purposes of supporting the liquidity of the borrower as well as the threat of insolvency.

In the case of securities, an initial check is performed as to whether the market value has decreased in the last twelve months, either permanently by at least 10 % or once in the last six months by 20 % below the cost of acquisition. This applies to both equity and debt instruments. If an equity instrument is involved, it must be written down to fair value in such a case.

However, if debt instruments meet either of these criteria, they are checked as part of a multi-step risk assessment process to see if there are any indicators for impairment. An indicator for an impairment of a security is, for example, a downgrade to non-investment grade. Where a security is already non-investment grade and the rating deteriorates by another three categories, this would be another indicator. Asset-backed security (ABS) transactions are checked to see if the over-collateralisation mechanisms have seen a significant deterioration since purchase or issue. For collateralised debt obligations (CDOs) the par value and interest cover tests can normally be used, for example.

Specific loan loss provisions for interest-bearing securities are generally recognised in the amount of the difference between acquisition cost and fair value.

Identifiable default risks from the lending business are dealt with by making specific loan loss provisions for the loan or advance in question. To calculate the amount of the specific loan loss provisions, the net present value of the anticipated cash flows arising from the loan or advance – that is, achievable amount – is compared to its carrying amount. The anticipated cash flows may comprise capital repayments, interest payments or the proceeds from disposal of collateral less liquidation costs. If the carrying amount is greater than the realisable amount, a specific loan loss provision is created in the amount of the difference.

Assessments as to the need for loan loss provisions are frequently made on the basis of information which is partly provisional in nature (e.g. planned restructuring of borrowers, draft reorganisation reports) or are subject to increased volatility (e.g. collateral value of real estate and ships).

This results in increased uncertainty regarding estimates of key parameters of loan loss provisions. In such cases the large degree of uncertainty is mainly due to the assessment of expected cash flows which are dependent on borrowers, industries, the assessment of the overall economy among other factors. The assumptions made are subject to a periodic review and are adapted to the changed underlying conditions where necessary.

With respect to risks which have already occurred but have not yet been identified, general loan loss provisions are created for groups of assets which are comparable on the basis of their default risk. When determining the general loan loss provisions, current developments in the economic environment are taken into account through parameters from an expected loss approach. The general loan loss provisions are determined as of the reporting date on the basis of risk parameters derived from the determination of internal economic counterparty default risk. For the calculation the parameters probability of default (PD), loss given default (LGD) and for off-balance sheet items the credit conversion factor (CCF) are used. The loss identification period (LIP) in the calculation represents the interval between the occurrence of a default event and its announcement, transforming the expected loss approach to an incurred loss approach.

Additional general loan loss provisions had to be created for risks resulting from the challenging environment in particular in the shipping market.

Risks of uncertainties in assessment for the hedged portfolio are assumed by the guarantor under the second loss guarantee.

As the posting of the loan loss provision depends on the category of financial assets, the following distinctions must be made with regard to measurement:

a. Financial instruments belonging to the category LaR which are measured at amortised cost

Impairments to loans and advances to banks and customers are recorded in separate loan loss provisions accounts under the item Loan loss provisions. Loan loss provisions thus created are written off at the time when the amount of the actual default of the receivable is determined or the receivable defaults or is derecognised. Irrecoverable receivables for which no specific loan loss provisions existed are written off directly as is the case for losses in the case of impaired receivables which exceed the recorded loan loss provisions. Impairments to LaR securities are recorded by means of direct write-downs to the securities. Recoveries on receivables written-off are recognised in profit or loss.

b. Financial instruments belonging to the AfS category which are measured at fair value in OCI and not recognised in the statement of income

In the case of permanent or significant impairment to an AfS equity financial instrument, a direct write-down is recognised in profit or loss. In the process, the cumulative gains taken through the statement of income and recognised as equity are rebooked to net income from financial investments. This approach is used for AfS debt instruments accordingly. In the case of debt securities only, if the reasons for impairment no longer apply a write-up to the maximum of amortised cost is made in profit or loss. Amounts beyond this and write-ups to equity securities are recognised directly in the revaluation reserve in OCI.

Loan loss provisions are also set up for off-balance-sheet transactions and carried on the statement of financial position as provisions in the lending business.

Specific and general loan loss provisions are determined at first without taking the hedging effect of the guarantees received into account (cf. Note 3). The hedging effect is then mapped in the statement of financial position through the recognition of a compensation item, which directly reduces loan loss provisions.

D) Determining fair value

Under IFRS 13 the fair value represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value of financial instruments is determined on the basis of the listed price on an active market (mark-to-market), or if this is not possible on the basis of recognised valuation techniques and models (mark-to-matrix or mark-to-model). Irrespective of whether and to what extent the inputs applied in determining the fair value are observable in the market, financial instruments are assigned to one of the three fair value hierarchy levels as defined in IFRS 13.

Fair value can be determined using the mark-to-market method if a market price is available at which a transaction could be entered into or has been entered into for a similar financial instrument as at the measurement date. This is generally the case for shares traded on liquid markets. Such an unadjusted market price at the measurement date for the identical instrument is classified as level 1 of the valuation hierarchy under IFRS 13.

If such a market price is not available for the identical instrument, the measurement is carried out using valuation techniques or models.

1. Valuation techniques and models

   When using valuation techniques the market approach is the preferable method for determining the fair value. The fair value is determined to the extent possible on the basis of prices that come from transactions executed on the measurement date. If the fair value cannot be determined from market or transaction prices for the identical financial instrument, prices of comparable financial instruments or indices, which are representative for the financial instrument, are used as an alternative and adjusted where necessary (mark-to-matrix method). The fair value is assigned to level 2 of the fair value hierarchy if the adjustment to the prices or parameters observable in the market is not material. However, if the adjustment is material and affects unobservable inputs, the fair value is assigned to level 3.

   The fair value is determined based on an income approach using an appropriate model (e.g. option price model, discounted cash flow method), if the market approach using the mark-to-market or mark-to-matrix method is not possible or is not of sufficient quality. Where available, inputs observable in the market as well as quality assured market data from appropriate pricing agencies or also validated prices from market partners (arrangers) are also used as a primary source for model valuations. Fair values determined by means of model valuations, for which only observable inputs are used or which are only based to an insignificant extent on unobservable inputs, are assigned to level 2 of the fair value hierarchy. Observable market data is usually available for liquid securities and simple OTC derivatives traded on liquid markets (for example interest rate swaps, forward foreign exchange transactions and foreign exchange options in certain currencies as well as derivatives of certain listed equities or indices). If the fair values determined using valuation models are based to a significant extent on unobservable inputs, they are assigned to level 3 of the fair value hierarchy. Valuation models that are based on unobservable market data, and which therefore require assumptions concerning the relevant parameters, are often necessary for structured securities – or for securities whose markets are illiquid and for complex OTC derivatives.

   The fair value of receivables and liabilities measured at amortised cost is mainly determined by discounting the cash flows of the financial instruments. In the case of receivables with a default rating, the fair values are determined based on the still to be expected future cash flows.

   A portion of the liabilities measured at fair value comes under the guarantee obligation (Gewährträgerhaftung) (credit enhancements). Lower credit spreads are applied in determining the fair values for such liabilities than is the case for liabilities for which similar obligations of third parties do not exist.

   The following section gives an overview of the parameters and assumptions used and the valuation procedures they are based on.

2. Parameters used in valuation techniques and models

   The following are the parameters used to determine the fair value for each class of financial assets and liabilities. We refer to the information set out in Note 54 regarding the quantitative disclosures on significant, unobservable parameters.

   a. Trading assets/trading liabilities (HfT):

      Securities in the trading portfolio are valued using quoted market prices and prices from the liquid OTC market to a large extent. If a current price from a liquid market is not available, interest-bearing securities are valued using mixed prices of pricing services or the discounted cash flow method based on rating- and sector-dependent yield curves derived from market data of fixed-income securities.

      Exchange-traded derivatives are also valued using market prices. If no current price is available, recognised valuation models (such as the Black-Scholes model for European options) that are based on estimates of unobservable parameters to an insignificant extent at most are used.

      OTC derivatives are valued using valuation techniques and models. A distinction is drawn between plain vanilla derivatives traded in liquid markets, such as interest rate swaps, cross-currency interest rate swaps, FX forwards, FX options, single-name and index credit default swaps and complex derivatives where markets are illiquid. The former are valued using recognised techniques and models (such as the discounted cash flow method for simple interest rate and cross currency swaps) that are based on unobservable market parameters to an insignificant extent at most, while the latter require a significant number of judgements to be made with regard to the selection of both the model and the parameter estimates.

The financial crisis has resulted in derivatives being increasingly concluded on a secured basis in the interbank market (under a collateral agreement, e.g. CSA). At the same time, the collateral is also explicitly taken into account in the valuation of OTC derivatives.

b. Positive/negative fair value of hedging derivatives:

This class contains exclusively plain vanilla interest rate and cross-currency interest rate swaps which can be measured using recognised techniques and models.

c. Financial investments (AfS):

HSH Nordbank's financial investments comprise mainly fixed income securities. Substantial parts are valued using liquid market prices, such as prices from the liquid OTC market. If a current price from a liquid market is not available, interest-bearing securities are valued using mixed prices of pricing services or the discounted cash flow method based on rating- and sector-dependent yield curves derived from market data of fixed-income securities.

The financial investments also include ABS as partial holdings in the credit investment business. These are valued using the pricing hierarchy described previously.

Fair values are also calculated as a general rule for unlisted equity instruments (interests in affiliated companies, equity holdings in non-affiliated companies and equities recognised pursuant to IAS 39 or IFRS 5). The fair values are mainly calculated using the discounted cash flow method.

d. Credit derivative second loss guarantee (HfT):

The fair value is calculated on the basis of the assumption of full guarantee utilisation and a correspondingly discounted cash flow which takes account of the expected settlement dates and based on the present value of the premium of 2.2 % p.a. for the undrawn portion of the guarantee for the share of partial guarantee Two.

e. Assets/liabilities designated at fair value (DFV):

Assets designated at fair value carried under financial investments and loans and advances to customers or banks primarily comprise bonds. The pricing hierarchy mentioned above is used for these products.

Liabilities designated at fair value disclosed under Securitised liabilities, Liabilities to customers or Liabilities to banks and Subordinated capital include complex structured registered and bearer securities with embedded interest, currency and equity, as well as other risks, which are mainly directly hedged by corresponding derivatives (so-called back-to-back transactions). Where current market prices or OTC market prices are available for securitised liabilities on liquid markets, these are used. However, the vast majority of DFV liabilities is measured using valuation techniques and models. These make extensive use of complex techniques and models (such as option price models) which also use market parameters which are not directly observable.

The components of the change in fair value of the DFV positions attributable to the credit rating are determined on the basis of the spreads ascertainable in the market for instruments in the respective rating category. For liabilities categorised as DFV, a distinction is made in assigning an appropriate spread between instruments with and without guarantee obligation (Gewährträgerhaftung).

In light of the fact that the financial liabilities designated at fair value through profit or loss at HSH Nordbank are not linked, in economic terms, to corresponding asset positions, the recognition of the impact of changes in the default risk associated with the liabilities (changes in HSH Nordbank's own credit spread) in other comprehensive income does not produce/increase any accounting anomaly in profit and loss.

f. Assets not measured at fair value on the balance sheet (LaR):

Cash flows are discounted using the discounted cash flow method to determine the fair value of loans and advances to customers and loans and advances to banks. Sectoral-dependent market interest rate curves as well as rating- and ratio-dependent credit spreads are used as significant parameters in this regard.

Financial instruments in the LaR category disclosed under financial investments are mainly interest-bearing securities. If a stock exchange price or a price from the liquid OTC market is not available, prices obtained from pricing services are used or the discounted cash flow method is applied, whereby rating- and sector-dependent interest rate curves derived from market data for interest-bearing securities are used as parameters for discounting the cash flows.

For current receivables (e.g. current accounts) the carrying amount is taken as the fair value. This also applies to most of the cash reserve, as this comprises credit balances at central banks.

g. Liabilities not measured at fair value on the balance sheet (LIA)

The majority of financial instruments disclosed under the Liabilities to banks, Liabilities to customers, Securitised liabilities, Other liabilities and Subordinated capital balance sheet line items is allocated to the LIA category. These mainly comprise non-complex structured loan notes and bearer bonds as well as deposits. If a liquid stock exchange price or a price from the liquid OTC market is not available, mixed prices obtained from pricing services are used or the discounted cash flow method is applied, in order to determine the fair value. The spreads used for this are derived from the type of collateral and the ranking of the financial instrument in relation to other liabilities of the Bank. Any existing cancellation options are also taken into account.

For current liabilities (e.g. current accounts) the carrying amount is shown at fair value

3. Value adjustments

If the value of a financial instrument as determined by a valuation technique or model does not take adequate account of factors such as bid-offer spreads or closing costs, liquidity, model risks, parameter uncertainties, funding costs and benefits as well as credit and/or counterparty default risks, the Bank makes corresponding valuation adjustments, which a purchaser of similar positions would also take into account. The methods applied for this draw to some extent on unobservable market parameters in the form of estimates.

Funding costs and benefits arise on the hedging of the risks relating to an uncollateralised OTC derivative with a collateralised OTC derivative. A funding valuation adjustment is determined as part of the method used to determine fair values for derivatives and is included in the fair value of the uncollateralised OTC derivative for funding costs/benefits arising on the provision or receipt of collateral due to the hedging asymmetry of the derivatives.

Hedge relationships (back-to-back transactions) and corresponding risk-compensating effects are taken into account when determining value adjustments to be made for model risks and uncertainties regarding parameters. The value adjustment for funding costs and benefits as well as credit risk is determined for OTC derivatives at the level of a group of financial instruments of a business partner (so-called portfolio-based valuation adjustment). This is permitted if the conditions stipulated in IFS 13.49 for a portfolio-based measurement are met.

The portfolio-based valuation adjustment for funding costs and benefits as well as for credit risk is allocated to assets or liabilities in proportion to a corresponding valuation adjustment for the asset or liability respectively, excluding portfolio effects. Allocation only takes place to the assets or liabilities depending on whether there is an excess of assets or liabilities (so-called “relative fair value approach” – net approach).

4. Day One Profit and Loss

The use of a valuation model may give rise to differences between the transaction price and the fair value determined using such a valuation model on the initial recognition date. If the applicable market on which the determination of the fair value is to be based differs from the market, in which the transaction was concluded and the valuation model is not based to any great extent on observable parameters, such differences (so-called day one profits and losses) are accrued to day one profit and loss reserve. This reserve is reversed over the term.

The day one profit and loss reserve does not form part of the fair value of the corresponding individual financial instruments. It is included in the carrying amount as well as in the fair value as a discount to the fair value.

5. Measurement processes

The Bank has implemented various processes and controls for the purpose of determining the fair values of financial instruments and has embedded principles regarding the use of measurement methods in a guideline in the written rules of procedure. These measures also ensure that financial instruments to be assigned to level 3 of the fair value hierarchy are measured in accordance with IFRS 13. The Group Risk Management division, which is independent from the Bank’s market departments, is responsible for ensuring that the measurement methods applied are in accordance with external accounting requirements. Information available on the methods applied by other market participants is also taken into account in this regard.

Fair values of financial instruments assigned to level 3 are determined again on a periodic basis – but at least on a monthly basis. Any changes in value that have occurred since the previous period are reviewed for plausibility. Where available, observable market information such as transaction prices or attributes of valuation parameters are also used in the internal price validation. If there are material differences between the fair values determined by the Bank and prices offered by counterparties, the valuation model used is subjected to an ad hoc validation process.

Information purchased from pricing service companies is also used. Where possible, the prices and procedures of these service companies are periodically checked for plausibility and reviewed in order to assess the quality of the information provided.

The measurement procedures and models as well as the estimation technique used to determine the level-3 inputs and their parameterisation are periodically reviewed and, if applicable, developed further, recalibrated or replaced by new measurement procedures or models.

E) Hybrid financial instruments

IAS 39.A8 states that for financial instruments, not to be measured at fair value, the carrying amount of financial assets and liabilities must be adjusted and recognised in profit or loss if the estimated future cash flows associated with the instrument change. The new carrying amount is given by the present value of the newly estimated future cash flows using the financial instrument's original effective interest rate for discounting. In subsequent years the discount effect reduces with constant effective interest rate, leading to a write-up for financial liabilities which is recognised in Net interest income.

Application of IAS 39.A8 had an effect in the year under review on valuation of the hybrid financial instruments issued by HSH Nordbank, as the estimated future cash flows differ from the contractual cash flows.

The term "hybrid financial instruments" covers silent participations, profit participations and bonds issued by consolidated subsidiaries measured at amortised acquisition cost. A key common feature of these instruments is that their interest depends on profit and they participate in an annual net loss of the Bank.

The future cash flows whose amount and payment dates have to be estimated are payments of interest and principal which take into account:

- participations in loss by investors, where these will probably not be made up by the expected redemption date of an instrument;
- any contractually agreed retrospective coupon payments.

The loss situation of the reporting period is not viewed in isolation on the measurement of hybrid instruments in accordance with IAS 39.A8. Specifically, it involves more than assigning the prorated loss in the period under review. In addition, the possible effects of possible future assignment of loss and the cancellation or postponement of future interest payments must be recognised in profit or loss in the period in which the estimate is changed. This can mean that in future loss-making periods no further loss participations will be recognised in profit or loss, if these future losses correspond to the estimates made previously. The loss participation recognised in profit or loss is anticipated accordingly, rather than being left to the period in which the loss arises. Future loss-related reductions in interest also do not result in full relief to interest expenses, if the reduction in interest has already been taken into account in the estimate. Instead, the reversal of the effect of discounting applied in the year the estimate was changed is recognised in expenses (write-up of the liability due to the passage of time).

The estimation of future cash flows from hybrid financial instruments required in applying IAS 39.A8 requires material assumptions which are associated with uncertainties. The assumptions made are subject to a periodic review and are adapted to the changed underlying conditions where necessary. Among the key sources of uncertainty in estimation is the future income of HSH Nordbank, which depends specifically on the development of the economy. Assumptions are also required about the exercise of termination or extension options associated with the individual transactions. Based on the degree of knowledge about uncertainties at the time financial statements are drawn up, the possibility cannot be excluded that changing information in subsequent periods will require departure from previous assumptions, which would require new adjustments to the carrying amount of hybrid financial instruments recognised in profit or loss. In the case of declining expectations of loss, the participation in loss of investors would also decrease, which would be associated with an increase in our repayment obligations recognised in expenses. The same considerations apply to the reverse case.

Net income from hybrid financial instruments is shown as a separate item under Net interest income, and in addition to current interest expenses it includes the effects of applying IAS 39.A8 (see Note 8). Deferred taxes arise because of the difference between valuation for tax purposes and measurement in the Group financial statements. The associated effects on net income are recognised under income taxes. Hybrid financial instruments are shown either as securitised liabilities or as subordinated capital (see Notes 39 and 48).

F) Hedge accounting

Under IFRS, changes in value of items in IAS 39 categories AfS, LaR and LIA are not recognised in profit or loss. Changes in the value of derivatives are always recognised in profit or loss. If underlying transactions in IAS 39 category AfS, LaR or LIA are hedged with derivatives, the result is to distort the statement of income so that it does not correspond to the economic reality. One possibility to avoid these distortions is to use fair value hedge accounting. In fair value hedge accounting the changes in value of hedged items, which are attributable to the hedged risk, are recognised in profit or loss.

HSH Nordbank uses derivatives to hedge market risks resulting from loans, issues and securities portfolios. Portfolios of financial instruments are hedged in this way.

Portfolio fair value hedge accounting is used to avoid distortions in the statement of income. Currently only hedges of fair value against interest rate risk are taken into account. Fixed-interest rate loans, issued instruments and securities positions are designated as underlying transactions (hedged items), while only interest rate and interest rate currency swaps are designated as hedging instruments.

Where portfolios of underlying transactions are hedged, the hedging of these items with matching external derivatives is shown under portfolio fair value hedge accounting to the extent that this meets the requirements of IAS 39.

In the case of portfolio fair value hedge for interest rate risks, portfolios of assets and liabilities hedged for interest rate risks are taken into account. This involves an iterative procedure. At the start of a hedging period, the financial instruments in the portfolios are allocated to maturity ranges on the basis of their anticipated maturity or interest adjustment dates, and the hedged amount is then determined for each maturity range. The hedging transactions are also allocated at the start of the hedging period.

At the end of the hedging period, the hedge is recognised and measured and a new hedge is designated. The changes in the fair value of the hedged amounts of the underlying transactions due to the hedged risk are recognised in a separate item in the statement of financial position (asset or liability reconciling items from the portfolio fair value hedge). The fair value changes which are not attributable to the hedged risk are treated in accordance with the general rules for the corresponding IAS 39 category.

Using fair value hedge accounting requires a series of conditions to be met. These principally relate to the documentation of the hedge and its effectiveness. HSH Nordbank documents all hedging relationships in accordance with the requirements of IAS 39, including the hedging instrument, the hedged item (underlying transaction), the hedged risk and the result and method of measuring effectiveness.

Future changes in value of underlying and hedging transactions are simulated using a regression model within the framework of the prospective effectiveness test. Any actual changes in value are used in retrospective effectiveness testing. In portfolio fair value hedge accounting, HSH Nordbank uses the dollar offset method to measure effectiveness retrospectively. This tests whether the relationship between the changes in value of underlying and hedging transactions lies within an interval of 80 % to 125 %.

Changes in value of underlyings and hedging transactions in effective hedges which are attributable to the hedged risk are recognised in the Result from hedging.

Income and expenses from the depreciation of reconciling items for the fair value hedge portfolio and proceeds from the closing of the underlying transactions which contributed to reconciliation items are reported as part of the Net interest income.

G) Derecognition

A financial asset is derecognised when all material risks and opportunities associated with ownership of the asset have been transferred, i.e. when contractual claims on cash flows from the asset have been extinguished. Where not all risks and opportunities are transferred, the HSH Nordbank carries out a control test to ensure that no continuing involvement due to opportunities and risks retained prevents it from being derecognised. Financial assets are also derecognised if the contractual rights to cash flows have expired. Financial liabilities are derecognised when they are repaid, i.e. when the associated liabilities are settled or lifted or when due respectively. If the material contractual elements of an asset or liability are altered, this also results in a derecognition.

H) Repurchase agreements and securities lending transactions

HSH Nordbank only enters into genuine repo transactions. Genuine repo transactions, repo agreements or sell-and-buy-back transactions combine the spot purchase or sale of securities with their forward sale or repurchase, the counterparty being the same in both cases.

For genuine repo transactions with assets sold under repurchase agreements, the securities continue to be recognised by HSH Nordbank, as the interest, credit rating and other material risks associated with the securities continue to be borne by HSH Nordbank. According to counterparty, the inflow of liquidity from the repo transaction is shown in the statement of financial position as a liability either to banks or customers. Interest payments are recognised under interest expense over the term of the transaction. Outflows of liquidity caused by reverse repos are reported as loans and advances to banks or customers. Correspondingly, the securities bought under repurchase agreements are not carried or measured in the statement of financial position. Agreed interest payments are booked as interest income over the term of the transaction. Receivables arising from repos are not netted against liabilities from repos involving the same counterparty, since the criteria for netting are not met.

The emphasis in repo transactions is on bonds from German public sector issuers and from bank issuers and the Bank's own bonds. Securities lending transactions are carried on the statement of financial position in a similar way to genuine repurchase agreements. Lent securities remain in the securities portfolio, while borrowed securities are not capitalised on the statement of financial position. Cash collateral furnished for securities lending transactions is shown as a receivable, while collateral received is shown as a liability. Repo and securities lending transactions are carried out primarily in bonds.

I) Financial guarantee contracts

Pursuant to IAS 39.9, a financial guarantee is a contract that requires the issuer of the contract to make specified payments to reimburse the holder of the contract for the loss that the holder incurs because a specified debtor fails to make payment when due under the original or amended terms of a debt instrument. A credit derivative is treated as a financial guarantee based on the provisions of IAS 39 if the requirements of IAS 39.9 for the financial guarantee are met. Credit derivatives that do not meet the definition of a financial guarantee are allocated in accordance with the general valuation rules for the HfT category and valued at fair value.

Financial guarantees at HSH Nordbank are provided in the form of warranties, bank guarantees and letters of credit. Corresponding contingent liabilities are based on past events that may result in possible liabilities in the future. These liabilities arise as a result of the occurrence of unspecified future events where the amount required to meet them cannot be estimated with sufficient reliability. Financial guarantees are stated in accordance with the net method. If an adequately reliable estimate of the settlement amount is possible, a provision is recognised. If the premium payment to HSH Nordbank is distributed over the term of the financial guarantee, the guarantee will be stated as zero and the premium payment recognised on an accrual basis. If HSH Nordbank is the holder of a contract, the financial guarantee will be presented as collateral for the Group.

II. Notes on selected items relating to financial instruments in the statement of financial position

1. Cash reserve

   Cash on hand, balances with central banks, treasury bills and discounted treasury notes are stated under cash reserve.

   Both initial and subsequent measurement of assets (LaR) stated under cash reserve takes place at par value, which is equivalent to fair value due to its short-term nature.

   Treasury bills and discounted treasury notes recognised under AfS are measured at fair value.

2. Loans and advances

   Primarily assets from the loans and receivables (LaR) category are recognised in the statement of financial position under Loans and advances to banks and Loans and advances to customers. In addition, financial instruments in the categories DFV and AfS are recognised here.

   Loans and receivables of the category LaR are stated gross (before deduction of impairments). Loan loss provisions for impairments are stated in a separate item Loan loss provisions, shown under Loans and advances as a deduction. Financial instruments in the DFV and AfS categories are stated net. Where loans and receivables have been acquired or incurred with the intention of trading, they are stated under trading assets. If the disposal of loans and advances was decided and initiated as at the balance sheet date and it is highly probable that it can be completed within the following twelve months, they are reclassified as Non-current assets held for sale and disposal groups.

   Interest income from loans and advances to banks and customers is recorded under Interest income from lending and money market transactions. This also includes early repayment penalties from premature repayment of receivables. Premiums and discounts are accrued over the term of the loans and advances using the effective interest rate method. Accrued interest is also allocated to this item in the statement of financial position.

   If it is determined that a loan or advance is impaired, the calculation of interest accruals in accordance with the contractual terms of the loan or advance is discontinued. Interest income is instead determined on the basis of the interest rate used to discount the future cash flows for determining the impairment amount (unwinding).

Fees charged that are directly linked to the granting of a loan are deferred and accrued over the term of the loan or advance. Fees for services that are provided over a certain period of time are recognised over this period in which the service is performed. Commissions associated with the provision of a certain service are recognised as at the date the service has been provided in full.

If, in the case of non-genuine securitisation transactions, our loans and advances are not derecognised and the risk on such loans and advances remains fully with HSH Nordbank, we recognise any necessary loan loss provisions solely on our original loans and advances.

3. Positive and negative market value of hedge derivatives

This item shows the market value of derivatives which have a positive or negative fair value and which are used in hedge accounting. Only interest rate and interest rate currency swaps are taken into account as hedging instruments currently. If a derivative is only partially designated under hedge accounting, this item contains the corresponding share of that derivative's fair value. In these cases, the remainder is stated under Trading assets or Trading liabilities.

4. Reconciling asset and liability items from the fair value hedge portfolio

The asset-side reconciling item from portfolio fair value hedge accounting contains the value change of the hedged object to be attributed to the hedged risk from portfolio fair value hedges for assets. Similarly, the liability-side reconciling item from portfolio fair value hedge accounting contains the value change of the hedged object to be attributed to the hedged risk from portfolio fair value hedges for liabilities.

5. Trading assets and trading liabilities

Only financial assets classified as HfT are stated under Trading assets. These include primary financial instruments held for trading purposes, particularly fixed income securities and pro rata interest, and also equities and other trading portfolios such as precious metals. Loans and loan commitments with hard syndication conditions are also reported here. A significant component continues to be derivatives with a positive market value which are either trading derivatives or not designated as a hedging derivative because they do not meet the requirements of hedge accounting.

Measurement gains and losses are recognised in Net trading income. Interest income and expenses as well as dividend income are disclosed under Net interest income. Dividends are recognised when the right to receive payment is established. Commission income and expenses are disclosed in Net commission income.

In a similar way to Trading assets, Trading liabilities only include financial obligations belonging to the category held for trading (HfT), which includes derivatives with a negative market value which are either trading derivatives or which have not been designated as a hedging derivatives because they do not meet the requirements of hedge accounting. Delivery commitments from short sales of securities and pro rata interest from these are also stated in this category.

6. Financial investments

Financial investments include particularly portfolios in the AfS category, and also securities or holdings in the categories LaR and to a lesser extent in the DFV category. This item includes fixed-interest securities including accrued interest, equities and other non-fixed-interest securities, holdings in unconsolidated affiliated companies, and holdings in joint ventures and associates not carried at equity. Realised gains and losses from financial investments are shown in the statement of financial position in Net income from financial investments to the extent they are not DFV holdings. Changes in the value of the AfS instruments measured at fair value are recognised in Other comprehensive income (OCI). Net interest income from financial investments is shown in Net interest income. Dividends on financial assets are recognised when the right to receive payment is established. If the disposal of equity holdings or interests in affiliated companies was decided and initiated at the balance sheet date and it is highly probable that it can be completed within the following twelve months, they are reclassified as Non-current assets held for sale and disposal groups.

7. Financial investments accounted for under the equity method

Shares in associates included in the Group financial statements under the equity method are reported in this item. Such ownership interests are measured in accordance with the guidelines of IAS 28 in conjunction with IFRS 11.

For the impairment testing of financial investments accounted for under the equity method the total carrying amount of the investment measured under the equity method is assessed for impairment as a single asset in accordance with IAS 36. Its realisable amount is always compared with the carrying amount for this purpose, if there are indications on applying IAS 39 that the investment could be impaired.

The realisable amount is defined as the greater of fair value less costs to sell and value in use (for information on the calculation of the value in use, please refer to 7.III.1.).

8. Liabilities

Liabilities include financial liabilities in categories LIA and DFV. They are recognised as Liabilities to banks, Liabilities to customers, Subordinated debt and Securitised liabilities.

Financial liabilities are recognised at fair value at the time of issue plus transaction costs, which generally corresponds to the transaction price. In subsequent periods securities categorised as LIA are measured pursuant to IAS 39.47 at amortised cost applying the effective interest method. Changes in the measurement of LIA financial instruments are only recorded when the relevant instrument is sold. Differences between acquisition costs and repayment amount (e.g. premiums and discounts) are allocated according to the effective interest rate method and taken to Net interest income. Valuation results relating to DFV financial instruments are stated under the revaluation reserve.

Repurchased own debentures are set off against Securitised liabilities. For repurchased debentures in the DFV liabilities holding category (DFP (IAS39), FVPL_DFP (IFRS 9)), the non-recyclable, pro rata credit risk-induced valuation effects initially recognised in the revaluation reserve from own issues measured at fair value in profit or loss are stated in the revenue reserves. In respect of the discretionary rights under IFRS 9.1.7.2, we refer to the content of IFRS 9 Initial recognition in Note 1.

9. Subordinated capital

Subordinated liabilities, silent participations and profit-sharing certificates are shown under Subordinated capital, due to their different nature from other liabilities. Silent participations are structured as so-called hybrid financial instruments without exception and so are some profit-sharing certificates (cf. Note 7.I.E.). No obligation to other creditors for premature redemption of subordinated liabilities is possible. In the case of liquidation or insolvency, subordinated liabilities may only be repaid after the claims of all senior creditors have been met.

Based on their contractual structure and financial character, the participations of the typical silent partner represent debt, which is why they are stated under Subordinated capital.

Subordinated capital categorised as LIA is recognised and measured initially at fair value (taking the transaction costs into account) and at amortised acquisition cost subsequently. Premiums and discounts are allocated on a constant effective interest rate basis.

Current gains and losses from measuring subordinated capital categorised as DFV are stated under the revaluation reserve.

See Note 7.I.E. with regard to the treatment of hybrid financial instruments in the year under review.

III. Notes on other items in the statement of financial position

1. Intangible assets

Software acquired or developed in-house and acquired goodwill are accounted for under Intangible assets. In accordance with IAS 38.21, HSH Nordbank capitalises software development costs if the production of the in-house software is likely to generate an economic benefit and the costs can be reliably determined. In accordance with IAS 38.21, HSH Nordbank capitalises software development costs if the production of the in-house software is likely to generate an economic benefit and the costs can be reliably determined. Subsequent costs are only to be capitalised if they lead to a significant improvement of the software in the form of an expansion of the software's functionality. Since HSH Nordbank does not apply the full goodwill approach, goodwill arises on acquisition of subsidiaries, when the cost of acquisition exceeds the Group's share in the remeasured net assets (shareholders' equity) of the company acquired.

The initial measurement of intangible assets is made at acquisition or production costs in accordance with IAS 38.24. They are subsequently measured at amortised acquisition or production cost.

Software developed in-house is subject to linear depreciation over two to ten years.

If there are indications of impairment, intangible assets are subject to an impairment test. For this test the carrying amount of these intangible assets is compared with the realisable amount. The realisable amount is defined as the greater of fair value less costs to sell and value in use. An asset is impaired if its carrying amount exceeds its realisable amount. Intangible assets with an indefinite useful life, intangible assets not ready for use as well as goodwill are subject to an annual impairment test even if there are no signs which suggest impairment.

Examination of the value of goodwill is carried out on the basis of cash-generating units. Cash-generating units of HSH Nordbank for non-strategic investments are defined based on the internal management level (global head structure). Each global head unit forms an own cash-generating unit. A company is regarded as a non-strategic investment if underlying subsidiaries are integrally involved in the business activities of the respective global heads. However, if the value in use is expected to be realised by cash inflows or an increase in value of a subsidiary alone, then the subsidiary itself continues to be a cash-generating unit (so-called strategic investment). Where the anticipated benefit can no longer be determined, a write-down is made.

The value in use of a cash generating unit is determined on the basis of forecast and discounted net cash flows. Net cash flows are usually determined on the basis of Group planning for a detailed planning period of five years. For subsequent periods the planned cash flows of the last year of the plan are taken into account allowing for a growth trend. The planned cash flows are based on a risk-adequate discount rate.

2. Property, plant and equipment

Land and buildings, plant and equipment and leasing assets under operating leases where HSH Nordbank acts as lessor are stated under this item. Property, plant and equipment is stated at cost of acquisition or production less linear depreciation in line with its expected useful life. Subsequent costs of acquisition or production are capitalised provided they increase the economic utility of the asset concerned. Interest paid to finance acquisition costs of property, plant and equipment is recorded as an expense in the period concerned.

Physical wear and tear, technical obsolescence and legal and contractual restrictions are taken into consideration when determining useful life. For property, plant and equipment, linear depreciation is calculated over the following periods:

CATEGORY OF PROPERTY, PLANT AND EQUIPMENT

	Useful life in years
Buildings	50
Leasehold improvements	Calculation of residual life is based on the remaining term of the rental agreement.
Other operating equipment	3–15
Leasing assets	Customary useful life

Property, plant and equipment is reviewed at each reporting date for signs which suggest impairment.

Gains and losses from the disposal of property, plant and equipment are shown under Other operating income in the statement of income. Repairs, servicing and other maintenance costs are recorded as an expense in the period concerned.

3. Investment property

Under the item Investment property properties are disclosed that are held to earn rental income or make capital gains but are not used for own operations. For mixed use properties a percentage allocation of the carrying amount is made. Own-used properties are reported under Property, plant and equipment; rented-out or empty parts are reported as Investment property. The properties are recognised at acquisition cost and depreciated on a straight-line basis. A useful life of 50 years is used for depreciation purposes. The capitalised income method is used in determining the fair value of investment properties, using market data from internal certified appraisers. The fair value is disclosed in Note 32.

4. Non-current assets held for sale and disposal groups and liabilities relating to disposal groups

Non-current assets whose carrying amounts will be predominantly or primarily realised through a sale and not through continuing use must be classified as held for sale in accordance with IFRS 5 on the condition that a sale has already been decided on and initiated as of the reporting date, and is extremely likely to be completed within the following twelve months.

A disposal group is a group of assets which are sold to the same purchaser in a single transaction and at a single price. A disposal group can also include liabilities, if these are taken over by the purchaser together with the assets.

Non-current assets and disposal groups held for sale are to be measured at the lower of carrying amount or fair value less sale costs. Financial instruments continue to be measured according to the requirements of IAS 39.

5. Provisions

Provisions are created where the Group has existing legal and actual obligations resulting from previous events and it is likely that meeting the obligation will require an outflow of resources and a reliable assessment of the amount of the obligation can be made. Provisions are examined and redetermined at least quarterly.

Pension provisions

The majority of employees of HSH Nordbank AG as well as employees of several domestic subsidiaries are entitled to benefits from different staff pension plans, which include both defined contribution and defined benefit plans.

In the case of defined contribution plans, contractual relationships with Provinzial NordWest Lebensversicherung AG for direct insurance policies partly financed by employees exist. As the insurance company is required to be a member of Protektor Lebensversicherungs-AG, the insured employees are protected against its insolvency, so that HSH Nordbank AG is not burdened even in the event of Provinzial NordWest Lebensversicherung AG's insolvency. These direct insurance policies represent insured benefits and are treated as defined contribution plans.

In the case of the defined benefit plans, the amount of benefit depends on various factors, such as age, salary and length of service. Pension plans include specifically retirement and disability pensions and survivor benefits. They are based primarily on employment contracts of Landesbank Schleswig-Holstein Girozentrale, the retirement plan of Hamburgische Landesbank Girozentrale, retirement pension guidelines of the Hamburgische Landesbank Girozentrale relief fund, the pension plan of Hamburgische Landesbank Girozentrale and Section 2 (4) of the Investment Bank Act in the version of 23 January 1998. The pension payment amount depends on the final salary paid immediately prior to retirement, the salary trend up to retirement is irrelevant (no performance components). The pension plans provide for on-going pension payments and no capital payments. Minimum guarantees are not provided for. Pension provisions for defined benefit plans are equivalent to the net present value of the pension entitlements earned as of the reporting date, factoring in anticipated wage and salary increases and the trend in annuities. Calculations are based solely on actuarial reports based on IAS 19, which are prepared by independent actuaries using the projected unit credit method.

These defined benefit plans were closed in 2002.

HSH Nordbank AG also participates in a multi-employer plan which is run by BVV Versorgungskasse des Bankgewerbes e.V. Contributions are regularly paid with participation from the employees. The BVV tariffs provide for fixed pension payments with profit participation. For BVV, employers have a subsidiary liability for the liabilities of their employees. HSH Nordbank AG classifies the BVV plan as a defined-benefit joint pension scheme provided by a number of employers. As the BVV relief fund does not fully allocate its assets neither to the beneficiaries nor the member companies and as the information available for its accounting treatment as a defined benefit plan is insufficient to be able to allocate the assets and pension commitments to the current and former employees of the individual member companies, the plan is treated as a defined contribution plan for accounting purposes. It appears unlikely that there will be any call based on the statutory subsidiary liability.

The remeasurement of net defined benefit liabilities is disclosed under Other comprehensive income and under Equity in Retained earnings in the year in which they arise. Pension provisions are discounted as long-term liabilities.

The interest expense included in expense for retirement pensions is recognised as part of Net interest income.

The following assumptions are made in calculating direct benefit pension liabilities:

ACTUARIAL ASSUMPTIONS

	2017	2016
Discount rate		
Domestic	1.87 %	1.66 %
Foreign (weighted)	1.87 %	1.66 %
Salary growth (weighted)	2.0 %	2.0 %
Adjustment rate for pensions		
Domestic		
Employment contract 1/ old pension provision rules	individual	individual
New pension provisionrules (weighted)	2.0 %	2.0 %
Employment contract 4 (weighted)	2.0 %	2.0 %
Mortality, disability, etc.	Based on the 2005 G tables of K. Heubeck	Based on the 2005 G tables of K. Heubeck

Actuarial assumptions are subject to a sensitivity analysis as described in Note 43.

Defined benefit pension plans are partly financed from assets and qualified insurance policies used exclusively for pensions (plan assets). Plan assets are measured at fair value and recognised in the statement of financial position as reducing provisions.

Other provisions

Other provisions include provisions in the lending business, for restructuring, litigation risks and costs, for personnel expenses (without pensions) and other provisions.

Provisions in the lending business are created, among other reasons, for any sudden calls to pay under warranty bonds, guarantees and letters of credit. The parameters used for the calculation are presented in the section Loan loss provisions and impairment of financial instruments (Note 7.I.C).

Provisions for restructuring are created to the extent HSH Nordbank had developed and communicated a sufficiently detailed plan for such measures and had started to implement such plan.

As soon as the obligation is sufficiently certain or can be quantified – e.g. through the signing of agreements – it is transferred to Other liabilities or Provisions for pensions and similar obligations as a matter of principle.

In the statement of income, the item “Net income from restructuring and privatisation” is used to report the ongoing expenses incurred in respect of restructuring measures taken in connection with the formal decision made in the state aid proceedings by the European Commission on 2 May 2016 on the replenishment of the second loss guarantee, as well as the expenses connected with the privatisation of HSH Nordbank. The expenses incurred in the 2017 financial year are explained in more detail in Note 18.

Provisions for litigation costs comprise expected payments for court costs as well as for non-court costs in connection with litigation such as, e.g. attorneys' fees and other costs. For litigation in progress, only costs for the current jurisdictional level may be included within the provision.

Provisions for litigation risks are to be created when HSH Nordbank AG or any of its consolidated subsidiaries is the defendant in an action and the probability that the Bank will lose the action is presumed to be greater than 50%. Provisions include only payments for probable liability for damages and fines as well as costs of litigation at the current level of appeal. The general measurement rules on provisions apply. The mandatory disclosures defined in IAS 37.86 are made for litigation risks that are not considered likely to arise, but which cannot be entirely excluded.

Under Provisions for personnel expenses, in general all outstanding benefits within the personnel expenses are presented with the exception of pension obligations. In the HSH Nordbank, these are in particular provisions for variable performance-related pay, anniversary payments, partial retirement and long-term credits for hours. Provisions for anniversary payments and partial retirement are accounted for based on actuarial expert reports.

In accordance with IAS 37, provisions are mainly determined based on the best estimate of management. The most likely amount necessary to meet the obligations identifiable on the reporting date is recognised. Long-term provisions are reported at present value to the extent discounting effects are significant. For discounting purposes, interest rates that are valid on the reporting date and are term-appropriate are used based on risk-free interest curves. Addition of accrued interest to be performed during the reporting year is reported under Net interest income.

6. Income taxes

Current tax assets and liabilities are stated at the amount of the anticipated refund from, or payment to, the tax authorities, applying the tax provisions of the countries in question.

Deferred tax assets are created for all deductible timing differences between the value of an asset or liability as measured by IFRS standards and its assigned value in tax terms, provided it is probable that taxable income will be available against which such differences can be utilised. Deferred tax liabilities are created for all taxable temporary differences. Deferred taxes on tax loss carryforwards are stated as the amount likely to be used in future. Deferred taxes are calculated using the tax rates and rules anticipated to be valid at the time when the deferred tax assets are to be realised. The effects of tax rate changes on deferred taxes are taken into account on adoption of the legislative amendment. Deferred tax assets are recognised and measured as deferred income tax claims and deferred tax liabilities as deferred income tax liabilities.

HSH Nordbank prepares tax results planning for the purpose of assessing deferred tax asset impairment.

Expenses and income from deferred taxes are in principle recognised on an accrual basis in the statement of income under Income taxes, separate from actual tax expenses and income. In doing so, the accounting treatment of the underlying situation is taken into account. Deferred taxes are recognised in the statement of income if the item in the statement of financial position itself is recognised in profit or loss. Deferred taxes are charged or credited directly to equity in OCI, if the underlying item itself is charged or credited directly to equity (IAS 12.61A).

At each reporting date HSH Nordbank makes an assessment as to whether the realisation of future tax benefits is sufficiently probable to recognise deferred tax assets. Amongst other things, this requires a management assessment of the tax benefits that arise from the existing tax strategies and future taxable income as well as the consideration of other positive and negative factors. The deferred tax assets disclosed could decrease, if the estimates of the planned taxable income and the tax benefits achievable under the existing tax strategies are revised downwards or if changes to current tax legislation restrict the timing and extent of the realisability of future tax benefits.

7. Other assets and other liabilities

All remaining assets and liabilities not allocable to any other item are stated under Other assets or Other liabilities. These include accrued expenses and income amongst other things.

The general recognition and measurement criteria for assets are observed. Initial recognition is at cost. For financial instruments included in this item the provisions of IAS 39 apply.

IV. Leasing transactions

Pursuant to IAS 17, the term “lease” refers to the transfer of use for an agreed period in return for a fee. A distinction is made between finance and operating leases. The allocation depends on whether substantially all risks and rewards are transferred to the lessee or not.

A finance lease is considered to be present where the economic risks and rewards as defined by IAS 17 lie with the lessee; consequently, the leased asset is reported in the latter’s statement of financial position. All other leasing arrangements are classified as operating leases. The classification is made at the beginning of each lease.

1. Finance leases

In the case of finance leases, HSH Nordbank acts solely as lessor and recognises a receivable in the amount of the net investment value either under Loans and advances to banks or Loans and advances to customers, depending on the lessee.

Leasing rates due are divided into a repayment part which is not recognised in profit or loss and an interest part which is. The part taken to profit or loss is recognised in Net interest income.

Impairments of finance lease receivables attributable to changes in credit risk are recognised in Loan loss provisions. Impairments not attributable to changes in credit risk, such as the impairment of the non-guaranteed residual value of a leasing receivable, are recognised in other operating expense.

2. Operating leases

   As lessor HSH Nordbank states leasing objects as assets measured at amortised cost under Property, plant and equipment or as Investment property.

   Leasing instalments received are stated under Other operating income, and the corresponding depreciation stated in Administration expenses.

V. Currency translation

The Group financial statements of HSH Nordbank are drawn up in euros. The euro is the functional currency of the overwhelming majority of the individual financial statements included in the Group financial statements. However some Group companies have another functional currency.

The following principles are applied when translating foreign currency items within single entity financial statements and for translating the financial statements of Group companies which do not draw up their accounts in euro.

1. Presentation of foreign currency transactions in the Group financial statements

   Initial measurement of assets and liabilities from all foreign currency transactions takes place at the spot rate for the transaction.

   In subsequent measurement, monetary items are translated based on the spot mid-rate as of the reporting date. Non-monetary items that are stated in the statement of financial position at fair value are translated using the spot mid-rate applicable at the time of measurement and any other non-monetary items at the historical rate.

   Expenses and income in foreign currency arising from the measurement of items in the statement of financial position are translated using the rates applied for translating the items in question. The transaction rates are used for all other expenses and income.

   For monetary and non-monetary items measured at fair value, currency translation differences are always recognised in the statement of income of the period when the result arose. An exception are currency translation gains and losses from the measurement of non-monetary AfS financial instruments recognised at fair value, which are recognised in OCI.

2. Translation of financial statements prepared in foreign currency for inclusion in the Group financial statements

   Assets and liabilities from financial statements denominated in foreign currencies are translated at the period-end rate. Average rates for the reporting period are used to translate expenses and income. With the exception of the revaluation reserve reported to be included in the financial statements, which is translated at the closing rate, equity is translated at historic rates (date of the transaction).

   Any differences arising from this method of translation are reported under OCI and under Equity in the Currency reserve.

NOTES ON THE GROUP STATEMENT OF INCOME

8. NET INTEREST INCOME

NET INTEREST INCOME

(€ m)	**2017**	2016
Interest income from		
Lending and money market transactions	1,030	1,245
Fixed-interest securities	215	259
Trading transactions	4	5
Derivative financial instruments	1,420	1,624
Unwinding	94	162
Sale of promissory note loans	299	142
Current income from		
Equities and other non-fixed-interest securities	7	8
Equity holdings in non-affiliated companies	15	17
Other holdings	2	4
Interest income	**3,086**	**3,466**
of which attributable to financial instruments not classified as HfT or DFV	1,398	1,561
Negative interest resulting from		
Lending and money market transactions	– 30	– 13
Derivative financial instruments	– 275	– 178
Negative interest	**– 305**	**– 191**
Interest expenses for		
Liabilities to banks	118	148
Liabilities to customers	423	472
Securitised liabilities	220	299
Subordinated capital	17	25
Trading transactions	1	0
Other liabilities	18	24
Sale of promissory note loans	1	11
Derivative financial instruments	1,404	1,754
Interest expenses	**2,202**	**2,733**
of which attributable to financial instruments not classified as HfT or DFV	490	571
Positive interest for		
Liabilities to banks	– 8	– 2
Liabilities to customers	– 14	– 6
Derivative financial instruments	– 274	– 175
Positive interest	**– 296**	**– 183**
Net income from re-estimating interest and repayment cash flows	413	–
Net income from discounting and compounding	– 109	– 118
Net loss from hybrid financial instruments	**304**	**– 118**
of which attributable to financial instruments not classified as HfT or DFV	304	– 118
Total	**1,179**	**607**

Interest income and expenses relating to trading and hedging derivatives are disclosed under interest income and expense from/for trading and hedging derivatives.

Net interest income includes income and expenses arising from the amortisation of the adjustment items for portfolio fair value hedge relationships and corresponding proceeds from the closing of the underlying transactions which contributed to the adjustment item.

The net interest income from impaired loans and advances is determined by compounding the present value of the expected payment flows at the original effective rate of interest (unwinding).

The term hybrid financial instruments covers silent participations, profit participation capital and bonds measured at amortised cost, the return on which is profit-related and which participate in the net loss for the year and accumulated losses of the Bank.

The total of current participation in losses (not allowing for reversals of impairment losses) relating to the 2017 financial year was € 285 million (previous year: € 0 million).

Net income or loss from hybrid financial instruments includes both the effects on profit/loss resulting from the application of IAS 39.A8 as well as the current interest income from the instruments that fall under the scope of application of this standard.

The cumulative net income from hybrid financial instruments amounts to € 647 million as at 31 December 2017 (previous year: € 343 million). € 2,057 million is attributable to the result from re-estimating interest and principal repayment flows (previous year: € 1,644 million) and € – 1,410 million is attributable to the income/loss from discounting and compounding (previous year: € – 1,301 million).

The difference between the valuation for tax purposes and measurement under IAS 39.A8 results in deferred tax assets of € 7 million (previous year: € 15 million).

9. NET COMMISSION INCOME

NET COMMISSION INCOME

(€ m)	2017	2016
Commission income from		
Lending business	53	52
Securities business	7	10
Guarantee business	10	15
Payments and account transactions as well as documentary business	25	25
Other commission income	12	13
Commission income	**107**	**115**
Commission expense from		
Lending business	3	4
Securities business	3	6
Guarantee business	27	5
Payments and account transactions as well as documentary business	6	5
Other commission expenses	3	8
Commission expenses	**42**	**28**
Total	**65**	**87**

Financial instruments not classified as HfT or DFV accounted for € 68 million (previous year: € 87 million) of Net commission income.

The premium expense resulting from the synthetic securitisation transaction (see Note 3 II) is reported under Net commission expense of guarantee business in the amount of € 25.9 million.

10. RESULT FROM HEDGING

The change in value attributable to the hedged risk for designated underlying and hedging transactions in effective hedging relationships is reported under the item Result from hedging. The item contains the corresponding profit contributions from portfolio fair value hedges as well as from micro fair value hedges in the previous year. Hedge accounting is used solely for interest rate risks.

RESULT FROM HEDGING

(€ m)	2017	2016
Fair value changes from hedging transactions	– 54	– 15
Micro fair value hedge	–	– 16
Portfolio fair value hedge	– 54	1
Fair value changes from underlyings	36	11
Micro fair value hedge	–	16
Portfolio fair value hedge	36	– 5
Total	**– 18**	**– 4**

11. NET TRADING INCOME

Net trading income comprises realised gains and losses and measurement gains and losses on financial instruments classified as HfT and DFV. Interest income and expense for financial instruments in these categories are disclosed in Net interest income.

Gains and losses arising on currency translation are generally disclosed in this statement of income line item. The results from the translation of loan loss provisions denominated in foreign currency are disclosed in the loan loss provisions.

Other products comprises the income from foreign exchange transactions, credit derivatives and commodities.

NET TRADING INCOME

(€ m)	**2017**	2016
Bonds and interest rate derivatives		
HfT	173	10
DFV	19	96
Total	**192**	**106**
Equities and equity derivatives		
HfT	–	– 2
DFV	– 1	– 4
Total	**– 1**	**– 6**
Other products		
HfT	63	– 11
DFV	–	– 1
Total	**63**	**– 12**
Total	**254**	**88**

Net trading income includes net income from foreign currency of € 76 million (previous year: € – 6 million).

During the reporting period € 13 million (previous year: € – 18 million)) of the changes in fair value of the financial assets categorised as DFV related to changes in the credit spread rather changes in market interest rates. In cumulative terms, a total of € 3 million (previous year: € – 25 million) is attributable to changes in the credit spread.

Since 1 January 2017, changes in value related to changes in the credit spread rather than to market interest rate changes for liabilities in the category DFV have been reported in Other comprehensive income (OCI). This is due to the early application of IFRS 9 for credit risk-induced fair value changes in the Bank's own liabilities (see Note 1, IFRS 9 – Financial Instruments). In the previous year, € 9 million (€ 13 million in cumulative terms) was reported under Net trading income.

12. NET INCOME FROM FINANCIAL INVESTMENTS

In addition to any realised gains and losses from financial investments classified as loans and receivables (LaR) and available for sale (AfS), write-downs and write-ups and general loan loss provisions are reported under this item. In the case of financial investments classified as AfS, write-ups are only recognised in the statement of income for debt instruments up to a maximum of the amortised cost.

NET INCOME FROM FINANCIAL INVESTMENTS

(€ m)	**2017**	2016
Classified as AfS		
+ Realised gains/losses (–)	82	69
– Write-downs	68	44
+ Write-ups	–	–
Total	**14**	**25**
Classified as LaR		
+ Realised gains/losses (–)	28	41
– Write-downs	1	6
+ Write-ups	45	77
Total	**72**	**112**
+ Reversal of general loan loss provisions (LaR portfolios)	4	3
Total	**4**	**3**
Total	**90**	**140**

In the year under review, equity instruments classified as AfS not measured at fair value with a carrying amount of € 43 million (previous year: € 26 million) were disposed of. This did not result in any realised income, as was already the case in the previous year.

Remaining instruments of this kind were written down by € 0 million (previous year: € 3 million).

13. NET INCOME FROM FINANCIAL INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

As at 31 December 2017, HSH Nordbank does not hold any shares in companies that are included in the Group financial statements under the equity method (previous year: one associate and one joint venture). For information on this development, please refer to Note 5.

The pro rata net income assigned to the Group from financial investments accounted for under the equity method as at 31 December 2017 is summed up below:

NET INCOME FROM FINANCIAL INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

(€ m)	**2017**	2016
Pro rata net income for the period	2	3
Total	**2**	**3**

Net income from financial investments accounted for under the equity method is disclosed in the segment report as a part of Net income from financial investments. The main net income from financial investments accounted for under the equity method is shown under the Non-Core Bank segment. This relates to First Ship Lease Trust up until its reclassification as held for sale (see Note 5).

14. LOAN LOSS PROVISIONS IN THE LENDING BUSINESS

LOAN LOSS PROVISIONS IN THE LENDING BUSINESS

(€ m)	2017	2016
– Expense from additions to loan loss provisions	2,307	2,621
+ Income from the reversal of loan loss provisions	764	1,178
Result from changes in loan loss provisions	**-1,543**	**-1,443**
– Expenses from allocations to provisions in the lending business	46	75
+ Income from reversals of provisions in the lending business	83	67
Result from changes to provisions in the lending business	**37**	**-8**
– Direct write-downs	49	187
+ Payments received on loans and advances previously written down	153	61
Result from other changes to loan loss provisions	**104**	**-126**
Result from changes in loan loss provisions before currency translation gains or losses and compensation	**-1,402**	**-1,577**
Currency translation gains or losses on loan loss provisions denominated in foreign currency	**44**	**-76**
Compensation under the second loss guarantee	**-728**	**2,284**
Total loan loss provisions in the lending business	**-2,086**	**631**

With regard to the compensation item related to the second loss guarantee, please refer to Note 3.

Direct write-downs of € 49 million (previous year: € 187 million) relate entirely to Loans and advances to customers.

Loan loss provisions in on-balance-sheet lending business relate exclusively to loans and advances classified as LaR. The following table shows the net changes:

NET CHANGES IN LOAN LOSS PROVISIONS IN THE LENDING BUSINESS

(€ m)	2017	2016
Specific loan loss provisions	-1,771	-1,682
General loan loss provisions	228	239
Net change in loan loss provisions in the lending business	**-1.543**	**-1,443**
Provisions for specific risks	2	-16
Provisions for portfolio risks	35	8
Net change in provisions in the lending business	**37**	**-8**

15. ADMINISTRATIVE EXPENSES

ADMINISTRATIVE EXPENSES

(€ m)	2017	2016
Personnel expenses	230	256
Operating expenses	249	278
Depreciation on property, plant and equipment and amortisation on intangible assets	36	100
Total	**515**	**634**

PERSONNEL EXPENSES

(€ m)	2017	2016
Wages and salaries	180	209
Social security contributions	28	31
of which employer contributions to government-sponsored pension plans	14	15
Expenses for pensions and support	22	16
Total	**230**	**256**

Please refer to Note 43 for detailed information on expenses for pensions and support as well as expenses for defined contribution plans.

OPERATING EXPENSES

(€ m)	2017	2016
IT costs	93	106
Costs for external services and project work	52	62
Legal service costs	41	42
Expenses for land and buildings	12	13
Obligatory contributions and expenses related to corporate law	8	10
Costs of advertising, PR and promotional work	5	6
Expenses on plant and equipment	1	1
Other expenses	37	38
Total	**249**	**278**

Depreciation on property, plant and equipment and amortisation on intangible assets are broken down as follows:

DEPRECIATION

(€ m)	2017	2016
Scheduled depreciation on		
Plant and equipment	3	3
Property	3	3
Acquired software	3	3
Software developed in-house	2	3
Leasing assets	–	20
Technical equipment and machinery	–	2
Unscheduled depreciation on		
Property	–	4
Leasing assets	–	33
Technical equipment and machinery	–	29
Non-current assets held for sale and disposal groups	25	–
Total	**36**	**100**

Of the scheduled depreciation on property € 0 million (previous year: € 1 million) related to investment property.

The unscheduled depreciation on Assets held for sale was recognised for assets that form part of a disposal group. Further information in this regard can be found in Note 33.

The total unscheduled depreciations are attributable to the Non-Core Bank segment.

16. OTHER OPERATING INCOME

OTHER OPERATING INCOME

(€ m)	**2017**	2016
Income		
from reversal of other provisions and release of liabilities	34	25
from cost allocations and refunds of expenses	38	34
from leasing transactions	25	41
from single-ship companies (charter rates)	18	–
from disposal of property, plant and equipment	11	2
from the write-up of property, plant and equipment	9	–
from legal disputes	5	33
from the reversal of provisions for processing fees in the lending business	2	2
from interest on receivables from the tax office	1	11
from investment property (rental income)	–	5
Other income	46	33
Total income	**189**	**186**
Expenses		
from additions to other provisions	71	16
from the disposal of receivables	25	–
for interest expenses pursuant to Section 233 AO	11	14
from disposal of property, plant and equipment	10	1
for investment property	3	7
Other expenses	45	67
Total expenses	**165**	**105**
Income/loss arising on the deconsolidation of companies	– 2	– 23
Total	**22**	**58**

With regard to the income or loss arising from the deconsolidation of companies, please refer to our explanations in Note 5.

The other income includes € 7 million in income from the initial consolidation of single-ship companies (see Note 5).

17. EXPENSES FOR BANK LEVY AND DEPOSIT GUARANTEE FUND

EXPENSES FOR BANK LEVY AND DEPOSIT GUARANTEE FUND

(€ m)	**2017**	2016
Expenses for European bank levy and deposit guarantee	41	56
Total	**41**	**56**

The expenses for the bank levy were recognised in full at the beginning of the year.

The expense for the deposit guarantee of the German Savings Bank Finance Group (Sparkassen Finanzgruppe) is also disclosed under this item. The contribution was levied based on the Deposit Guarantee Act (Einlagensicherungsgesetz).

18. NET INCOME FROM RESTRUCTURING AND PRIVATISATION

NET INCOME FROM RESTRUCTURING AND PRIVATISATION

(€ m)	**2017**	2016
Personnel expenses due to restructuring	–	63
Operating expenses due to restructuring	25	52
Income largely from reversals of provisions for restructuring	11	8
Net income from restructuring	**-14**	**-107**
Expenses from privatisation	52	3
Net income from restructuring and privatisation	**-66**	**-110**

The programmes for the reduction of operating and personnel expenses initiated in 2014 and 2016 continued during the year under review. In particular, general and administrative expenses were incurred, largely relating to the implementation of defined cost-cutting measures within IT projects. The expenses associated with the privatisation of HSH Nordbank are also reported under Net income from restructuring and privatisation. The privatisation expenses during the reporting period relate primarily to external project support and legal advice relating to the preparations for privatisation.

19. EXPENSES FOR GOVERNMENT GUARANTEES

EXPENSES FOR GOVERNMENT GUARANTEES

(€ m)	**2017**	2016
HSH Finanzfonds AöR	149	214
Total	**149**	**214**

In June 2013, the guarantee granted by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg was replenished to € 10 billion. An amount € 22 million of the one-off payment for the replenishment of the second loss guarantee was recognised on a pro rata temporis basis in the previous year. The share of the premium relating to partial guarantee Two (CDS) is disclosed under the line item Hedging effect of the credit derivative in the amount of € 5 million (previous year: € 12 million). The drop in expenses is due to the increased utilisation of the guarantee in connection with the agreement that guarantee premiums are only payable on the non-utilised portion of the guarantee (see Note 3).

20. INCOME TAXES

INCOME TAXES

(€ m)	**2017**	2016
Corporate tax and solidarity surcharge		
Domestic	22	20
Foreign	–	–
Trade income tax		
Domestic	20	19
Current income taxes	**42**	**39**
Income tax from previous years	5	6
Subtotal current income tax	**47**	**45**
Income from deferred tax		
from temporary differences	– 53	4
from losses carried forward	83	4
from consolidation	– 2	– 1
Subtotal deferred income tax	**28**	**7**
Income tax expense (+)/ income (–)	**75**	**52**

A write-down of € 265 million of deferred tax assets recognised on temporary differences was required due to the lack of recoverability.

The possibility of using existing tax loss carryforwards in the head office is reduced in the future by the expected privatisation. As a result, no deferred tax assets were recognised on tax loss carryforwards.

Deferred taxes on tax loss carryforwards are measured on the basis of a recoverability analysis, which is based on the corporate plan.

In the reporting year, the expenses with regard to deferred taxes on loss carryforwards essentially relate to the New York branch, because the deferred tax liabilities on the basis of which the deferred tax assets on loss carryforwards were originally set up declined considerably.

RECONCILIATION INCOME TAXES

(€ m / %)	**2017**	2016
Group net result	– 528	69
Income tax expense	75	52
Income before taxes incl. income from transfer of losses	– 453	121
Domestic income tax rate to be applied (in %)	31.97	31.67
Imputed income tax expenses in the financial year	**– 145**	**38**
Tax effects due to		
appreciation/depreciation of deferred taxes on losses carried forward	– 64	– 67
differing effective tax rates in Germany and abroad	– 21	–
non-deductible expenses	54	39
corrections to trade taxes	– 9	–
changes in tax rate	– 7	–
Taxes for previous years	3	6
Tax-free income	– 1	– 5
Appreciation/depreciation of deferred taxes on temporary differences and miscellaneous	265	41
Total tax expense (+)/income (–)	**75**	**52**

The tax expense consists primarily of current income taxes for the 2017 financial year and expense resulting from the increase in provisions for tax risks due to changes in the risk assessment as a result of findings from the ongoing tax audit. The change in income tax expense for previous years is largely based on the adjustment of tax loan loss provisions at head office.

In calculating taxes for 2017, a rate of 31.97 % (previous year: 31.67 %) was used for domestic taxes.

The main effects in the reconciliation of the notional to the actual tax expense include the write-down of deferred taxes on temporary differences in the financial year in an amount of € 265 million, as well as a reduction in the tax expense due to utilisation of loss carryforwards for which no deferred tax assets had been recognised to date (€ 64 million). This use of loss carryforwards that had not been deferred to date related mainly to the head office and the Luxembourg branch and is mainly attributable to the increase in income due to the non-recognition, for tax purposes, of loan loss provisions set up in the financial year.

In addition, there were material reconciliation effects resulting from non-tax-deductible expenses, trade tax corrections and different effective tax rates for foreign Group units.

21. NET GAINS AND LOSSES FROM FINANCIAL INSTRUMENTS

Net gains and losses from financial instruments include both realised gains and measurement gains within Net trading income and Net income from financial investments, the hedging effect of the credit derivative under the second loss guarantee as well as loan loss provisions with regard to credit business shown on the statement of financial position, broken down into IAS 39 categories. Neither Net interest nor Net commission income is included in this item.

NET GAINS AND LOSSES FROM FINANCIAL INSTRUMENTS

(€ m)	**2017**	2016
DFV	18	91
AfS	14	25
LaR	– 2,047	754
HfT	1,046	– 478
Total	**– 969**	**392**

Derecognition of the fair value changes cumulated in equity associated with value adjustments and sales of financial instruments categorised as AfS is shown in Note 49.

The change in IAS 39 category for LaR portfolios is due to the change in the loan loss provisions. The increase in the HfT category is the result of the increase in the hedging effect of the credit derivative.

22. EARNINGS PER SHARE

For the calculation of Earnings per share, the Group net result attributable to HSH Nordbank shareholders is divided by the weighted average number of ordinary shares outstanding during the year under review. As in the previous year, HSH Nordbank AG has not issued any issued any diluted forms of capital as at 31 December 2017, i.e. the diluted and undiluted earnings are the same. The calculation was based on non-rounded values.

EARNINGS PER SHARE

	2017	2016
Attributable Group net result (€ m) – undiluted/diluted	– 535	67
Number of shares (millions)		
Average number of ordinary shares outstanding – undiluted/diluted	302	302
Earnings per share (€)		
Undiluted	– 1.77	0.22
Diluted	– 1.77	0.22

NOTES ON THE GROUP STATEMENT OF FINANCIAL POSITION

23. CASH RESERVE

CASH RESERVE

(€ m)	**2017**	2016
Cash on hand	4	5
Balances at central banks	6,515	3,368
of which at the Deutsche Bundesbank	6,499	3,342
Treasury bills, discounted treasury notes and similar debt instruments issued by public-sector institutions	106	118
Total	**6,625**	**3,491**

24. LOANS AND ADVANCES TO BANKS

LOANS AND ADVANCES TO BANKS

(€ m)	**2017**			2016		
	Domestic	Foreign	**Total**	Domestic	Foreign	Total
Payable on demand	582	1,333	1,915	694	2,257	2,951
Other loans and advances	1,773	150	1,923	1,164	77	1,241
Total before loan loss provisions	**2,355**	**1,483**	**3,838**	**1,858**	**2,334**	**4,192**
Loan loss provisions	–	1	1	–	1	1
Total after loan loss provisions	**2,355**	**1,482**	**3,837**	**1,858**	**2,333**	**4,191**

€ 222 million (previous year: € 245 million) of Loans and advances to banks have a residual maturity of more than one year.

Loans and advances to banks include money market transactions in the amount of € 2,317 million (previous year: € 3,268 million).

Information on collateral transferred which also contains information regarding securities lending and repurchase agreements can be found in Note 63.

25. LOANS AND ADVANCES TO CUSTOMERS

LOANS AND ADVANCES TO CUSTOMERS

(€ m)	2017			2016		
	Domestic	Foreign	**Total**	Domestic	Foreign	Total
Retail customers	651	36	687	963	38	1,001
Corporate clients	18,424	16,152	34,576	22,802	22,103	44,905
Public authorities	3,752	159	3,911	4,530	474	5,004
Total before loan loss provisions	**22,827**	**16,347**	**39,174**	**28,295**	**22,615**	**50,910**
Loan loss provisions	1,952	2,541	4,493	3,321	3,157	6,478
Total after loan loss provisions	**20,875**	**13,806**	**34,681**	**24,974**	**19,458**	**44,432**

Of Loans and advances to customers, holdings of € 25,420 million (previous year: € 31,119 million) have a residual maturity of more than one year.

Loans and advances to customers include money market transactions in the amount of € 982 million (previous year: € 1,508 million).

Loans and advances to customers include receivables under finance lease transactions in the amount of € 76 million (previous year: € 98 million). The gross investment value of the leasing transactions is € 82 million (previous year: € 105 million). Further details on leasing transactions can be found in Note 62.

Information on collateral transferred which also contains information regarding securities lending and repurchase agreements can be found in Note 63.

26. LOAN LOSS PROVISIONS

LOAN LOSS PROVISIONS

(€ m)	**2017**	2016
Loan loss provisions for loans and advances to banks	1	1
Loan loss provisions for loans and advances to customers and non-current assets held for sale and disposal groups	4,493	6,711
Loan loss provisions in the lending business	**4,494**	**6,712**
Compensation under the second loss guarantee	–5,181	–7854
Loan loss provisions for items in the statement of financial position	**–687**	**–1,142**
Provisions in the lending business	67	110
Loan loss provisions for items in the statement of financial position and off-balance-sheet risk in the lending business	**–620**	**–1,032**

The specific and general loan loss provisions are determined at first without taking the hedging effect of the guarantee received into account. The hedging effect is then mapped in the statement of financial position through the recognition of a compensation item, which directly reduces loan loss provisions (see Note 3). Impairment losses of € 0 million (previous year: € 233 million) are attributable to the Non-current assets held for sale line and disposal groups item in the statement of financial position.

The compensation item also includes compensatory claims against the guarantor HSH Finanzfonds AöR resulting from settled losses for transactions for which loan loss provisions had already been recognised.

This means that there is still an overcompensation of the loan loss provisions as at 31 December 2017.

When calculating the loan loss provisions for the credit portfolio that was sold on 28 February 2018, which has a volume of € 6.3 billion (EaD), the probable purchase price shares attributed to the individual sold assets were taken into account as expected cash flows at the expected closing date. In order to confirm that the portfolio transaction was consistent with the arm's length principle, the Management Board of HSH Nordbank AG obtained a valuation report as well as a fairness opinion. The valuation report, which was prepared by an internationally recognised auditing company in accordance with professional standard IDW S 1, was also used for the allocation of the purchase price for the overall portfolio to the individual assets.

The development of loan loss provisions for banks during the period under review was as follows:

DEVELOPMENT OF LOAN LOSS PROVISIONS FOR LOANS AND ADVANCES TO BANKS BEFORE COMPENSATION

(€ m)	Specific loan loss provisions		General loan loss provisions		Total	
	2017	2016	**2017**	2016	**2017**	2016
As at 1 January	**–**	**14**	**1**	**1**	**1**	**15**
Additions	–	–	–	–	–	–
Reversals	–	–	–	–	–	–
Utilisation	–	14	–	–	–	14
As at 31 December	**–**	**–**	**1**	**1**	**1**	**1**

The development of loan loss provisions for customers during the period under review was as follows:

DEVELOPMENT OF LOAN LOSS PROVISIONS FOR LOANS AND ADVANCES TO CUSTOMERS AND NON-CURRENT ASSETS HELD FOR SALE AND DISPOSAL GROUPS BEFORE COMPENSATION

(€ m)	Specific loan loss provisions		General loan loss provisions		Total	
	2017	2016	**2017**	2016	**2017**	2016
As at 1 January	**6,336**	**7,601**	**375**	**611**	**6,711**	**8,212**
Additions	2,307	2,590	–	31	2,307	2,621
Reversals	536	908	228	270	764	1,178
Utilisation	3,093	2,864	–	–	3,093	2,864
Other changes	–	–7	–	–	–	–7
Reclassifications	–	–	–	–	–	–
Unwinding	–94	–162	–	–	–94	–162
Changes in the scope of consolidation	–13	6	–	–	–13	6
Exchange rate changes	–552	80	–9	3	–561	83
As at 31 December	**4,355**	**6,336**	**138**	**375**	**4,493**	**6,711**

The other changes in 2016 are attributable to the extension of the scope of consolidation due to the initial consolidation of a subsidiary that was previously considered immaterial (see Note 5). The changes in holdings due to the exchange rate are due to the significant proportion of impairment allowances in USD. The EUR/USD exchange rate had changed in favour of the EUR as against 31 December 2016 (+14%).

The loan loss provisions relate exclusively to items categorised as Loans and Receivables (LaR). The total volume of loans impaired amounts to € 6,813 million (previous year: € 10,541 million), of which € 0 million relates to receivables disclosed under the line item Non-current assets held for sale and disposal groups (previous year: € 233 million).

27. POSITIVE FAIR VALUE OF HEDGING DERIVATIVES

The positive fair value of derivatives used in hedge accounting is accounted for in this item. Only interest rate and cross currency interest rate swaps are taken into account as hedging instruments currently. If a derivative is only partially designated under hedge accounting, this item contains the corresponding share of that derivative's fair value. In these cases, the remainder is stated under Trading assets. Hedge accounting is used solely for interest rate risks.

POSITIVE FAIR VALUE OF HEDGING DERIVATIVES

(€ m)	**2017**	2016
Positive fair value of derivativesused in portfolio fair value hedges	264	508
Total	**264**	**508**

Of hedging derivatives, holdings of € 255 million (previous year: € 477 million) have a residual maturity of more than one year.

Changes in this item are directly related to changes in the item Negative fair value of the hedging derivatives. The overall changes in this item are mainly due to changes in the portfolio compositions and movements in interest rates in the euro and US dollar capital markets.

28. TRADING ASSETS

Only financial assets classified as HfT are stated under Trading assets. Mainly included in this category are original financial instruments held for trading purposes, including accrued interest, and derivatives with a positive fair value which are either not designated as a hedge derivative or are used as hedging instruments but do not meet the requirements of IAS 39 for hedge accounting.

TRADING ASSETS

(€ m)	**2017**	2016
Bonds and debentures		
from public-sector issuers	42	277
negotiable and listed	42	277
from other issuers	159	181
negotiable and listed	156	142
negotiable and not listed	3	39
Debentures and other fixed-interest securities	**201**	**458**
Positive fair value of financial derivatives		
Interest rate-related transactions	2,990	4,340
Currency-related business	72	137
Other business	358	466
Positive fair value of financial derivatives	**3,420**	**4,943**
Other, including promissory notes held for trading	13	23
Receivables from syndication transactions	7	9
Total	**3,641**	**5,433**

Trading assets of € 3,313 million (previous year: € 4,930 million) have a residual maturity of more than one year.

Information on collateral transferred which also contains information regarding securities lending and repurchase agreements can be found in Note 63.

29. FINANCIAL INVESTMENTS

Disclosed as financial investments are, specifically, financial instruments not held for trading purposes classified as AfS and LaR and, to a lesser extent, as DFV. This item includes bonds and other fixed-interest securities, equities and other non-fixed-interest securities, holdings in unconsolidated affiliated companies, holdings in joint ventures and associates not carried at equity in the Group financial statements.

FINANCIAL INVESTMENTS

(€ m)	**2017**	2016
Debentures and other fixed-interest securities	13,545	15,203
negotiable and listed	12,704	13,946
negotiable and not listed	841	1,257
Shares and other non-fixed-interest securities	51	170
negotiable and listed	5	6
negotiable and not listed	10	37
Equity holdings in non-affiliated companies	50	119
negotiable and listed	1	43
negotiable and not listed	6	5
Interests in affiliated companies	1	1
negotiable and listed	–	–
negotiable and not listed	–	–
Total	**13,647**	**15,493**

Financial investments of € 11,076 million (previous year: € 14,119 million) have a residual maturity of more than one year.

Write-downs on debentures and other fixed-interest securities amount to € 2 million (previous year: € 162 million), on shares and other non-fixed-interest securities they amount to € 78 million as at the reporting date (previous year: € 18 million).

General loan loss provisions amount to € 2 million (previous year: € 7 million).

Changes in specific and general loan loss provisions are recognised in Net income from financial investments.

This portfolio also contains shares and other non-fixed-interest securities measured at cost of € 0 million (previous year: € 125 million). Equity capital instruments accounted for at cost that relate to interests in affiliated companies and equity holdings in non-affiliated companies amount to € 0 million (previous year: € 78 million).

Information on collateral transferred which also contains information regarding securities lending and repurchase agreements can be found in Note 63.

Developments with regard to equity holdings and interests in affiliated companies are presented below:

DEVELOPMENT IN EQUITY HOLDINGS AND INTERESTS IN AFFILIATED COMPANIES

(€ m) **2017**	Equity holdings in non-affiliated companies	Interests in affiliated companies	**Total**
Acquisition costs as at 1 January 2017	**223**	**3**	**226**
Additions	10	–	10
Disposals	100	–	100
Reclassifications	–	–	–
Exchange rate changes	–	–	–
Changes in the scope of consolidation	–	–	–
As at 31 December 2017	**133**	**3**	**136**
Amortisation as at 1 January 2017	**104**	**2**	**106**
Additions	2	–	2
Disposals	45	–	45
Reclassifications	–	–	–
Change in measurement recognised directly in equity	22	–	22
Exchange rate changes	–	–	–
As at 31 December 2017	**83**	**2**	**85**
Carrying amount as at 31 December 2017	**50**	**1**	**51**
Carrying amount as at 1 January 2017	**119**	**1**	**120**

DEVELOPMENT IN EQUITY HOLDINGS AND INTERESTS IN AFFILIATED COMPANIES

(€ m) 2016	Equity holdings in non-affiliated companies	Interests in affiliated companies	**Total**
Acquisition costs as at 1 January 2016	**245**	**2**	**247**
Additions	15	1	16
Disposals	11	–	11
Reclassifications	–26	–	–26
Exchange rate changes	–	–	–
Changes in the scope of consolidation	–	–	–
As at 31 December 2016	**223**	**3**	**226**
Amortisation as at 1 January 2016	**121**	**2**	**123**
Additions	11	–	11
Disposals	–	–	–
Reclassifications	–8	–	–8
Change in measurement recognised directly in equity	–20	–	–20
Exchange rate changes	–	–	–
As at 31 December 2016	**104**	**2**	**106**
Carrying amount as at 31 December 2016	**119**	**1**	**120**
Carrying amount as at 1 January 2016	**124**	**–**	**124**

30. FINANCIAL INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

Shares in associates and joint ventures included in the Group financial statements under the equity method are disclosed in this line item.

As at the reporting date of 31 December 2017, the HSH Nordbank Group does not hold any shares in companies that are included in the Group financial statements under the equity method (previous year: one associate and one joint venture). The carrying amount was € 13 million as at 31 December 2016.

An overview of and detailed information on the associates and joint ventures included in the Group financial statements are set out in Note 5. Net income from financial investments accounted for under the equity method is disclosed in Note 13.

Please see Note 29 for a summary of financial information related to financial investments not accounted for under the equity method.

31. INTANGIBLE ASSETS

The Intangible assets item comprises software developed in-house or acquired.

INTANGIBLE ASSETS

(€ m)	**2017**	2016
Software	9	12
developed in-house	3	5
acquired	6	7
Software in development	1	2
acquired	1	2
Total	**10**	**14**

Changes in the carrying amounts of intangible assets are shown below:

DEVELOPMENT IN INTANGIBLE ASSETS

(€ m)		Software		Software in development		
2017	Goodwill	Software developed in-house	Acquired software	Software developed in-house	Acquired software	**Total**
Acquisition costs as at 1 January 2017	**190**	**98**	**172**	**–**	**2**	**462**
Additions	–	–	1	–	–	1
Disposals	–	–	1	–	–	1
Reclassifications	–	–	1	–	– 1	–
As at 31 December 2017	**190**	**98**	**173**	**–**	**1**	**462**
Amortisation as at 1 January 2017	**190**	**93**	**165**	**–**	**–**	**448**
Additions	–	2	3	–	–	5
Disposals	–	–	1	–	–	1
As at 31 December 2017	**190**	**95**	**167**	**–**	**–**	**452**
Carrying amount as at 31 December 2017	**–**	**3**	**6**	**–**	**1**	**10**
Carrying amount as at 1 January 2017	**–**	**5**	**7**	**–**	**2**	**14**

DEVELOPMENT IN INTANGIBLE ASSETS

(€ m)		Software		Software in development		
2016	Goodwill	Software developed in-house	Acquired software	Software developed in-house	Acquired software	Total
Acquisition costs as at 1 January 2016	**190**	**98**	**170**	**–**	**–**	**458**
Additions	–	–	2	–	2	4
Disposals	–	–	–	–	–	–
Reclassifications	–	–	–	–	–	–
As at 31 December 2016	**190**	**98**	**172**	**–**	**2**	**462**
Amortisation as at 1 January 2016	**190**	**90**	**162**	**–**	**–**	**442**
Additions	–	3	3	–	–	6
Disposals	–	–	–	–	–	–
As at 31 December 2016	**190**	**93**	**165**	**–**	**–**	**448**
Carrying amount as at 31 December 2016	**–**	**5**	**7**	**–**	**2**	**14**
Carrying amount as at 1 January 2016	**–**	**8**	**8**	**–**	**–**	**16**

As in the previous year, no research costs were incurred in the year under review in connection with the implementation of software developed in-house.

32. PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTY

PROPERTY, PLANT AND EQUIPMENT

(€ m)	**2017**	2016
Land and buildings	219	222
Plant and equipment	12	13
Assets under construction	1	1
Total	**232**	**236**

Under the item Investment property all property (land or buildings) is recorded that is held to earn rent or for capital appreciation but is not used in the production or supply of goods or services of the Bank.

INVESTMENT PROPERTY

(€ m)	**2017**	2016
Investment property	13	12
Total	**13**	**12**

The fair value of investment property amounts to € 13 million (previous year: € 12 million). The fair values of investment property are allocated without exception to level 3 of the fair value hierarchy. Market-based and income-based valuation techniques are used to determine fair value.

The development in Property, plant and equipment and Investment properties in the financial year was as follows:

DEVELOPMENT IN PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTIES

(€ m) **2017**	Land and buildings	Plant and equipment	Assets under construction	Investment property	Leasing assets	Technical equipment and machinery
Acquisition costs as at 1 January 2017	**233**	**64**	**1**	**14**	**–**	**–**
Additions	2	1	–	–	–	–
Disposals	–	1	–	–	–	–
Other changes	–	–	–	–	–	–
Reclassifications	– 3	–	–	1	–	–
Exchange rate changes	–	–	–	–	–	–
Changes in the scope of consolidation	–	–	–	–	–	–
As at 31 December 2017	**232**	**64**	**1**	**15**	**–**	**–**
Amortisation as at 1 January 2017	**11**	**51**	**–**	**2**	**–**	**–**
Additions	2	3	–	–	–	–
Disposals	–	2	–	–	–	–
Other changes	–	–	–	–	–	–
Reclassifications	–	–	–	–	–	–
Exchange rate changes	–	–	–	–	–	–
Changes in the scope of consolidation	–	–	–	–	–	–
As at 31 December 2017	**13**	**52**	**–**	**2**	**–**	**–**
Carrying amount as at 31 December 2017	**219**	**12**	**1**	**13**	**–**	**–**
Carrying amount as at 1 January 2017	**222**	**13**	**1**	**12**	**–**	**–**

Land and buildings in the amount of € 3 million were reclassified as investment properties in the year under review.

€ 2 million was reclassified from investment properties to non-current assets held for sale. These assets were sold in the year under review.

Further details on depreciation are presented in Note 15.

DEVELOPMENT IN PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTIES

(€ m) 2016	Land and buildings	Plant and equipment	Assets under construction	Investment property	Leasing assets	Technical equipment and machinery
Acquisition costs as at 1 January 2016	**222**	**63**	**7**	**106**	**325**	**148**
Additions	6	2	–	–	9	1
Disposals	–	2	–	4	78	–
Other changes	–	–	–	–	77	–
Reclassifications	5	1	–6	–57	–344	–152
Exchange rate changes	–	–	–	–	11	3
Changes in the scope of consolidation	–	–	–	–31	–	–
As at 31 December 2016	**233**	**64**	**1**	**14**	**–**	**–**
Amortisation as at 1 January 2016	**9**	**50**	**–**	**42**	**162**	**70**
Additions	2	3	–	5	53	31
Disposals	–	2	–	2	39	–
Other changes	–	–	–	–	23	–
Reclassifications	–	–	–	–22	–206	–104
Exchange rate changes	–	–	–	–	7	3
Changes in the scope of consolidation	–	–	–	–21	–	–
As at 31 December 2016	**11**	**51**	**–**	**2**	**–**	**–**
Carrying amount as at 31 December 2016	**222**	**13**	**1**	**12**	**–**	**–**
Carrying amount as at 1 January 2016	**213**	**13**	**7**	**64**	**163**	**78**

The other changes in the previous year are attributable to the extension of the scope of consolidation due to the initial consolidation of a subsidiary that was previously considered immaterial.

Some items reported under assets under construction were reclassified as land and buildings and as plant and equipment.

There were also reclassifications made from tangible assets to Non-current assets held for sale. A total carrying amount of € 48 million was reclassified from technical equipment and machinery, with a total amount of € 138 million being reclassified from leasing assets.

A total carrying amount of € 35 million was also transferred from Investment Properties to Non-current assets held for sale.

The line item Investment property, under Changes in scope of consolidation, only includes disposals from the scope of consolidation.

33. NON-CURRENT ASSETS HELD FOR SALE AND DISPOSAL GROUPS

NON-CURRENT ASSETS HELD FOR SALE AND DISPOSAL GROUPS

(€ m)	**2017**	2016
Loans and advances to banks	1	2
Loans and advances to customers	12	1,133
Financial investments	–	18
Property, plant and equipment	113	186
Investment property	–	34
Other assets	13	9
Total before loan loss provisions	**139**	**1,382**
Loan loss provisions	–	233
Total after loan loss provisions	**139**	**1,149**

As at 31 December 2016, this item largely included assets that were sold on the market as part of the implementation of the EU decision of 2 May 2016 (market portfolio). The market portfolio consisted of non-strategic loan portfolios in the LaR category which are to be allocated in full to the Non-Core Bank segment As at 31 December 2016, the market portfolio comprised the Aviation I, Aviation II, Continental European Commercial Real Estate, Energy and International Real Estate disposal groups.

With the sale of the Continental European Commercial Real Estate disposal group in the first quarter of 2017, the Investment property in an amount of € 34 million reported under Non-current assets held for sale and disposal groups as at 31 December 2016, as well as loans and advances to customers in an amount of € 448 million were completely derecognised in 2017.

The sale of the Energy disposal group was closed in the second quarter of 2017. Within this context, property, plant and equipment in an amount of € 33 million and loans and advances to customers in an amount of € 147 million were derecognised.

Loans and advances to customers in an amount of € 43 million, which were attributable to the International Real Estate disposal group, were also sold and derecognised in full in the third quarter of 2017.

With the sale of the Aviation I disposal group, further loans and advances to customers in an amount of € 495 million were derecognised in the 2017 financial year.

The Aviation II disposal group that existed as at 31 December 2016 comprised loan receivables from six fully consolidated special purpose companies. The Group financial statements of HSH Nordbank recognise the assets and liabilities of these subsidiaries. The underlying loan receivables are eliminated in the Group financial statements as intra-Group obligations. The sale plan as at 31 December 2016 provided for the sale of these loan receivables to a buyer (investor) as part of a portfolio deal. In accordance with the transaction structure, this loan portfolio sale was also to involve the transfer of property, plant and equipment (aircraft), other assets (cash accounts) and provisions held by the special purpose companies to the investor. This means that, as at 31 December 2016, these assets and liabilities held by the subsidiaries were reported as held for sale.

In the reporting year, there was a change in the sales plan relating to the former Aviation II disposal group. This change relates to the fact that the Bank is no longer pursuing the originally envisaged loan portfolio sale with the investor any further due to a failure to reach a commercial agreement, and now plans (as at 31 December 2017) to implement the NPE reduction that it is still planning to achieve in respect of these financing arrangements as part of an individual asset realisation structure. The transaction structure underlying the individual asset realisation provides for the sale of the property, plant and equipment held by the subsidiaries in an amount of € 113 million within the next twelve months in order to repay the loan receivables to the greatest extent possible. Within this context (and as was also the case with the originally planned portfolio sale), the provisions and cash accounts of the special purpose companies are also to be transferred to the respective buyers of the aircraft. As a result of the amended sales plan, the former Aviation II disposal group is largely unchanged in its composition, but is now split into six disposal groups (Aviation II/I to Aviation II/VI) as a result of the individual asset realisation plan. Within the context of the subsequent measurement of these disposal groups in accordance with IFRS 5, losses in an amount of € 25 million (reported under Administrative expenses) and other operating income in an amount of € 9 million were incurred in the financial year. As at 26 February 2018, the sale of the Aviation II/I disposal group was concluded with definitive effect. No gain or loss arose from the sale. The fair value of the property, plant and equipment is assigned to levels 1 and 3 in the valuation hierarchy.

As at 30 June 2017, two other loan portfolios met the criteria for classification as “held for sale” pursuant to IFRS 5. These also consisted of non-strategic loan portfolios in the real estate and aviation asset classes (attributable to the Non-Core Bank) and were split into a total of nine disposal groups. The transaction for the Real Estate disposal group, which comprised loans and advances to customers in an amount of € 152 million, was closed in the fourth quarter of 2017. The purchase agreement for the eight disposal groups in the aviation asset class was signed in August 2017. The purchase agreement provides for staggered closing individually for each of the portfolio items contained in the disposal groups. Seven out of eight closings had already been achieved in the third and fourth quarter of 2017. There were total loan loss provisions of € 65 million for the receivables derecognised in the Group statement of financial position within this context. The transaction for the remaining loans and advances to customers in an amount of € 12 million (Non-Core Bank segment) is expected to be closed in the first quarter of 2018. The loans and advances to customers are assigned to the LaR category.

In the fourth quarter of 2017, the FSL Group, consisting of three subsidiaries and one associate (Non-Core Bank segment), was classified as a disposal group in accordance with IFRS 5, as the sale plan, which was developed in accordance with the commitment strategy, results in the loss of control/significant influence over the companies in the FSL Group. As at 31 December 2017, this disposal group includes not only loans and advances to banks (€ 1 million) but also, in particular, other assets in an amount of € 12 million. The latter relate primarily to the share in the associate First Ship Lease Trust (Non-Core Bank segment), which was included in accordance with the equity method directly before IFRS 5 classification. The remeasurement in accordance with IFRS 5 did not result in any significant earnings effects. This transaction was closed in February 2018.

In addition, four loan receivables amounting to € 35 million in the LaR category (attributable to the Non-Core Bank segment) were sold to another credit institution as part of a sale transaction in the third quarter of 2017. Loan loss provisions of € 17 million had been set up for these four loan receivables.

An investment property located in the US, which had been allocated to the Non-Core Bank segment, was sold in the third quarter of 2017, generating a profit of € 1.1 million.

An equity holding held for sale as at 31 December 2016 (€ 18 million), which had been assigned to the Other and consolidation segment, was sold in the 2017 financial year. The change in fair value of the equity holding of € 18 million recognised directly in equity in other comprehensive income as at 31 December 2016 was realised through profit or loss in the third quarter of 2017.

As a result of a restructuring measure implemented on 1 June 2017, five single-ship companies, whose main assets were ships, were included in the Group financial statements on a fully consolidated basis. Since there was already an intention to sell at the time of purchase, the vessels allocated to the Non-Core Bank segment were already reported as held for sale under Property, plant and equipment at the time of purchase. The vessels were sold in the third quarter of 2017. No gain or loss arose from the sale.

In addition, a bond from the public cover pool (€ 130 million) reported under financial investments (Core Bank segment) was classified as held for sale as at 30 June 2017. The sale will be implemented as part of the planned realisation of unrealised gains by way of the sale of promissory note loans. This financial investment was sold in the third quarter of 2017 with realised net income from financial investments in an amount of € 36 million.

34. CURRENT TAX ASSETS

CURRENT TAX ASSETS

(€ m)	2017	2016
Domestic	41	60
Foreign	5	5
Total	**46**	**65**

35. DEFERRED TAX ASSETS

Deferred tax assets arose due to temporary differences in the tax base of the following items in the statement of financial position and tax losses carried forward:

DEFERRED TAX ASSETS

(€ m)	2017	2016
Assets		
Loans and advances to banks	12	16
Loan loss provisions	715	330
Trading assets	61	–
Financial investments	17	12
Intangible assets	–	4
Other assets	55	86
Liabilities		
Liabilities to customers	–	15
Securitised liabilities	45	60
Negative fair values of hedging derivatives	44	88
Liabilities adjustment item from portfolio fair value hedges	148	239
Trading liabilities	241	240
Provisions	197	300
Other liabilities	218	274
Tax losses carried forward	17	100
Subtotal for deferred tax assets	**1,770**	**1,764**
of which long-term	121	205
Netting of deferred tax liabilities	– 1,047	– 997
Total	**723**	**767**

Out of the deferred tax assets after offsetting, € 706 million is attributable to Germany and € 17 million to abroad.

Deferred taxes on loss carryforwards were recognised in the amount of € 17 million (previous year: € 100 million). As at 31 December 2017, these are attributable to the Singapore branch in the amount of € 17 million (previous year: € 5 million), to the former New York branch in the amount of € 0 million (previous year: € 90 million) and to consolidated subsidiaries in the amount of € 0 million (previous year: € 5 million). For the Singapore branch, the recoverability of the deferred taxes on loss carryforwards results from planned future income.

In addition, there were unused tax loss carryforwards of € 7,343 million as at the reporting date (previous year: € 6,143 million) for which no deferred tax assets were recognised.

The increase of € 6 million in deferred tax assets before netting is mainly attributable to the recognition of further loan loss provisions connected to the sale of the credit portfolio (portfolio transaction) on 28 February 2018 and to changes in measurement differences for the trading asserts, the securitised liabilities, the negative market values of hedging derivatives, the negative adjustment item from portfolio fair value hedges and the provisions. On the portfolio transaction please refer to Note 2.

The recoverability of deferred tax assets results from positive future net income, in particular due to the fact that the Bank has been relieved of guarantee premiums. Deferred tax assets were not recognised on temporary differences of € 1,030 million due to the lack of recoverability.

€ 18 million of the reduction from deferred tax assets relates to deferred taxes for pension obligations recognised directly in equity.

The difference between the valuation for tax purposes of hybrid financial instruments (Note 7.I.E) and the measurement of such instruments under IAS 39.A8 results in deferred tax assets of € 7 million (previous year: € 15 million).

36. OTHER ASSETS

OTHER ASSETS

(€ m)	**2017**	2016
Receivables from insurance contracts	16	27
Other prepaid expenses	16	18
Receivables from fund transactions	9	7
Receivables from other taxes	5	7
Other assets	28	46
Total	**74**	**105**

Other assets in the amount of € 12 million (previous year: € 9 million) have a residual maturity of more than one year.

€ 35 million of the assets reported here relate to financial instruments (previous year: € 50 million).

37. LIABILITIES TO BANKS

LIABILITIES TO BANKS

(€ m)	2017			2016		
	Domestic	Foreign	**Total**	Domestic	Foreign	Total
Payable on demand	433	184	617	1,373	170	1,543
Other term liabilities	6,580	1,074	7,654	5,572	2,386	7,958
Total	**7,013**	**1,258**	**8,271**	**6,945**	**2,556**	**9,501**

Liabilities to banks of € 3,871 million (previous year: € 4,976 million) have a residual maturity of more than one year.

The difference between the carrying amount of the liabilities categorised as DFV and their par value, which corresponds to the contractually agreed repayment amount at the due date, amounted as at 31 December 2017 to € –3 million (previous year: € –5 million). € 1 million of this results from credit risk-induced changes in value.

Information on collateral transferred which also contains information regarding securities lending and repurchase agreements can be found in Note 63.

38. LIABILITIES TO CUSTOMERS

LIABILITIES TO CUSTOMERS BY CUSTOMER GROUP

(€ m)	**2017**	2016
Corporate clients	20,907	26,292
Public authorities	14,024	12,035
Retail customers	1,274	1,845
Total	**36,205**	**40,172**

LIABILITIES TO CUSTOMERS

(€ m)	2017			2016		
	Domestic	Foreign	**Total**	Domestic	Foreign	Total
Savings deposits with agreed notice periods of						
3 months	14	–	14	18	–	18
Other liabilities						
Payable on demand	9,146	1,743	10,889	10,709	1,562	12,271
Term liabilities	23,015	2,287	25,302	25,442	2,441	27,883
Total	**32,175**	**4,030**	**36,205**	**36,169**	**4,003**	**40,172**

Liabilities to customers of € 9,791 million (previous year: € 10,904 million) have a residual maturity of more than one year.

The difference between the carrying amount of the liabilities categorised as DFV and their par value, which corresponds to the contractually agreed repayment amount at the due date, amounted as at 31 December 2017 to € –73 million (previous year: € –113 million). € 7 million of this results from credit risk-induced changes in value. Information on collateral transferred which also contains information regarding securities lending and repurchase agreements can be found in Note 63.

39. SECURITISED LIABILITIES

SECURITISED LIABILITIES

(€ m)	**2017**	2016
Debentures issued	12,441	16,555
Money market securities issued	3	69
Total	**12,444**	**16,624**

Securitised liabilities of € 8,798 million (previous year: € 13,104 million) have a residual maturity of more than one year.

Debentures issued include € 508 million of hybrid financial instruments (previous year: € 660 million). The carrying amount of these hybrid financial instruments was determined based on assumptions (see Note 7.I.E). A new estimate of the cash flows from hybrid financial instruments resulted in a reduction in the carrying amounts of these financial instruments as at 31 December 2017.

In the item Securitised liabilities repurchased own debentures in the amount of € 2,666 million (previous year: € 2,643 million) were deducted.

The difference between the carrying amount of Securitised liabilities categorised as DFV and their par value, which corresponds to the contractually agreed repayment amount at the due date, amounted to € –136 million at 31 December 2017 (previous year: € –165 million). € 3 million of this related to credit risk-induced changes in value.

40. NEGATIVE FAIR VALUES OF HEDGING DERIVATIVES

This item shows the negative fair value of derivatives used in hedge accounting. Only interest rate and interest rate currency swaps are currently taken into account as hedging instruments. If a derivative is only partially designated under hedge accounting, this item contains the corresponding share of that derivative's fair value. The remainder is stated under Trading liabilities. Hedge accounting is used solely for interest rate risks.

NEGATIVE FAIR VALUES OF HEDGING DERIVATIVES

(€ m)	**2017**	2016
Negative fair value of derivativesused in portfolio fair value hedges	163	290
Total	**163**	**290**

Under the item Negative fair value of hedging derivatives portfolios in an amount of € 159 million (previous year: € 285 million) have a residual maturity of more than one year.

Changes in this item are directly related to changes in the item Positive fair value of the hedging derivatives (see Note 27). The overall changes in this item are mainly due to changes in the portfolio compositions and movements in interest rates in the euro and US dollar capital markets.

41. TRADING LIABILITIES

Only financial liabilities classified as HfT are disclosed under Trading liabilities. Mainly included in this category are derivatives with a negative fair value which are either not designated as a hedging derivative or are used as hedging instruments but do not meet the requirements of IAS 39 for hedge accounting.

TRADING LIABILITIES

(€ m)	2017	2016
Negative fair value from derivative financial instruments		
Interest rate-related business	3,374	5,152
currency-related business	59	191
Other business	442	638
Total	**3,875**	**5,981**

Trading liabilities of € 3,614 million (previous year: € 5,391 million) have a residual maturity of more than one year.

Information on collateral transferred is presented in Note 63.

42. PROVISIONS

PROVISIONS

(€ m)	2017	2016
Provisions for pension obligations and similar obligations	1,103	1,152
Other provisions		
Provisions for personnel expenses	24	39
Provisions in the lending business	67	110
Provisions for restructuring	45	85
Provisions for litigation risks and costs	98	34
Other provisions	101	101
Total	**1,438**	**1,521**

Provisions of € 1,167 million (previous year: € 1,249 million) have a residual maturity of more than one year.

Provisions with a maturity of less than one year mainly relate to Provisions for restructuring, Provisions in the lending business as well as provisions for litigation risks. Further information regarding Provisions in the lending business can be found in Note 26.

Provisions for personnel expenses largely include outstanding variable performance-related remuneration, as well as long-service bonus payments (see note 7.III. 5. Other provisions). The expected workforce development was taken as a basis for the amount of the provisions for long-service bonuses. Depending on the actual development of the workforce, the actual amount used may vary from the amount set up as a provision.

As far as provisions in the lending business are concerned, the uncertainties are due, in particular, to the development of the credit quality of the borrowers. For details, please refer to the explanations set out in the Forecast for loan loss provisions section of the Forecast, Opportunities and Risks Report in the Management Report.

Provisions for restructuring in the amount of € 25 million (previous year: € 54 million) relate to personnel expenses and € 20 million (previous year: € 31 million) to operating expenses. The provisions were set up primarily in connection with restructuring programmes from 2014 and 2016. The amount of the provisions was estimated on the basis of the expected utilisation of the restructuring programmes. Depending on the actual utilisation of the restructuring programmes, the amount set up as a provision may vary from the amount utilised.

Other provisions mainly include interest on tax liabilities, provisions for onerous contracts as well as an expected back payment from the tax audit. The actual amount may differ from the provisions set up depending on the outcome of the company tax audit.

HSH Nordbank has set up provisions as at the balance sheet date for litigation risks and costs. To determine for which claim the possibility of a loss is likely, and in order to estimate the amount of the potential payment obligations, HSH Nordbank takes a variety of factors into account. These include, among other things, the type of claim and the underlying facts of the case, the status of the individual proceedings, (provisional) decisions made by courts and arbitration bodies, the experience of HSH Nordbank and third parties in comparable cases (insofar as they are known to the Bank), prior settlement negotiations, as well as the expert opinions and assessments of the Bank's internal and external legal advisors and other professionals.

A major portion of the provisions for litigation risks relates to the legal proceedings mentioned below. The individual provision amounts are not set out in detail in order not to influence the outcome of the respective proceedings. The current status of the proceedings and the expected outcome of the proceedings are taken into account for accounting purposes. Depending on the actual outcome of the proceedings, the actual amounts may vary from the amounts set up as a provision.

Since 2005, HSH Nordbank AG has been involved in legal proceedings with a Turkish shipping group and up to now had to pay a total amount of € 54 million US dollar in the year 2013 due to decisions of Turkish courts. The plaintiffs have filed suits asserting further claims for damages due to a loss of profit and due to third-party liabilities in connection with collateral realisation measures of the Bank in respect of a loan.

In addition, HSH Nordbank AG is being sued by a previous borrower for the payment of € 197 million plus interest. The plaintiff is asserting various claims, in particular claims for the payment of damages and resulting from unjust enrichment in connection with measures taken by the Bank in respect of a problem loan. Various legal disputes have already been conducted in the past on essential partial aspects of the case on which this claim is based and the Bank had won these cases, brought before various courts, with the exception of relatively small amounts.

Furthermore, claims are also being brought against the Bank in actions in connection with different legal opinions on contractual interpretation for certain financial instruments on the liabilities side.

Changes in pension provisions are presented in Note 43.

Other provisions changed as follows:

CHANGES IN OTHER PROVISIONS

(€ m) **2017**	For personnel expenses	In the lending business	For restructuring	For litigation risks and costs	Other	**Total**
As at 1 January 2017	**39**	**110**	**85**	**34**	**101**	**369**
Additions	15	46	2	70	58	191
Reversals	6	83	9	4	25	127
Other changes	–	–	–	–	–	–
Reclassifications	– 19	–	– 19	–	–	– 38
Changes in exchange rates	–	– 4	– 1	–	– 1	– 6
Changes in the scope of consolidation	–	–	–	–	–	–
Utilisation in the financial year	5	2	13	2	32	54
As at 31 December 2017	**24**	**67**	**45**	**98**	**101**	**335**

Reclassifications were mainly made from Provisions to Provisions for pension obligations in the amount of € 13 million and to Liabilities in the amount of € 25 million.

CHANGES IN OTHER PROVISIONS

(€ m) 2016	For personnel expenses	In the lending business	For restructuring	For litigation risks and costs	Other	Total
As at 1 January 2016	**43**	**107**	**94**	**37**	**185**	**466**
Additions	25	75	69	6	57	232
Reversals	2	67	4	2	22	97
Other changes	–	–	–	–	18	18
Reclassifications	–	–	–52	–	–62	–114
Changes in exchange rates	–	–	–	–	2	2
Changes in the scope of consolidation	–	–	–	–	–1	–1
Utilisation in the financial year	27	5	22	7	76	137
As at 31 December 2016	**39**	**110**	**85**	**34**	**101**	**369**

In the previous year, reclassifications were made from Provisions to Provisions for pension obligations in the amount of € 24 million, to Liabilities in the amount of € 28 million and to Liabilities from disposal groups in the amount of € 62 million.

Provisions in the lending business are composed of the following items:

The other changes are attributable to the extension of the scope of consolidation due to the initial consolidation of a subsidiary that was previously considered immaterial.

PROVISIONS IN THE LENDING BUSINESS

(€ m)	**2017**	2016
Specific loan loss provisions for		
Contingent liabilities	10	25
Irrevocable loan commitments	29	40
Other credit risks	21	2
Total	**60**	**67**
Portfolio loan loss provisions for		
Contingent liabilities	1	33
Irrevocable loan commitments	6	10
Total	**7**	**43**
Total	**67**	**110**

43. PENSION OBLIGATIONS AND SIMILAR OBLIGATIONS

In recognising and measuring direct benefit pension plans, the net present value of the obligations is reduced by the fair value of the plan assets.

PROVISIONS FOR PENSION OBLIGATIONS AND SIMILAR OBLIGATIONS

(€ m)	2017	2016
Net present value of obligations, wholly or partly financed through funds	15	11
Net present value of obligations not financed through funds	1,097	1,150
Net present value of pension obligations and similar obligations	**1,112**	**1,161**
Fair value of plan assets	9	9
Pension plan net liability (provisions for pension obligations and similar obligations)	**1,103**	**1,152**

The net present value of defined benefit pension obligations has changed as follows:

CHANGES IN NET PRESENT VALUE

(€ m)	2017	2016
Net present value as at 1 January	**1,161**	1,059
Actuarial losses/gains (–)	-	-
due to changed financial assumptions	– 38	125
due to experience-based adjustments	– 8	– 36
Interest expense	18	23
Current service cost	12	11
Benefits paid	– 46	– 46
Reclassifications	13	25
Net present value as at 31 December	**1,112**	**1,161**

Early retirement arrangements were negotiated as part of the restructuring and associated reduction in staff and the corresponding provisions were transferred from restructuring to pension provisions.

The fair value of plan assets has changed as follows:

CHANGES IN FAIR VALUE OF PLAN ASSETS

(€ m)	2017	2016
Fair value of plan assets as at 1 January	**9**	**8**
Actuarial gains	–	1
Fair value of plan assets as at 31 December	**9**	**9**

The change in actuarial gains and losses is mainly attributable to a rise in the discount rate.

The total actuarial gains for the financial year before deferred taxes amounted to € 46 million (previous year: € – 89 million). Allowing for deferred taxes, this results in a profit of € 28 million (previous year: € – 60 million), which is recognised in Other comprehensive income and disclosed in retained earnings on an accumulated basis. As at 31 December 2017, the balance of actuarial gains/losses in retained earnings before tax amounted to € – 196 million (previous year: € – 242 million) before tax and € – 138 million (previous year: € – 166 million) after tax.

BREAKDOWN OF PLAN ASSETS

(€ m)	2017	2016
Qualified insurance policies	8	8
Debentures and other fixed-interest securities	1	1
Total	**9**	**9**

The debentures and other fixed-interest securities included in the plan assets are traded on an active market.

Expenses of € 30 million were incurred for defined benefit pension plans in the 2017 reporting year (previous year: € 34 million).

Pension obligations represent future amounts to be paid and are uncertain both as to the amount and the date they fall due. Future fluctuations in the present value of the pension obligations can result particularly from a change in the actuarial assumptions such as the discount rate and life expectancy.

An increase or decrease in the actuarial assumptions (see Note 6) would have had the following impact on the present value of pension obligations as at 31 December 2017:

SENSITIVITY OF PENSION OBLIGATIONS

(€ m)	Increase	Decrease
2017		
Discount rate (+/– 0.25 %)	– 40	49
Inflation trend[1] (+/– 0.25 %)	39	– 36
Life expectancy (+ 1 year)	47	–

SENSITIVITY OF PENSION OBLIGATIONS

(€ m)	Increase	Decrease
2016		
Discount rate (+/– 0.25 %)	– 47	50
Inflation trend[1] (+/– 0.25 %)	41	– 39
Life expectancy (+ 1 year)	50	

[1] A variation in the inflation trend affects the salary trend. An assumption regarding future salary levels has a direct influence on future pension levels because of the fully dynamic pension commitments. The salary and pension trends were therefore not separately varied.

The average duration of the pension obligations determined as at 31 December 2017 was used as the basis for the sensitivity calculations. The impact of the major assumptions on the present value of the pension obligations is presented. As the sensitivity analyses are based on the average duration of the expected pension obligations and expected payment dates are therefore not taken into account, the figures represent only approximate values. Furthermore, where a change in an actuarial assumption is analysed, the other assumptions are kept constant.

HSH Nordbank expects to make payments of € 52 million to beneficiaries under defined benefit pension plan commitments for the 2018 financial year (previous year: € 48 million).

The weighted average duration of the defined benefit obligation is 18.0 years as at 31 December 2017 (previous year: 18.3 years).

Expenses for defined contribution plans were € 16 million in the 2017 reporting period (previous year: € 17 million). Payments to statutory pension schemes in the amount of € 14 million (previous year: € 15 million) are included in this figure.

44. LIABILITIES RELATING TO DISPOSAL GROUPS

LIABILITIES RELATING TO DISPOSAL GROUPS

(€ m)	**2017**	2016
Provisions	44	63
Other liabilities	2	2
Deferred tax liabilities	1	–
Total	**47**	**65**

All of the liabilities included in this item, both as at 31 December 2017 and as at 31 December 2016, are attributable to the disposal groups Aviation II (provisions) and the disposal group comprising the assets and liabilities of the FSL Group (see Note 33).

45. CURRENT TAX LIABILITIES

INCOME TAX LIABILITIES

(€ m)	**2017**	2016
Current tax liabilities		
Income tax liabilities to tax authorities	–	28
Provisions for income taxes	103	59
Total	**103**	**87**

Liabilities to tax authorities in the previous year included liabilities on income taxes due to domestic and foreign tax authorities.

Provisions for income taxes include tax liabilities for which no legally binding tax assessment notice has been received as at the balance sheet date.

46. DEFERRED TAX LIABILITIES

For temporary differences in the tax bases of the following items in the statement of financial position deferred tax liabilities were created.

DEFERRED TAX LIABILITIES

(€ m)	2017	2016
Assets		
Loans and advances to customers	90	87
Credit derivative under the second loss guarantee	296	45
Financial investments	338	249
Trading assets	–	9
Positive fair value of hedging derivatives	84	161
Asset-side adjustment item from portfolio fair value hedges	82	128
Property, plant and equipment	–	45
Intangible assets	1	–
Other assets	1	–
Liabilities		**–**
Liabilities to banks	28	25
Liabilities to customers	55	–
Securitised liabilities	4	–
Other liabilities	68	255
Total	**1,047**	**1,004**
Netting off deferred tax assets	– 1,047	– 997
Total	**–**	**7**

The rise in deferred tax liabilities before netting is mainly attributable to the change in temporary differences relating to the credit derivative under the second loss guarantee, financial assets, positive fair value of hedging derivatives, positive adjustment items from the portfolio fair value hedge and liabilities to customers.

€ 7 million of the total change is attributable to reductions recognised directly in equity relating to financial investments.

Deferred tax liabilities of € 2 million (previous year: € 2 million) associated with investments in subsidiaries (so-called outside basis differences) were not recognised in accordance with IAS 12.39, as realisation is not probable.

There were no timing differences as at the reporting date for which deferred tax liabilities had not been recognised.

47. OTHER LIABILITIES

OTHER LIABILITIES

(€ m)	2017	2016
Collateral provided for liabilities assumed	519	657
Liabilities for invoices outstanding	45	52
Outstanding payments for the second loss guarantee	33	45
Deferred income	13	18
Liabilities for restructuring	12	28
Personnel liabilities	8	9
Other tax liabilities	7	18
Other	21	18
Total	**658**	**845**

Other liabilities in the amount of € 530 million (previous year: € 668 million) have a residual maturity of more than one year.

The collateral provided for liabilities assumed serves to hedge leasing transactions of our customers with third parties.

€ 638 million of the liabilities reported here relate to financial instruments (previous year: € 812 million).

48. SUBORDINATED CAPITAL

HSH Nordbank discloses subordinated liabilities, silent participations and profit participation capital under this item.

SUBORDINATED CAPITAL

(€ m)	2017	2016
Subordinated liabilities	1,060	2,110
Maturing in less than two years	4	1,028
Silent participations	1,192	1,412
Profit participation capital	–	14
Maturing in less than two years	–	14
Total	**2,252**	**3,536**

Subordinated capital of € 2,248 million (previous year: € 2,411 million) have a residual maturity of more than one year.

The difference between the carrying amount of the liabilities categorised as DFV and their par value, which corresponds to the contractually agreed repayment amount at the due date, amounted to € 0 million as at 31 December 2017 (previous year: € –4 million).

Hybrid financial instruments included under Subordinated capital include silent participations and profit participation capital. The carrying amount of these hybrid financial instruments was determined based on assumptions (see Note 7.I.E). In addition to Hybrid financial instruments disclosed here, Hybrid financial instruments are also disclosed in the line item Securitised liabilities (cf. Note 39). A revaluation of the cash flow from hybrid financial instruments led to a reduction in the carrying amounts of these financial instruments as at 31 December 2017.

49. EQUITY

EQUITY

(€ m)	**2017**	2016
Share capital	3,018	3,018
Capital reserve	75	75
Retained earnings	1,701	1,617
of which: cumulative gains and losses arising on the revaluation of net defined benefit liabilities recognised in OCI	– 196	– 242
of which: deferred taxes on cumulative gains and losses arising on the revaluation of net defined benefit liabilities recognised in OCI	58	76
Revaluation reserve	117	127
thereof: from fair value measurement AfS (after taxes)	109	127
thereof: credit risk-induced changes in the value of liabilities designated at FV (after taxes)	8	–
Currency conversion reserve	2	60
Consolidated income/loss	– 535	67
Total before non-controlling interests	**4,378**	**4,964**
Non-controlling interests	– 5	– 14
Total	**4,373**	**4,950**

Share capital

The share capital of HSH Nordbank AG is divided into 301,822,453 registered shares each representing a notional of € 10.00 of share capital. All the issued shares have been fully paid up.

As at the reporting date, HSH Beteiligungs Management GmbH, Hamburg, was the largest shareholder with 94.90 % of the voting rights. HSH Finanzfonds AöR – Gemeinsame Anstalt der Freien und Hansestadt Hamburg und des Landes Schleswig-Holstein – holds an interest of 68.03 %, the Free and Hanseatic City of Hamburg, incl. the interest held indirectly via HGV Hamburger Gesellschaft für Vermögens- und Beteiligungs Management mbH holds an interest of 11.30 %, the Federal State of Schleswig-Holstein holds an interest of 10.02 % and Sparkassen- und Giroverband für Schleswig-Holstein holds an interest of 5.55 % in HSH Nordbank AG, with all of these interests being held indirectly via HSH Beteiligungs Management GmbH. As at 31 December 2017, the nine groups of investors advised by J.C. Flowers & Co LLC held 5.10 % of the voting rights. The ownership structure has not changed compared to the previous year.

HSH Beteiligungs Management GmbH, with its registered offices in Hamburg, notified us in June 2016 in accordance with Section 20 (1)/(4) of the German Stock Corporation Act (AktG) that it directly owns more than one-quarter of the shares of HSH Nordbank AG, and at the same time owns a majority interest within the meaning of Section 16 (1) AktG.

Neither HSH Nordbank AG nor any company dependent on it or majority-owned companies hold treasury stock. There are no cross-shareholdings as defined by Section 19 AktG.

CHANGES IN ORDINARY SHARES

(Number of shares)	**2017**	2016
Number at the beginning of the year	301,822,453	301,822,453
Number at the end of the year	**301,822,453**	**301,822,453**

Retained earnings and dividends

The item Retained earnings mainly shows amounts allocated from previous year profits and the profits of the current year. There are no statutory reserves or legal reserves within the meaning of Section 150 (2) of the German Stock Corporation Act (AktG).

Retained earnings include amounts of € 4,919 million (previous year: € 4,919 million) transferred from the capital reserve to disclose a break-even result on the balance sheet offset loss carryforwards of HSH Nordbank AG.

The retained earnings include income from own issues bought back in 2017 in an amount of € 1 million (previous year: € 0 million). This relates to the pro-rata credit risk-induced effects of own issues designated at fair value through other comprehensive income that were previously shown in the revaluation reserve. This is due to the exercise of the option in accordance with IFRS 9.7.1.2. With regard to the exercise of the option, please refer to the comments on the first-time application of IFRS 9 in Note 1.

As was the case for the previous financial year 2016, no dividend payments were made for previous years during the current financial year 2017.

Capital reserve

In the previous year, an amount of € 100 million was released from capital reserves to offset the losses of HSH Nordbank AG brought forward from 2015.

Revaluation reserve

The effects of the measurement of AfS financial instruments disclosed at fair value directly in equity are recorded in the revaluation reserve.

The effects of credit risk-induced changes in the value of liabilities designated at fair value are also reported in the revaluation reserve.

The changes in value associated with deferred taxes shown in the revaluation reserve are also presented in the revaluation reserve pursuant to IAS 12.61A.

Currency conversion reserve

Assets and liabilities in financial statements of subsidiaries in foreign currencies are translated at the reporting date exchange rate in preparing the Group financial statements, while average rates for the reporting period are used to translate expenses and income. Equity is translated at historical rates, with the exception of revaluation reserves in Group financial statements reported in foreign currencies, which are translated at the reporting date exchange rate.

Any differences arising from this method of translation compared to complete translation at the reporting date exchange rate are reported in this Equity item.

Capital management

The capital management of HSH Nordbank aims to comply with regulatory minimum capital ratios. In addition to these minimum requirements, capital management is used as the basis for complying with the capital ratios planned and is designed to ensure that the Bank's capital base meets the risk-bearing capacity requirements. The common equity Tier 1 capital ratio is the key parameter for capital management.

The regulatory capitalisation is in accordance with the provisions of the European Capital Requirements Regulation (CRR) in conjunction with the Supervisory Review and Evaluation Process (SREP). HSH Nordbank determines the capital requirements for counterparty risk in accordance with the approach permitted by the Federal Financial Supervisory Authority based on internal ratings (Advanced IRBA) and based on the CSA (standard approach). The capital base is reported to the regulatory authorities quarterly. The minimum ratios required under supervisory law were complied with on each reporting date in the course of the year under review.

REGULATORY FIGURES[1]

(in %)	**2017**	2016
Tier 1 capital ratio	23.2	18.5
Overall capital ratio	31.4	24.2
CET1 ratio	18.7	13.9

[1] Values before adoption of the Group financial statements of HSH Nordbank.

The regulatory capital commitment was monitored closely both at Bank and division level in the course of the financial year.

SEGMENT REPORTING

50. SEGMENT REPORT

(€ m / %)	Corporate Clients		Real Estate		Shipping		Treasury & Markets		Core Bank[]	
	31.12. 2017	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016
Net interest income	130	159	148	170	69	89	426	262	773	680
Net commission income	49	56	13	16	14	10	1	–1	77	81
Result from hedging	–	–	–	–	–	–	–	–	–	–
Net trading income	39	36	24	32	8	29	83	89	154	186
Net income from financial investments[1]	–	–	–	–	–	–1	51	86	51	85
Total income	**218**	**251**	**185**	**218**	**91**	**127**	**561**	**436**	**1,055**	**1,032**
Loan loss provisions incl. credit derivative under the second loss guarantee[2]	–53	–5	2	–	63	52	1	–	13	47
Administrative expenses	–124	–149	–54	–57	–40	–53	–84	–99	–302	–358
Other operating income	9	4	3	–1	2	2	2	–3	16	2
Expenses for bank levy and deposit guarantee fund	–6	–7	–8	–10	–4	–6	–10	–8	–28	–31
Net income before restructuring and privatisation	**44**	**94**	**128**	**150**	**112**	**122**	**470**	**326**	**754**	**692**
Net income from restructuring and privatisation	–	–	–	–	–	–	–	–	–	–
Expenses for government guarantees	–3	–5	–1	–2	–18	–18	–	–	–22	–25
Net income before taxes	**41**	**89**	**127**	**148**	**94**	**104**	**470**	**326**	**732**	**667**
Cost/income ratio (CIR)	55%	58%	29%	26%	43%	41%	15%	23%	28%	35%
Return on equity before tax	3%	7%	13%	19%	25%	24%	67%	42%	21%	21%
Average equity	1,460	1,228	972	780	378	434	701	780	3,511	3,222

(€ bn)	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016
Segment assets	**12**	**12**	**10**	**11**	**5**	**6**	**21**	**19**	**48**	**48**

[1] Including net income from financial investments accounted for under the equity method.
[2] Consolidation of the Loan loss provisions in the lending business and Hedging effect of credit derivative under the second loss guarantee.

(€ m / %)	Core Bank		Non-Core Bank		Other and Consolidation[3]		Group	
	31.12. 2017	**31.12** 2016	**31.12. 2017**	**31.12.** 2016	**31.12. 2017**	**31.12.** 2016	**31.12. 2017**	**31.12.** 2016
Net interest income	773	680	–9	15	415	–88	1,179	607
Net commission income	77	81	20	20	–32	–14	65	87
	–	–	–	–	–18	–4	–18	–4
Net trading income	154	186	84	–53	16	–45	254	88
Net income from financial investments[1]	51	85	–23	54	64	4	92	143
Total income	**1,055**	**1,032**	**72**	**36**	**445**	**–147**	**1,572**	**921**
Loan loss provisions in the lending business incl. credit derivative under the second loss guarantee[2]	13	47	–1,295	106	6	3	–1,276	156
Administrative expenses	–302	–358	–202	–299	–11	23	–515	–634
Other operating income	16	2	–22	62	28	–6	22	58
Expenses for bank levy and deposit guarantee fund	–28	–31	–9	–15	–4	–10	–41	–56
Net income before restructuring and privatisation	**754**	**692**	**–1,456**	**–110**	**464**	**–137**	**–238**	**445**
Net income from restructuring and privatisation	–	–	–	–	–66	–110	–66	–110
Expenses for government guarantees	–22	–25	–127	–189	–	–	–149	–214
Net income before taxes	**732**	**667**	**–1,583**	**–299**	**398**	**–247**	**–453**	**121**
Cost/income ratio (CIR)	28%	35%	–	–	–	–	32%	65%
Return on equity before tax	21%	21%	–	–	–	–	–10%	2%
Average equity	3,511	3,222	866	1,433	285	263	4,662	4,918

(€ bn)	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016	**31.12. 2017**	31.12. 2016
Segment assets	**48**	**48**	**12**	**22**	**10**	**14**	**70**	**84**

[1]Including Net income from financial investments accounted for under the equity method.
[2]Consolidation of the Loan loss provisions in the lending business and Hedging effect of credit derivative under the second loss guarantee.
[3]Consolidation includes the effect from different accounting.

(€ m / %)	2017			2016		
	Other	**Consolida-tion[3)]**	**Total Other and Consolidation**	Other	Consolidation[3)]	Total Other and Consolidation
Net interest income	391	24	415	– 18	– 70	– 88
Net commission income	– 27	– 5	– 32	– 6	– 8	– 14
Result from hedging	–	– 18	– 18	–	– 4	– 4
Net trading income	5	11	16	14	– 59	– 45
Net income from financial investments[1)]	66	– 2	64		4	4
Total income	**435**	**10**	**445**	**– 10**	**– 137**	**– 147**
Loan loss provisions in the lending business incl. credit derivative under the second loss guarantee[2)]	1	5	6	– 1	4	3
Administrative expenses	– 10	– 1	– 11	23	–	23
Other operating income	28	–	28	– 5	– 1	– 6
Expenses for bank levy and deposit guarantee fund	– 7	3	– – 4	– 10	–	– 10
Net income before restructuring and privatisation	**447**	**17**	**464**	**– 3**	**– 134**	**– 137**
Net income from restructuring and privatisation	–	– 66	– 66	–	– 110	– 110
Expenses for government guarantees	–	–	–	–	–	–
Net income before taxes	**447**	**– 49**	**398**	**– 3**	**– 244**	**– 247**
Cost/income ratio (CIR)	–	–	–	–	–	–
Return on equity before tax	–	–	–	–	–	–
Average equity	284	1	285	264	– 1	263

(€ bn)	2017			2016		
Segment assets	**10**	**–**	**10**	**14**	**–**	**14**

1) Including Net income from financial investments accounted for under the equity method.
2) Consolidation of the Loan loss provisions in the lending business and Hedging effect of credit derivative under the second loss guarantee.
3) Consolidation includes the effect from different accounting.

Segment reporting is in accordance with the provisions of IFRS 8. The Group has five segments subject to a reporting requirement: four in the Core Bank, and the Non-Core Bank. The Core Bank segments result from the Bank's internal organisational structure which is based on product and customer groups and which corresponds to the delimitation for internal Group management purposes. The formation of the segments is intended to achieve the greatest possible homogeneity of customer groups with regard to a focused loan financing product range as well as other products and services.

HSH Nordbank's Core Bank consists of the segments Real Estate, Shipping, Corporate Clients and Treasury & Markets. The business activities of the Real Estate, Shipping and Corporate Clients customer departments focus on offering financing solutions in the lending business.

As at 31 December 2017, the Real Estate segment includes business with real estate clients, while the Shipping segment includes the business with shipping clients. The strategic focus of the Corporate Clients segment primarily lies on the Logistics & Infrastructure, Energy & Utilities, Healthcare, Commerce & Food and Industry & Services business fields. Another key area is the advising of wealthy private clients, institutions and non-profit organisations with regard to asset management. The Treasury & Markets segment supports the customer departments in their business by providing a tailored range of capital market-oriented product solutions and within the framework of syndications. At the same time, support is provided to the savings banks and institutional clients in the areas of issuance and deposits. This segment is also responsible for the central management of the liquidity and market price risks relating to the Bank's position and the Bank's function as an issuer.

In 2017, the funding books used to manage securities issued by HSH Nordbank were bundled in the Treasury & Markets segment for the purposes of segment reporting. The transfer of the funding books from the sphere of the non-reportable segments (Other) to the Treasury & Markets segment is designed, within the context of internal control, to strengthen the Bank's issue function and improve governance.

The amount reported for the previous year in the segment reporting has been adjusted accordingly.

The Non-Core Bank includes credit and capital market transactions that are not continued in the Core Bank. These are overall bank positions for which the Overall Management Board is responsible. The focus is on reducing the risk potential whilst minimising the effect on income. The Special Credit Management business unit is responsible for loan restructuring and workout and, as a result, also for the active winding down of the portfolio of impaired loan commitments.

The expenses for the bank levy and deposit guarantee fund have been allocated to the segments based on the adjusted balance sheet volume.

Loan loss provisions are shown in the segments in which they originated. For the loan loss provisions set up for the individual segments, the hedging effect of the second loss guarantee including the hedging effect of the credit derivative under the second loss guarantee is also shown in the corresponding segments, insofar as the loan exposures in question are hedged using the second loss guarantee. The significant change year-on-year is due to the full utilisation of the guarantee. As a result, the loan loss provisions incurred in the reporting year were no longer compensated for in full. Up until the full utilisation of the guarantee, the Core Bank was allocated a compensatory effect in accordance with the assignment of the individual loan exposures to the Core Bank, insofar as the loan exposures were hedged using the second loss guarantee. Since the full utilisation of the guarantee, the changes in the compensatory effect of the second loss guarantee are allocated to the Non-Core Bank in order to simplify matters. Up until the time of full utilisation, the Non-Core Bank accounted for a share of 98 %.

By way of derogation from this principle, the guarantee fees are allocated to the segments based on the regulatory equity capital requirements for the guaranteed portfolio. Insofar as the guarantee fees would have been allocated based on the compensation effect in the reporting year, then the Core Bank would have had € 22 million (previous year: € 20 million) less to bear in guarantee fees, and the Non-Core Bank would have had to bear a higher amount accordingly.

The Other column shows the contributions made by segments not subject to a reporting requirement and the contributions made by other business activities. These include the administration and service divisions and the Transaction Banking product division, which offers tailor-made services in the fields of payment transactions, account management and foreign trade for the customer departments, insofar as these activities were not allocated to the segments subject to a reporting requirement as part of the business management of the Bank.

The Consolidation column contains effects from different accounting methods between the parameters reported internally and the presentation in the Group financial statements. The reconciliation effects included are shown separately in the table above pursuant to IFRS 8.28 and are explained in further detail below.

Net interest income for the purpose of internal reporting to management is calculated in accordance with the Fund Transfer Pricing (FTP). The planned investment and financing profit is distributed among the business segments on the basis of economic capital committed. The transformation contribution is allocated to the segments on the basis of receivables. Only the results from the liquidity management of the banking book (liquidity account) are distributed among the segments.

Reconciliation effects relating to Net interest income in the amount of € 24 million are due largely to valuation differences. These are largely the result of the use of internal transactions within the framework of internal interest rate and liquidity management/the consideration of imputed interest rate margins (fund transfer pricing, FTP) instead of gross interest in the lending business. Further reconciliation effects result, in particular, from the use of what are, in some cases, different calculation and amortisation methods within the context of internal reporting. In addition, in the internal management system, the measurement results of the hedging derivatives in hedge accounting are only shown in Net interest income upon the disposal of AfS, LaR and LIA positions, whereas under the IFRS hedge accounting regulations, the hedge adjustments are also continuously amortised within Net interest income.

The consolidation effects relating to Net trading income in the amount of € 11 million (net) include, in particular, differences resulting from the recognition and measurement of capital market transactions between the internal management system and IFRS accounting, as well as from different posting methods for foreign currency transactions (in the amount of approx. € 29 million). Further differences result from the hedging of certain financial instruments that are included in the portfolio fair value hedge in full in the internal recognition of the interest rate hedge transaction, whereas under the IFRS, they are not, or are only partly, included in the portfolio fair value hedge (in the amount of around € –36 million); moreover net trading income of individual subsidiaries in the scope of consolidation are not included in the internal management system (in the amount of around € 19 million).

In addition, net income from restructuring and privatisation is also shown in full under Consolidation as an item for reconciliation with the internally managed values.

The business activities of HSH Nordbank lie predominantly in loan financing in Germany. As a result, there is no need to publish geographical information in accordance with IFRS 8.33.

The cost/income ratio (CIR) and return on equity (RoE) are not shown in the segment report for the Non-Core Bank segment. In the case of the Non-Core Bank, the segment involves business areas which are not strategic and are currently being wound down. This segment is not managed on the basis of these ratios.

Total income recognised in the segments is exclusively generated from business conducted with external customers.

The allocation key for the allocation of the average reported equity capital to the segments is the regulatory capital commitment due to its management relevance.

The CIR is calculated as the ratio of Administrative expenses to Total income plus Other operating income. Return on equity is the ratio of net income before taxes to average equity capital.

See Note 13 for comments on companies consolidated under the equity method recognised as part of Net income from financial investments.

NOTES ON FINANCIAL INSTRUMENTS

51. CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS

CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS

(€ m) **2017**	LaR	AfS	DFV	HfT	LIA	No IAS 39 category	**Total**
Assets							
Cash reserve	6,519	106	–	–	–	–	6,625
Loans and advances to banks	3,759	79	–	–	–	–	3,838
Loans and advances to customers	37,798	45	1,255	–	–	–	39,098
Receivables under finance leases	–	–	–	–	–	76	76
Credit derivative under the second loss guarantee	–	–	–	1,014	–	–	1,014
Positive fair value of hedging derivatives	–	–	–	–	–	264	264
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	255	255
Trading assets	–	–	–	3,641	–	–	3,641
Financial investments	560	12,475	612	–	–	–	13,647
Non-current assets held for sale and disposal groups	26	–	–	–	–	–	26
Other assets	35	–	–	–	–	–	35
Total assets	**48,697**	**12,705**	**1,867**	**4,655**	**–**	**595**	**68,519**
Liabilities							
Liabilities to banks	–	–	118	–	8,153	–	8,271
Liabilities to customers	–	–	819	–	35,386	–	36,205
Securitised liabilities	–	–	1,627	–	10,817	–	12,444
Negative fair values of hedging derivatives	–	–	–	–	–	163	163
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	553	553
Trading liabilities	–	–	–	3,875	–	–	3,875
Liabilities relating to disposal groups	–	–	–	–	2	–	2
Subordinated capital	–	–	–		2,252	–	2,252
Other liabilities	–	–	–	–	638	–	638
Total liabilities	**–**	**–**	**2,564**	**3,875**	**57,248**	**716**	**64,403**

CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS

(€ m)

2016	LaR	AfS	DFV	HfT	LIA	No IAS 39 category	Total
Assets							
Cash reserve	3,373	118	–	–	–	–	3,491
Loans and advances to banks	4,108	84	–	–	–	–	4,192
Loans and advances to customers	49,430	61	1,321	–	–	–	50,812
Receivables under finance leases	–	–	–	–	–	98	98
Credit derivative under the second loss guarantee	–	–	–	199	–	–	199
Positive fair value of hedging derivatives	–	–	–	–	–	508	508
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	403	403
Trading assets	–	–	–	5,433	–	–	5,433
Financial investments	1,498	12,441	1,554	–	–	–	15,493
Non-current assets held for sale and disposal groups	1,140	19	–	–	–	–	1,159
Other assets	50	–	–	–	–	–	50
Total assets	**59,599**	**12,723**	**2,875**	**5,632**	**–**	**1,009**	**81,838**
Liabilities							
Liabilities to banks	–	–	120	–	9,381	–	9,501
Liabilities to customers	–	–	1,331	–	38,841	–	40,172
Securitised liabilities	–	–	2,256	–	14,368	–	16,624
Negative fair values of hedging derivatives	–	–	–	–	–	290	290
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	786	786
Trading liabilities	–	–	–	5,981	–	–	5,981
Liabilities relating to disposal groups	–	–	–	–	2	–	2
Subordinated capital	–	–	87	–	3,449	–	3,536
Other liabilities	–	–	–	–	812	–	812
Total liabilities	**–**	**–**	**3,794**	**5,981**	**66,853**	**1,076**	**77,704**

52. RECLASSIFICATION UNDER IAS 39 (REV. 2008)

HSH Nordbank exercised the option of reclassifying assets under IAS 39 (rev. 2008) as LaR where they meet the relevant requirements, were not intended for short-term sale at the time of reclassification and are due to be held for the foreseeable future. The assets were reclassified in 2008 and 2009 due to the global financial market crisis and the consequences it has had on the measurement of securities portfolios. The reclassifications were performed in accordance with IAS 39.50D or IAS 39.50E respectively.

The reclassification as LaR measures fair value at the time of reclassification at cost or amortised cost, respectively. At the time of reclassification an effective interest rate was determined which is used for subsequent measurement of the amortised acquisition cost. For reclassification of financial instruments from AfS to LaR the revaluation reserve recognised up to the point of reclassification is reversed through Net interest income on a pro rata temporis basis in accordance with IAS 39.54 a).

The financial instruments reclassified in 2008 fell due in 2015, meaning that they are not to be reported.

The reclassifications of assets in the second quarter of 2009 are shown in the table below:

(€ m)		**2017**		2016	
	Carrying amount as at the time of reclassification	**Carrying amount**	**Fair value**	Carrying amount	Fair value
Reclassified from AfS to LaR	6,336	356	433	623	733
Total financial assets reclassified as LaR	**6,336**	**356**	**433**	**623**	**733**

The effective interest rate applied in the case of financial instruments in the AfS category was between 0.87 % and 5.00 %. Anticipated repayments amounted to € 6,465 million.

The decrease in the carrying amounts and fair values of all reclassified financial instruments is due to extensive changes in holdings. Financial instruments that have been disposed of or fallen due since reclassification had a carrying amount of € 6,074 million in the AfS category at the time of the reclassification. The sales were carried out following the realignment of HSH Nordbank and were neither planned nor anticipated at the time of the restructuring.

Shown below is the impact the holdings reclassified to date that are still in the portfolio would have had on the income statement and revaluation reserve if they had not been reclassified. For financial instruments reclassified from AfS in the 2009 financial year, the valuation result in the revaluation reserve for the current reporting period would have been € 20 million (previous year: € 12 million).

The actual impact of the holdings reclassified to date that are still in the portfolio on the income statement of the current reporting period are shown below. In the reporting period, the statement of income includes Net interest income of € 9 million (previous year: € 18 million), Net trading income of € −2 million (previous year: € 10 million) and Net income from financial investments of € 53 million (previous year: € 73 million).

53. RESIDUAL MATURITY BREAKDOWN OF FINANCIAL INSTRUMENTS

When determining the residual maturities of financial liabilities for purposes of presenting liquidity risk, the contractually agreed maturity dates of non-discounted cash flows are used as the basis.

(€ m) **2017**	Payable on demand	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	**Total**
Liabilities						
Liabilities to banks	639	2,802	1,058	2,225	1,832	8,556
Liabilities to customers	10,986	10,739	4,717	6,956	4,768	38,166
Securitised liabilities	1	1,252	2,642	6,764	3,213	13,872
Negative fair values of hedging derivatives	–	23	41	134	16	214
Trading liabilities	8	343	500	1,698	1,654	4,203
thereof: derivatives	8	343	500	1,698	1,654	4,203
Liabilities relating to disposal groups	–	–	3	–	–	3
Other liabilities	9	59	56	523	6	653
Subordinated capital	–	1	13	229	2,800	3,043
Contingent liabilities	1,862	–	–	–	–	1,862
Irrevocable loan commitments	6,367	–	–	–	–	6,367
Total	**19,872**	**15,219**	**9,030**	**18,529**	**14,289**	**76,939**

(€ m) 2016	Payable on demand	Up to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	**Total**
Liabilities						
Liabilities to banks	1,681	1,213	827	4,169	1,873	9,763
Liabilities to customers	12,374	10,240	6,490	6,848	6,889	42,841
Securitised liabilities	–	517	3,017	10,109	4,610	18,253
Negative fair values of hedging derivatives	–	44	54	261	42	401
Trading liabilities	6	603	936	2,795	2,637	6,977
thereof: derivatives	6	603	936	2,795	2,637	6,977
Liabilities relating to disposal groups	–	–	2	–	–	2
Other liabilities	4	80	89	661	6	840
Subordinated capital	–	936	99	380	3,497	4,912
Contingent liabilities	2,189	–	–	–	–	2,189
Irrevocable loan commitments	6,654	–	–	–	–	6,654
Total	**22,908**	**13,633**	**11,514**	**25,223**	**19,554**	**92,832**

Interest rate swaps, cross currency interest rate swaps and equity swaps are presented on the basis of their future net payment obligations. Other derivatives are assigned to maturity bands by overall maturity at their carrying amount.

Liquidity management is described in detail in the Risk report section of the Group management report.

54. DISCLOSURE OF FAIR VALUE IN ACCORDANCE WITH IFRS 7 AND IFRS 13

I. Fair values of financial instruments

The fair values of financial assets and financial liabilities are disclosed by classes of financial instruments and compared with the respective carrying amount below after allowing for loan loss provisions:

FAIR VALUES OF FINANCIAL INSTRUMENTS

ASSETS

(€ m)	2017			2016		
	Carrying amount	**Fair value**	**Difference**	Carrying amount	Fair value	Difference
Held for Trading (HfT)						
Trading assets	3,641	3,641	–	5,433	5,433	–
Credit derivative under the second loss guarantee	1,014	1,014	–	199	199	–
Designated at fair Value (DFV)						
Loans and advances to customers	1,255	1,255	–	1,321	1,321	–
Financial investments	612	612	–	1,554	1,554	–
Available for Sale (AfS)			–			–
Cash reserve	106	106		118	118	
Loans and advances to banks	79	79	–	84	84	–
Loans and advances to customers	45	45	–	61	61	–
Financial investments[1]	12,475	12,718	243	12,441	12,603	162
of which equity instruments measured at cost	–	–		203	–	
Non-current assets held for sale and disposal groups	–	–		19	19	
Loans and receivables (LaR)						
Cash reserve	6,519	6,519	–	3,373	3,373	–
Loans and advances to banks	3,758	3,764	6	4,107	4,122	15
Loans and advances to customers	33,305	33,519	214	42,952	43,086	134
Financial investments	560	640	80	1,498	1,563	65
Non-current assets held for sale and disposal groups	26	26	–	907	910	3
Other assets	35	35	–	50	50	–
No IAS 39 category						
Positive fair value of hedging derivatives	264	264	–	508	508	–
Receivables under finance leases	76	76	–	98	98	–
Value adjustments from the portfolio fair value hedge	255	–	– 255	403	–	– 403
Total assets	**64,025**	**64,313**	**288**	**75,126**	**75,102**	**– 24**

1) The difference between the carrying amount and fair value of financial investments classified as AfS amounts to € 243 million. This amount is offset by the separately reported reconciling item from the portfolio fair value hedge in the amount of € 255 million, € 243 million of which is attributable to AfS financial investments. It corresponds to the effective portion of the hedging relationship recognised through profit or loss and is therefore not included in the carrying amount.

The effective portions of the hedging relationship recognised through profit or loss are disclosed in the Value adjustments from the portfolio fair value hedge item, of which € 243 million is accounted for by financial investments classified as available for sale (AfS) (previous year: € 365 million) and € 12 million (previous year: € 38 million) by loans and advances to banks and customers classified as LaR.

FAIR VALUES OF FINANCIAL INSTRUMENTS

LIABILITIES

(€ m)	**2017**			2016		
	Carrying amount	**Fair value**	**Difference**	Carrying amount	Fair value	Difference
Held for Trading (HfT)						
Trading liabilities	3,875	3,875	–	5,981	5,981	–
Designated at fair Value (DFV)						
Liabilities to banks	118	118	–	120	120	–
Liabilities to customers	819	819	–	1,331	1,331	–
Securitised liabilities	1,627	1,627	–	2,256	2,256	–
Subordinated capital	–	–	–	87	87	–
Other liabilities (LIA)						
Liabilities to banks	8,153	8,054	–99	9,381	9,387	6
Liabilities to customers	35,386	36,194	808	38,841	39,891	1,050
Securitised liabilities	10,817	10,786	–31	14,368	14,138	–230
Liabilities relating to disposal groups	2	2	–	2	2	–
Other liabilities	638	638	–	812	812	–
Subordinated capital	2,252	2,203	–49	3,449	2,948	–501
No IAS 39 category						
Negative fair values of hedging derivatives	163	163	–	290	290	–
Value adjustments from the portfolio fair value hedge	553	–	–553	786	–	–786
Total liabilities	**64,403**	**64,479**	**76**	**77,704**	**77,243**	**–461**

The carrying amounts of loans and advances to banks and loans and advances to customers classified as LaR are shown less the reported loan loss provisions, since fair value also reflects possible impairments.

II. Fair value hierarchy for financial instruments measured at fair value

Assets and liabilities show the following breakdown by level in the fair value hierarchy under IFRS 13. For assets and liabilities recognised and measured at fair value, the fair values are broken down by class of financial instrument in the three levels in the hierarchy.

HIERARCHY LEVELS, ASSETS

(€ m)	Assets recognised at fair value			
2017	Level 1	Level 2	Level 3	**Total**
Balance sheet item/ category/ instrument type				
Cash reserve				
AfS	–	106	–	106
of which debt instruments	–	106	–	106
Loans and advances to banks				
AfS	–	36	43	79
of which debt instruments	–	36	43	79
Loans and advances to customers				
AfS	–	–	45	45
of which debt instruments	–	–	45	45
DFV	–	54	1,201	1,255
of which debt instruments	–	54	1,201	1,255
Credit derivative under the second loss guarantee	–	–	1,014	1,014
of which credit derivatives	–	–	1,014	1,014
Positive fair value of hedging derivatives	–	264	–	264
of which interest rate derivatives	–	264	–	264
Trading assets (HfT)	81	3,212	348	3,641
of which debt instruments	81	120	7	208
of which interest rate derivatives	–	2,775	61	2,836
of which cross-currency interest rate derivatives	–	156	–	156
of which currency derivatives	–	71	1	72
of which credit derivatives	–	13	–	13
of which other derivatives	–	14	43	57
of which structured derivatives	–	51	236	287
of which other trading portfolios	–	12	–	12
Financial investments (excluding equity instruments measured at cost)				
AfS[1)]	11,322	1,068	85	12,475
of which debt instruments	11,307	1,067	–	12,374
of which equity and near-equity instruments	15	1	85	101
DFV	–	124	488	612
of which debt instruments	–	124	487	611
of which equity and near-equity instruments	–	–	1	1
Total	**11,403**	**4,864**	**3,224**	**19,491**

1) The difference between the total AfS financial investments in the asset hierarchy table and the fair value disclosures in Section I is attributable to effects in the item Value adjustments from the portfolio fair value hedge in the amount of € 243 million. These effects are not disclosed in the hierarchy table.

HIERARCHY LEVELS, ASSETS

(€ m)	Assets recognised at fair value			
2016	Level 1	Level 2	Level 3	**Total**
Balance sheet item/ category/ instrument type				
Cash reserve				
AfS	–	118	–	118
of which debt instruments	–	118	–	118
Loans and advances to banks				
AfS	–	40	44	84
of which debt instruments	–	40	44	84
Loans and advances to customers				
AfS	–	–	61	61
of which debt instruments	–	–	61	61
DFV	–	48	1,273	1,321
of which debt instruments	–	48	1,273	1,321
Credit derivative under the second loss guarantee	–	–	199	199
of which credit derivatives	–	–	199	199
Positive fair value of hedging derivatives	–	508	–	508
of which interest rate derivatives	–	508	–	508
Trading assets (HfT)	161	4,826	446	5,433
of which debt instruments	161	307	9	477
of which interest rate derivatives	–	4,001	96	4,097
of which cross-currency interest rate derivatives	–	244	–	244
of which currency derivatives	–	108	29	137
of which credit derivatives	–	27	–	27
of which other derivatives	–	12	51	63
of which structured derivatives	–	114	261	375
of which other trading portfolios	–	13	–	13
Financial investments (excl. equity instruments measured at cost)	–			
AfS[1]	9,968	2,241	29	12,238
of which debt instruments	9,913	2,239	–	12,152
of which equity and near-equity instruments	55	2	29	86
DFV	–	1,009	545	1,554
of which debt instruments	–	1,008	544	1,552
of which contractually linked instruments	–	1	–	1
of which equity and near-equity instruments	–	–	1	1
Non-current assets held for sale and disposal groups	–			
AfS	–	19	–	19
of which equity and near-equity instruments	–	19	–	19
Total	**10,129**	**8,809**	**2,597**	**21,535**

1) The difference between the total AfS financial investments in the asset hierarchy table and the fair value disclosures in Section I is attributable to effects in the item Value adjustments from the portfolio fair value hedge in the amount of € 365 million. These effects are not disclosed in the hierarchy table.

HIERARCHY LEVELS, LIABILITIES

(€ m)	Liabilities recognised at fair value			
2017	Level 1	Level 2	Level 3	**Total**
Liabilities to banks				
DFV	–	11	107	118
of which debt instruments	–	11	107	118
Liabilities to customers				
DFV	–	302	517	819
of which debt instruments	–	302	517	819
Securitised liabilities				
DFV	–	1,230	397	1,627
of which debt instruments	–	1,230	397	1,627
Negative fair values of hedging derivatives	–	163	–	163
of which interest rate derivatives	–	163	–	163
Trading assets (HfT)	–	3,134	741	3,875
of which interest rate derivatives	–	2,780	485	3,265
of which cross-currency interest rate derivatives	–	110	–	110
of which currency derivatives	–	59	–	59
of which other derivatives	–	–	43	43
of which structured derivatives	–	185	213	398
Total	**–**	**4,840**	**1,762**	**6,602**

HIERARCHY LEVELS, LIABILITIES

(€ m)	Liabilities recognised at fair value			
2016	Level 1	Level 2	Level 3	**Total**
Liabilities to banks				
DFV	–	11	109	120
of which debt instruments	–	11	109	120
Liabilities to customers				
DFV	–	313	1,018	1,331
of which debt instruments	–	313	1,018	1,331
Securitised liabilities				
DFV	–	1,762	494	2,256
of which debt instruments	–	1,762	494	2,256
Negative fair values of hedging derivatives	–	290	–	290
of which interest rate derivatives	–	290	–	290
Trading assets (HfT)	–	4,982	999	5,981
of which interest rate derivatives	–	4,171	583	4,754
of which cross-currency interest rate derivatives	–	396	–	396
of which currency derivatives	–	152	40	192
of which other derivatives	–	–	51	51
of which structured derivatives	–	263	325	588
Subordinated capital				
DFV	–	87	–	87
of which debt instruments	–	87	–	87
Total	**–**	**7,445**	**2,620**	**10,065**

Of the financial instruments allocated to level 3, € 1,871 million of assets (previous year: € 2,101 million) and € 1,384 million of liabilities (previous year: € 2,068 million) are in economic hedging relationships (at micro level), so that existing uncertainties and risk positions due to unobservable inputs offset each other at the level hedging relationships (at micro level) involved.

In the period under review financial instruments measured at fair value were transferred from one hierarchy level to another. These transfers are shown below together with the carrying amounts at the time of transfer for each class of financial instruments.

TRANSFER, ASSETS

(€ m) 2017	**Transfer to level 1**	**Transfer from level 1**	**Transfer to level 2**	**Transfer from level 2**	**Transfer to level 3**	**Transfer from level 3**
Trading assets (HfT)	39	– 27	27	– 79	40	–
of which debt instruments	39	– 27	27	– 39	–	–
of which interest rate derivatives	–	–	–	– 14	14	–
of which structured derivatives	–	–	–	– 26	26	–
Financial investments (excl. equity instruments measured at cost)						
AfS	5,744	– 4,218	4,218	– 5,744	–	–
of which debt instruments	5,744	– 4,218	4,218	– 5,744	–	–
Total	**5,783**	**– 4,245**	**4,245**	**– 5,823**	**40**	**–**

TRANSFER, ASSETS

(€ m) 2016	Transfer to level 1	Transfer from level 1	Transfer to level 2	Transfer from level 2	Transfer to level 3	Transfer from level 3
Trading assets (HfT)	223	– 86	87	– 223	–	– 1
of which debt instruments	223	– 86	86	– 223	–	–
Financial investments (excl. equity instruments measured at cost)						
AfS	3,770	– 1,853	1,864	– 3,770	–	– 11
of which debt instruments	3,770	– 1,853	1,864	– 3,770	–	– 11
Total	**3,993**	**– 1,939**	**1,951**	**– 3,993**	**–**	**– 12**

TRANSFER, LIABILITIES

(€ m) **2017**	**Transfer to level 1**	**Transfer from level 1**	**Transfer to level 2**	**Transfer from level 2**	**Transfer to level 3**	**Transfer from level 3**
Amounts owed to customers	–	–	–	–	–	–
DFV	–	–	–	–6	6	–
of which debt instruments	–	–	–	–6	6	–
Trading assets (HfT)	–	–	–	–31	31	–
of which interest rate derivatives	–	–	–	–5	5	–
of which structured derivatives	–	–	–	–26	26	–
Total	**–**	**–**	**–**	**–37**	**37**	**–**

There were no liability transfers in the reporting year.

IFRS 13 and IDW RS HFA 47 specify the principles to be applied in determining the fair value. They also include the guidelines for assigning input factors to the fair value hierarchy levels. HSH Nordbank uses prices obtained from pricing services such as Bloomberg or Reuters to measure interest-bearing securities, for which the OTC market is the relevant market. Average prices determined on the basis of binding offers or transaction-based prices are level 2 input factors within the meaning of IFRS 13 and IDW RS HFA 47. Interest-bearing securities were accordingly transferred from level 1 to level 2 or vice versa in the reporting period – depending on the prices used for measurement.

There were reclassifications from level 2 to level 3 within the context of model validations.

The following shows the reconciliation for all assets and liabilities recognised at fair value and assigned to level 3 in the fair value hierarchy. The data is presented by class of financial instrument from the start to the end of the period. The table takes into account all movements of assets and liabilities which were or are allocated to level 3 during the reporting period.

Income relating to liability items is shown with a negative sign and expenses are shown without a sign in the reconciliations below.

RECONCILIATION, ASSETS

(€ m)		Change in balance affecting income	
2017	1 January 2017	Realised net income (income statement)	Net income not recognised in profit or loss
Balance sheet item/ category/ instrument type			
Loans and advances to banks			
AfS	44	– 2	1
of which debt instruments	44	– 2	1
Loans and advances to customers			
AfS	61	– 9	–
of which debt instruments	61	– 9	–
DFV	1,273	– 58	–
of which debt instruments	1,273	– 58	–
Credit derivative second loss guarantee (HfT)	199	815	–
of which credit derivatives	199	815	–
Trading assets (HfT)	446	– 126	–
of which debt instruments	9	–	–
of which interest rate derivatives	96	– 49	–
of which currency derivatives	29	– 19	–
of which other derivatives	51	– 8	–
of which structured derivatives	261	– 50	–
Financial investments (excluding equity instruments measured at cost)			
AfS	29	– 54	8
of which equity and near-equity instruments	29	– 54	8
DFV	545	– 32	–
of which debt instruments	544	– 32	–
of which equity and near-equity instruments	1	–	–
Total	**2,597**	**534**	**9**

Quantitative change in balance			Transfers					
Purchases	Sales	Settlements	From level 3	To level 3	Reclas-sification	Exchange rate changes	**31 December 2017**	Net income from assets held as at 31 December 2017
								–
–	–	–	–	–	–	–	43	–2
–	–	–	–	–	–	–	43	–2
–	–	–	–	–	–	–7	45	–9
–	–	–	–	–	–	–7	45	–9
–	–11	–	–	–	–	–3	1,201	–58
–	–11	–	–	–	–	–3	1,201	–58
–	–	–	–	–	–	–	1,014	815
–	–	–	–	–	–	–	1,014	815
8	–20	–	–	40	–	–	348	–16
7	–9	–	–	–	–	–	7	–
–	–	–	–	14	–	–	61	–14
1	–10	–	–	–	–	–	1	–
–	–	–	–	–	–	–	43	–8
–	–1	–	–	26	–	–	236	6
–	–26	–	–	–	132	–4	85	–54
–	–26	–	–	–	132	–4	85	–54
–	–	–23	–	–	–	–2	488	1
–	–	–23	–	–	–	–2	487	1
–	–	–	–	–	–	–	1	–
8	**–57**	**–23**	**–**	**40**	**132**	**–16**	**3,224**	**677**

RECONCILIATION, ASSETS

(€ m)		Change in balance affecting income	
2016	1 January 2016	Realisednet income (income statement)	Net income not recognised in profit or loss
Balance sheet item/ category/ instrument type			
Loans and advances to banks			
AfS	44	–	– 1
of which debt instruments	44	–	– 1
Loans and advances to customers			
AfS	104	–	– 5
of which debt instruments	104	–	– 5
DFV	1,254	47	–
of which debt instruments	1,254	47	–
Credit derivative second loss guarantee (HfT)	663	– 464	–
of which credit derivatives	663	– 464	–
Trading assets (HfT)	496	– 62	–
of which debt instruments	–	–	–
of which interest rate derivatives	150	– 55	–
of which currency derivatives	29	–	–
of which other derivatives	17	34	–
of which structured derivatives	300	– 41	–
Financial investments (excluding equity instruments measured at cost)			
AfS	159	–	1
of which debt instruments	16	–	–
of which equity and near-equity instruments	143	–	1
DFV	546	24	–
of which debt instruments	544	24	–
of which equity and near-equity instruments	2	–	–
Total	**3,266**	**– 455**	**– 5**

	Quantitative change in balance			Transfers					
	Purchases	Sales	Settlements	From level 3	To level 3	Reclassification	Exchange rate changes	**31 December 2016**	Net income from assets held as at 31 December 2016
									–
	–	–	–	–	–	–	1	44	–
	–	–	–	–	–	–	1	44	–
									–
	–	–	–39	–	–	–	1	61	–
	–	–	–39	–	–	–	1	61	–
	–	–29	–	–	–	–	1	1,273	42
	–	–29	–	–	–	–	1	1,273	42
	–	–	–	–	–	–	–	199	–464
	–	–	–	–	–	–	–	199	–464
	9	–	–	–1	–	–	4	446	–16
	9	–	–	–	–	–	–	9	–
	–	–	–	–	–	–	1	96	–43
	–	–	–	–	–	–	–	29	–
	–	–	–	–1	–	–	1	51	34
	–	–	–	–	–	–	2	261	–7
	–	–120	–5	–11	–	–	5	29	–
	–	–	–5	–11	–	–	–	–	–
	–	–120	–	–	–	–	5	29	–
	–	–1	–28	–	–	–	4	545	26
	–	–	–28	–	–	–	4	544	26
	–	–1	–	–	–	–	–	1	–
	9	**–150**	**–72**	**–12**	**–**	**–**	**16**	**2,597**	**–412**

RECONCILIATION, LIABILITIES

(€ m)		Change in balance affecting income		
2017	1 January 2017	Realisednet income (income statement)	Net income not recognised in profit or loss	
Balance sheet item/ category/ instrument type				
Liabilities to banks				
DFV	109	– 2	–	
of which debt instruments	109	– 2	–	
Liabilities to customers				
DFV	1,018	– 40	3	
of which debt instruments	1,018	– 40	3	
Securitised liabilities				
DFV	494	– 19	6	
of which debt instruments	494	– 19	6	
Trading assets (HfT)	999	– 260	–	
of which interest rate derivatives	583	– 98	–	
of which currency derivatives	40	– 29	–	
of which other derivatives	51	– 8	–	
of which structured derivatives	325	– 125	–	
Total	**2,620**	**– 321**	**9**	

	Quantitative change in balance				Transfers					
	Purchases	Sales	New business	Settlements	From level 3	To level 3	Reclassification	Exchange ratechanges	**31 December 2017**	Net income from assets held as at 31 December 2017
	–	–	–	–	–	–	–	–	107	2
	–	–	–	–	–	–	–	–	107	2
	18	– 10	–	– 476	–	6	–	– 2	517	15
	18	– 10	–	– 476	–	6	–	– 2	517	15
	– 27	5	–	– 40	–	–	–	– 22	397	18
	– 27	5	–	– 40	–	–	–	– 22	397	18
	–	– 29	–	–	–	31	–	–	741	91
	–	– 5	–	–	–	5	–	–	485	92
	–	– 11	–	–	–	–	–	–	–	–
	–	–	–	–	–	–	–	–	43	8
	–	– 13	–	–	–	26	–	–	213	– 9
	– 9	**– 34**	**–**	**– 516**	**–**	**37**	**–**	**– 24**	**1,762**	**126**

RECONCILIATION, LIABILITIES

(€ m)		Change in balance affecting income		
2016	1 January 2016	Realised net income(income statement)	Net income not recognised in profit or loss	
Balance sheet item/ category/ instrument type				
Liabilities to banks				
DFV	120	–6	–	
of which debt instruments	120	–6	–	
Liabilities to customers				
DFV	1,166	–45	–	
of which debt instruments	1,166	–45	–	
Securitised liabilities				
DFV	644	–39	–	
of which debt instruments	644	–39	–	
Trading assets (HfT)	885	112	–	
of which interest rate derivatives	541	42	–	
of which currency derivatives	40	–	–	
of which other derivatives	16	34	–	
of which structured derivatives	288	36	–	
Total	**2,815**	**22**	**–**	

	Quantitative change in balance				Transfers					
	Purchases	Sales	New business	Settlements	From level 3	To level 3	Reclassification	Exchange rate changes	**31 December 2016**	Net income from assets held as at 31 December 2016
	5	–	–	–10	–	–	–	–	109	7
	5	–	–	–10	–	–	–	–	109	7
	58	–7	–	–155	–	–	–1	2	1,018	67
	58	–7	–	–155	–	–	–1	2	1,018	67
	–6	–	12	–144	–	–	–	27	494	6
	–6	–	12	–144	–	–	–	27	494	6
	–	–	–	–	–	–	–	2	999	–164
	–	–	–	–	–	–	–	–	583	–48
	–	–	–	–	–	–	–	–	40	–
	–	–	–	–	–	–	–	1	51	–34
	–	–	–	–	–	–	–	1	325	–82
	57	**–7**	**12**	**–309**	**–**	**–**	**–1**	**31**	**2,620**	**–84**

The following tables show the items containing realised and unrealised gains and losses in the income statement and equity (statement of comprehensive income).

NET INCOME ITEMS FROM RECONCILIATION, ASSETS

(€ m)

	Realised/unrealised net income (income statement)				
2017	Net interest income	Net trading income	Net income from financial investments	Hedging effect of credit derivative second loss guarantee	**Total**
Balance sheet item/ category/ instrument type					
Loans and advances to banks					
AfS	–2	–	–	–	–2
of which debt instruments	–2	–	–	–	–2
Loans and advances to customers					
AfS	–	–	–9	–	–9
of which debt instruments	–	–	–9	–	–9
DFV	–	–58	–	–	–58
of which debt instruments	–	–58	–	–	–58
Credit derivative second loss guarantee (HfT)	–	–	–	815	815
of which credit derivatives	–	–	–	815	815
Trading assets (HfT)	–49	–77	–	–	–126
of which interest rate derivatives	–49	–	–	–	–49
of which currency derivatives	–	–19	–	–	–19
of which other derivatives	–	–8	–	–	–8
of which structured derivatives		–50			–50
Financial investments (excluding equity instruments measured at cost)	–	–	–	–	–
AfS	–	–	–54	–	–54
of which equity and near-equity instruments	–	–	–54	–	–54
DFV	–	–32	–	–	–32
of which debt instruments	–	–32	–	–	–32
Total	**–51**	**–167**	**–63**	**815**	**534**

	Other net income for the period	Net income from assets still held as at 31 December 2017					
	Revaluation reserve	Net interest income	Net trading income	Net income from financial investments	Hedging effect of credit derivative second loss guarantee	**Total**	Other net income for the period
	1	–2	–	–	–	–2	1
	1	–2	–	–	–	–2	1
	–	–	–	–9	–	–9	–
	–	–	–	–9	–	–9	–
	–	–	–58	–	–	–58	–
	–	–	–58	–	–	–58	–
	–	–	–	–	815	815	–
	–	–	–	–	815	815	–
	–	2	–18	–	–	–16	–
	–	–	–14	–	–	–14	–
	–	–	–	–	–	–	–
	–	–	–8	–	–	–8	–
		2	4	–	–	6	–
	–	–	–		–		–
	8	–	–	–54	–	–54	8
	8	–	–	–54	–	–54	8
	–	2	–1	–	–	1	–
	–	2	–1	–	–	1	–
	9	**2**	**–77**	**–63**	**815**	**677**	**9**

NET INCOME ITEMS FROM RECONCILIATION, ASSETS

(€ m)

2016	Realised/unrealised net income (income statement) Net interest income	Net trading income	Net income from financial investments	Hedging effect of credit derivative second loss guarantee	Total
Balance sheet item/ category/ instrument type					
Loans and advances to banks					
AfS	–	–	–	–	–
of which debt instruments	–	–	–	–	–
Loans and advances to customers	–	–	–	–	–
AfS	–	–	–	–	–
of which debt instruments	–	–	–	–	–
DFV	– 1	48	–	–	47
of which debt instruments	– 1	48	–	–	47
Credit derivative second loss guarantee (HfT)	–	–	–	– 464	– 464
of which credit derivatives	–	–	–	– 464	– 464
Trading assets (HfT)	– 10	– 52	–	–	– 62
of which interest rate derivatives	– 5	– 50	–	–	– 55
of which other derivatives	– 5	39	–	–	34
of which structured derivatives	–	– 41	–	–	– 41
Financial investments (excluding equity instruments measured at cost)					
AfS	–	–	–	–	–
of which debt instruments	–	–	–	–	–
of which equity and near-equity instruments	–	–	–	–	–
DFV	– 1	25	–	–	24
of which debt instruments	– 1	25	–	–	24
Total	**– 12**	**21**	**–**	**– 464**	**– 455**

	Other net income for the period	Net income from assets still held as at 31 December 2016					
	Revaluation reserve	Net interest income	Net trading income	Net income from financial investments	Hedging effect of credit derivative second loss guarantee	**Total**	Other net income for the period
	–1	–	–	–	–	–	–1
	–1	–	–	–	–	–	–1
	–5	–	–	–	–	–	–7
	–5	–	–	–	–	–	–7
	–	–	42	–	–	42	–
	–	–	42	–	–	42	–
	–	–	–	–	–464	–464	–
	–	–	–	–	–464	–464	–
	–	4	–20	–	–	–16	–
	–	1	–44	–	–	–43	–
	–	–	34	–	–	34	–
	–	3	–10	–	–	–7	–
	1	–	–	–	–	–	–2
	–	–	–	–	–	–	–1
	1	–	–	–	–	–	–1
	–	–	26	–	–	26	–
	–	–	26	–	–	26	–
	–5	**4**	**48**	**–**	**–464**	**–412**	**–10**

NET INCOME ITEMS FROM RECONCILIATION, LIABILITIES

(€ m)	Realised/unrealised net income (income statement)				Other net income for the period	Net income from liabilities still held as at 31 December 2017				
2017	Net interest income	Net trading income	Net income from financial investments	**Total**	Revaluation reserve	Net interest income	Net trading income	Net income from financial investments	**Total**	Other net income for the period
Balance sheet item/category/instrument type										
Liabilities to banks										
DFV	–	2	–	2	–	–	2	–	2	–
of which debt instruments	–	2	–	2	–	–	2	–	2	–
Liabilities to customers										
DFV	–6	46	–	40	–3	–	15	–	15	–2
of which debt instruments	–6	46	–	40	–3	–	15	–	15	–2
Securitised liabilities										
DFV	–	19	–	19	–6	–	18	–	18	–6
of which debt instruments	–	19	–	19	–6	–	18	–	18	–6
Trading liabilities (HfT)	23	237	–	260	–	2	89	–	91	–
of which interest rate derivatives	3	95	–	98	–	2	90	–	92	–
of which currency derivatives	–	29	–	29	–	–	–	–	–	–
of which other derivatives	–	8	–	8	–	–	8	–	8	–
of which structured derivatives	20	105	–	125	–	–	–9	–	–9	–
Total	**17**	**304**	**–**	**321**	**–9**	**2**	**124**	**–**	**126**	**–8**

NET INCOME ITEMS FROM RECONCILIATION, LIABILITIES

(€ m)	Realised/unrealised net income (income statement)				Other net income for the period	Net income from liabilities still held as at 31 December 2016				
2016	Net interest income	Net trading income	Net income from financial investments	**Total**	Revaluation reserve	Net interest income	Net trading income	Net income from financial investments	**Total**	Other net income for the period
Balance sheet item/category/ instrument type										
Liabilities to banks										
DFV	–	6	–	6	–	–	7	–	7	–
of which debt instruments	–	6	–	6	–	–	7	–	7	–
Liabilities to customers										
DFV	5	40	–	45	–	– 1	68	–	67	–
of which debt instruments	5	40	–	45	–	– 1	68	–	67	–
Securitised liabilities										
DFV	1	38	–	39	–	–	6	–	6	–
of which debt instruments	1	38	–	39	–	–	6	–	6	–
Trading liabilities (HfT)	5	– 117	–	– 112	–	– 3	– 161	–	– 164	–
of which interest rate derivatives	2	– 44	–	– 42	–	–	– 48	–	– 48	–
of which other derivatives	–	– 34	–	– 34	–	–	– 34	–	– 34	–
of which structured derivatives	3	– 39	–	– 36	–	– 3	– 79	–	– 82	–
Total	**11**	**– 33**	**–**	**– 22**	**–**	**– 4**	**– 80**	**–**	**– 84**	**–**

III. Fair value hierarchy for financial instruments not measured at fair value

The following tables show the distribution of fair values by asset and liability class to the individual levels of the fair value hierarchy as defined under IFRS 13 for financial instruments not measured at fair value on the balance sheet.

HIERARCHY LEVELS, ASSETS

(€ m)	Assets not recognised at fair value			
2017	Level 1	Level 2	Level 3	**Total**
Balance sheet item/ category/ instrument type				
Cash reserve (LaR)	–	6,519	–	6,519
Loans and advances to banks (LaR)	–	3,676	88	3,764
of which debt instruments	–	3,676	88	3,764
Payable on demand	–	349	–	349
Other receivables	–	3,327	88	3,415
Loans and advances to customers (LaR)	–	2,955	30,564	33,519
of which debt instruments	–	2,955	30,564	33,519
Retail customers	–	14	643	657
Corporate clients	–	1,369	28,629	29,998
Public authorities	–	1,572	1,292	2,864
Financial investments (LaR)	21	602	17	640
of which debt instruments	21	519	17	557
of which contractually linked instruments	–	83	–	83
Non-current assets held for sale and disposal groups (LaR)	–	14	12	26
of which debt instruments	–	14	12	26
of which securitisation instruments	–	–	–	–
of which equity and near-equity instruments	–	–	–	–
Other assets (LaR)	–	35	–	35
of which debt instruments	–	35	–	35
Total	**21**	**13,801**	**30,681**	**44,503**

HIERARCHY LEVELS, ASSETS

(€ m)	Assets not recognised at fair value			
2016	Level 1	Level 2	Level 3	**Total**
Balance sheet item/ category/ instrument type				
Cash reserve (LaR)	–	3,373	–	3,373
Loans and advances to banks (LaR)		4,070	52	4,122
of which debt instruments	–	4,070	52	4,122
Payable on demand	–	2,969	–	2,969
Other receivables	–	1,101	52	1,153
Loans and advances to customers (LaR)		6,226	36,860	43,086
of which debt instruments	–	6,226	36,860	43,086
Retail customers	–	32	953	985
Corporate clients	–	2,379	35,407	37,786
Public authorities	–	3,815	500	4,315
Financial investments (LaR)	40	956	567	1,563
of which debt instruments	40	791	15	846
of which contractually linked instruments	–	165	552	717
Non-current assets held for sale and disposal groups (LaR)	–	7	903	910
of which debt instruments	–	7	903	910
Other assets (LaR)	–	50	–	50
of which debt instruments	–	50	–	50
Total	**40**	**14,682**	**38,382**	**53,104**

HIERARCHY LEVELS, LIABILITIES

(€ m)	Liabilities not recognised at fair value			
2017	Level 1	Level 2	Level 3	**Total**
Liabilities to banks (LIA)	–	7,570	484	8,054
of which debt instruments	–	7,570	484	8,054
Liabilities to customers (LIA)	–	35,734	460	36,194
of which debt instruments	–	35,734	460	36,194
Securitised liabilities (LIA)	–	10,786	–	10,786
of which debt instruments	–	10,159	–	10,159
of which contractually linked instruments	–	627	–	627
Liabilities from disposal groups (LIA)	–	–	2	2
of which debt instruments	–	–	2	2
Subordinated capital (LIA)	–	1,399	804	2,203
of which debt instruments	–	1,399	804	2,203
Other liabilities (LIA)	–	638	–	638
of which debt instruments	–	638	–	638
Total	**–**	**56,127**	**1,750**	**57,877**

HIERARCHY LEVELS, LIABILITIES

(€ m)	Liabilities not recognised at fair value			
2016	Level 1	Level 2	Level 3	**Total**
Liabilities to banks (LIA)	–	8,155	1,232	9,387
of which debt instruments	–	8,155	1,232	9,387
Liabilities to customers (LIA)	–	39,233	658	39,891
of which debt instruments	–	39,233	658	39,891
Securitised liabilities (LIA)	–	14,138	–	14,138
of which debt instruments	–	13,144	–	13,144
of which contractually linked instruments	–	994	–	994
Liabilities from disposal groups (LIA)	–	–	2	2
of which debt instruments	–	–	2	2
Subordinated capital (LIA)	–	2,862	86	2,948
of which debt instruments	–	2,862	86	2,948
Other liabilities (LIA)	–	812	–	812
of which debt instruments	–	812	–	812
Total	**–**	**65,200**	**1,978**	**67,178**

IV. Information on significant unobservable inputs

Quantitative information on significant unobservable inputs

The following overview contains quantitative information on significant unobservable inputs.

FAIR VALUE

(€ m) **2017**			Assets	Liabilities	Measurement procedures	Significant unobservable inputs (level 3)	Margin	(Weighted) average margin
Loans and advances to banks	AfS	Debt instruments	43	–	DCF method	Spread (bps)	54	54
Loans and advances to customers	AfS	Debt instruments	45	–	DCF method Price	Spread (bps)Price	700	700
	DFV	Debt instruments	1,201	–	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate FX correlation	– 29 % – 33 %	– 10 %
					Price	Price	25 – 83	68
Credit derivative under the second loss guarantee	HfT	Credit derivatives	1,014	–	DCF method	Expected cash flow	–	–
Trading assets/trading liabilities	HfT	Debt instruments	7	–	DCF method	Spread (bps)	175 – 200	199
		Interest rate derivatives	61	485	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	5 % – 23 %	12 %
						Interest rate FX correlation	– 29 % – 33 %	– 10 %
		Currency derivatives	1	–	Option pricing model	FX correlation	44 % – 64 %	54 %
		Other derivatives	43	43	Option pricing model	Shares FX correlation	– 45 % – 25 %	– 5 %
		Structured derivatives	236	213	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	5 % – 23 %	12 %
						Interest rate correlation	– 73 % – 21 %	21 %
						Interest rate FX correlation	– 29 % – 33 %	– 10 %
						FX correlation	44 % – 64 %	54 %

FAIR VALUE

(€ m) **2017**			Assets	Liabilities	Measure-ment procedures	Significant unobservable inputs (level 3)	Margin	(Weighted) average margin
Financial investments	AfS	Equity and near-equity instruments	85	–	Price	Price	1 – 12,000	1600
					DCF method	Spread (bps)	20	20
						Capital costs	6 % – 10 %	8 %
	DFV	Debt instruments	487	–	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	5 % – 23 %	12 %
		Equity and near-equity instruments	1	–	Price	Price	5	5
Liabilities to banks	DFV	Debt instruments	–	107	Option pricing model	Interest rate volatility	5 % – 23 %	12 %
						Interest rate FX correlation	– 29 % – 33 %	– 10 %
Liabilities to customers	DFV	Debt instruments	–	517	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	5 % – 23 %	12 %
						Interest rate correlation	– 73 % – 21 %	21 %
						Interest rate FX correlation	– 29 % – 33 %	– 10 %
Securitised liabilities	DFV	Debt instruments	–	397	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	5 % – 23 %	12 %
						FX correlation	44 % – 64 %	54 %
						Shares FX correlation	– 45 % – 25 %	– 5 %
					Price	Price	52 – 83	62
			3,224	**1,762**				

FAIR VALUE

(€ m) 2016			Assets	Liabilities	Measurement procedures	Significant unobservable inputs (level 3)	Margin	(Weighted) average margin
Loans and advances to banks	AfS	Debt instruments	44	–	DCF method	Spread (bps)	54	54
Loans and advances to customers	AfS	Debt instruments	61	–	DCF method Price	Spread (bps)Price	700	700
	DFV	Debt instruments	1,273	–	Option pricing model	Mean reversion	0 % – 10 %	2 %
			–			Interest rate FX correlation	– 32 % – 16 %	– 16 %
					Price	Price	37 – 87	73
Credit derivative under the second loss guarantee	HfT	Credit derivatives	199	–	DCF method	Expected cash flow	–	–
Trading assets/trading liabilities	HfT	Debt instruments	9	–	Price	Price	100	100
		Interest rate derivatives	96	583	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	19 % – 77 %	31 %
						Interest rate correlation	– 51 % – 100 %	23 %
						Interest rate FX correlation	– 32 % – 16 %	– 16 %
		Currency derivatives	29	40	Option pricing model	FX correlation	35 % – 66 %	49 %
		Other derivatives	51	51	Option pricing model	Shares FX correlation	– 30 % – 44 %	– 1 %
		Structured derivatives	261	325	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	19 % – 77 %	31 %
						Interest rate correlation	– 51 % – 100 %	23 %
						Interest rate FX correlation	– 32 % – 16 %	– 16 %
						FX correlation	35 % – 66 %	49 %

FAIR VALUE

(€ m) 2016			Assets	Liabilities	Measure-ment procedures	Significant unobservable inputs (level 3)	Margin	(Weighted) average margin
Financial investments	AfS	Equity and near-equity instruments	29	–	Price	Price	1 – 14,000	279
	DFV	Debt instruments	544	–	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	19 % – 77 %	31 %
					Price	Price	7	7
		Equity and near-equity instruments	1	–	Price	Price	1 – 100	94
Liabilities to banks	DFV	Debt instruments	–	109	Option pricing model	Interest rate volatility	19 % – 77 %	31 %
						Interest rate FX correlation	– 32 % – 16 %	– 16 %
Liabilities to customers	DFV	Debt instruments	–	1,018	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	19 % – 77 %	31 %
						Interest rate correlation	– 51 % – 100 %	23 %
						Interest rate FX correlation	– 32 % – 16 %	– 16 %
Securitised liabilities	DFV	Debt instruments	–	494	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	19 % – 77 %	31 %
						FX correlation	35 % – 66 %	49 %
						Shares FX correlation	– 30 % – 44 %	– 1 %
					Price	Price	62	62
			2,597	**2,620**				

The correlation and volatility ranges shown for derivatives cover derivatives with different types of underlying, tenors and exercise prices.

The overview also includes financial instruments, whose change in value resulting from inputs unobservable in the market does not give rise to any P&L effect due to economic hedging relationships (at the micro level). Changes in value attributable to the respective relevant inputs are offset for these financial instruments by the changes in value of the hedging derivatives.

Sensitivities of fair values in relation to unobservable inputs

The following describes how the fair values of financial instruments can change as a result of fluctuations in significant unobservable inputs.

Correlation

Correlation can represent an important unobservable input for the measurement of derivatives. It is a measure of the degree to which two reference values move in relation to each other. Correlation is an important input for the model-based determination of the fair value of derivatives with more than one underlying. Financial instruments of this type include, for example, derivatives with several currencies ("FX basket") or several shares as the underlyings ("equity basket" derivatives). Currency correlations describe the relationship between changes in value of several currencies. Share correlations express the relationship between yields on different shares. A high degree of correlation means that there is a high relationship between the changes in value of the respective underlyings.

Depending on the type of derivative changes in correlation can have a positive or negative effect on the fair value. For example, in the case of a "best of two" derivative, an increase in the correlation between two underlyings results in a decrease of the fair value of the derivative from the perspective of the purchaser.

Volatility

Volatility can also represent an important unobservable input for the measurement of options. It expresses how strongly the value of the underlying fluctuates over time. The amount of volatility depends on the type of the underlying, its tenor and the exercise price agreed for the option.

The fair value of options typically increases if volatility increases. The sensitivity of the fair value of options to changes in volatility can vary considerably. For example, the sensitivity of the fair value to changes in volatility is comparatively high, if the price of the underlying is close to the agreed exercise price ("at-the-money"). By contrast, sensitivity to changes in volatility is lower, if the price of the underlying is far from the exercise price ("far out-of-the-money" or "far in-the-money").

Price

Prices can represent an important unobservable input for the measurement of financial instruments. These prices represent pricing information of third parties within the meaning of IFRS 13.93(d) sentence 4, whereby the Bank does not produce any quantitative, unobservable input factors for measuring the fair value of the respective financial instrument. More detailed quantitative information on these input factors is not required therefore. The fair value increases, if the price increases, and it falls, if the price declines.

Reciprocal effects between unobservable inputs

Reciprocal effects between unobservable inputs can exist in principle. If several unobservable inputs are used in determining fair value, the range of the possible characteristics for another unobservable input can be restricted or increased by the characteristic used for one of the relevant unobservable inputs.

Effects of unobservable inputs

If the measurement of a financial instrument is based partly on unobservable inputs, the fair value determined is the best estimated value in accordance with a discretionary decision made by the Bank. However, it remains subjective in that there may be alternative input selection options that cannot be refuted by observable market data. For many of the financial instruments included (such as derivatives) the unobservable inputs only represent a subset of the total inputs required for the measurement. The remaining inputs are observable inputs.

An alternative choice of inputs for the unobservable inputs depending on the limits of a possible range would have had the effect on the fair value of the financial instruments in question as set out in the following tables. Advantageous and disadvantageous changes to fair value arise as a result of the recalculation of fair values based on possible alternative values to the relevant unobservable inputs. In doing so, interest rate volatilities were changed by +/– 5%, all correlations by +/– 20% (capped at +/– 100%), mean reversion by +/– 0.5% and spreads by +/– 50 bp.

a) Financial instruments for which there are no economic hedging relationships in place (at the micro level):

FAIR VALUE CHANGES LEVEL 3

(€ m)			2017		2016	
			advantageous	**disadvantageous**	advantageous	disadvantageous
Loans and advances to customers	AfS	Debt instruments	1	1	3	3
Credit derivative under the second loss guarantee	HfT	Credit derivatives	3	3	9	10
Trading assets/trading liabilities	HfT	Interest rate derivatives	8	8	1	1
		Other derivatives	–	–	1	1
		Structured derivatives	4	4	2	2
Financial investments	AfS	Equity and near-equity instruments	4	4	1	1
			20	**20**	**17**	**18**
thereof measured in profit or loss			15	15	13	14
thereof not measured in profit of loss			5	5	4	4

There are no hedging derivatives in place for the financial instruments included in the above table that fully hedge the risk relating to changes in fair value caused by changes in unobservable inputs. However, there may be hedging derivatives in place that approximately hedge the changes in value.

b) Financial instruments for which there are economic hedging relationships in place (at the micro level):

FAIR VALUE CHANGES LEVEL 3

(€ m)			2017		2016	
			advantageous	**disadvantageous**	advantageous	disadvantageous
Loans and advances to customers	DFV	Debt instruments	1	1	2	2
Trading assets/trading liabilities	HfT	Interest rate derivatives	1	1	1	1
		Structured derivatives	2	2	2	2
Liabilities to banks	DFV	Debt instruments	1	1	1	1
Liabilities to customers	DFV	Debt instruments	–	–	1	1
Securitised liabilities	DFV	Debt instruments	1	1	1	1
			6	**6**	**8**	**8**
thereof measured in profit or loss			6	6	8	8
thereof not measured in profit of loss			–	–	–	–

There are hedging derivatives in place for the financial instruments included in the above table that hedge the risk relating to changes in fair value caused by changes in unobservable inputs. The changes in value shown would not be reflected in the income statement as they are offset by changes in fair value of the hedging derivatives.

V. Day One Profit and Loss

The day one profit and loss reserve developed as follows:

(€ m)	**2017**	2016
Holdings as at 1 January	13	22
Additions not recognised in profit or loss	1	2
Reversals recognised in profit or loss	12	11
Holdings as at 31 December	**2**	**13**

The day one profit and loss reserve is solely attributable to financial instruments classified as HfT.

VI. Equity instruments measured at cost

Fair values are calculated for equity instruments which are not listed. The portfolio of shares and other non-interest bearing securities measured at cost amounts to € 0 million (previous year: € 125 million). Equity capital instruments accounted for at cost that relate to interests in affiliated companies and equity holdings in non-affiliated companies amount to € 0 million (previous year: € 78 million).

In the year under review, equity instruments classified as AfS not measured at fair value with a carrying amount of € 43 million (previous year € 26 million) were disposed of. This did not result in any income, as was the case in the previous year.

55. OFFSETTING OF FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are netted and disclosed as a net amount on the balance sheet, if there is a legal entitlement to do so at the current point in time. Furthermore, it is intended to settle the claims on a net basis or to settle the associated liability at the time the asset concerned is realised.

Set out below are the financial instruments on the balance sheet that were netted as at the reporting date as well as financial instruments, which are subject to a legally enforceable global netting agreement, irrespective of whether the financial instruments concerned are actually netted on the face of the balance sheet. ISDA master agreements and the Master Agreement for Financial Derivative Transactions (DRV) are the master agreements customarily used by HSH Nordbank for OTC transactions. These only provide for the netting of reciprocal claims and obligations in the event of the termination of all individual transactions under a master agreement that is based on specific events and therefore do not permit netting of the assets and liabilities on the balance sheet. HSH Nordbank has entered into clearing agreements with brokers for certain OTC derivatives enabling the Bank to access central counterparties (clearing houses). The contractual arrangements for these transactions include a legal right to set off financial assets and financial liabilities that can be enforced legally at any time and thereby result in the offsetting of positive and negative fair values of derivative financial instruments and of collateral provided and received in accordance with IAS 32.42.

The fair value of the collateral received or provided in this connection is also given in this table. This includes cash collateral as well as financial instruments received or provided as collateral.

FINANCIAL ASSETS

(€ m) 2017	Gross carrying amount	Gross carrying amount from netting	Net amount	Gross amount, netting criteria not met	Collateral received	Net amount after collateral
Loans and advances to banks	1,492	–	1,492	–	1,432	60
Loans and advances to customers	505	–	505	–	424	81
Derivatives	4,206	945	3,261	2,068	326	867

In the year under review the netted amounts disclosed under Loans and advances to banks and Loans and advances to customers relate to genuine repo transactions.

Of the net amount of derivatives disclosed on the balance sheet positive fair value of hedging derivatives accounts for € 264 million and Trading assets for € 2,997 million.

FINANCIAL LIABILITIES

(€ m) 2017	Gross carrying amount	Gross carrying amount from netting	Net amount	Gross amount, netting criteria not met	Collateral provided	Net amount after collateral
Liabilities to banks	572	20	552	–	543	9
Liabilities to customers	460	250	210	–	199	11
Derivatives	4,697	675	4,022	2,068	1,856	98

In the year under review the netted amounts disclosed under liabilities to banks and liabilities to customers relate to genuine repo transactions.

Of the net amount of derivatives disclosed on the balance sheet negative market values of hedging derivatives account for € 163 million and Trading liabilities for € 3,859 million.

FINANCIAL ASSETS

(€ m) 2016	Gross carrying amount	Gross carrying amount from netting	Net amount	Gross amount, netting criteria not met	Collateral received	Net amount after collateral
Loans and advances to banks	1	–	1	–	–	1
Loans and advances to customers	109	106	3	–	–	3
Derivatives	5,574	741	4,833	3,280	333	1,220

In the previous year, the netted amounts disclosed under Loans and advances to banks and Loans and advances to customers exclusively concern current accounts.

Of the net amount of derivatives disclosed on the balance sheet positive fair value of hedging derivatives accounts for € 506 million and Trading assets for € 4,327 million.

FINANCIAL LIABILITIES

(€ m) 2016	Gross carrying amount	Gross carrying amount from netting	Net amount	Gross amount, netting criteria not met	Collateral provided	Net amount after collateral
Liabilities to banks	1,216	28	1,188	–	812	376
Liabilities to customers	338	70	268	–	25	243
Derivatives	7,005	749	6,256	3,280	2,816	160

In the previous year, the netted amounts disclosed under Liabilities to banks and Liabilities to customers exclusively resulted from current account transactions.

Of the net amount of derivatives disclosed on the balance sheet negative market values of hedging derivatives account for € 290 million and Trading liabilities for € 5,966 million.

56. FINANCIAL TRANSACTIONS ENTERED INTO WITH SELECTED STATES

The following tables contain overviews of HSH Nordbank's exposure in European states where an increased economic risk is assumed. They present the risk directly attributable to the listed countries.

ASSETS CLASSIFIED AS LAR

(€ m)	Gross carrying amount		Specific loan loss provisions		Fair value	
	2017	2016	**2017**	2016	**2017**	2016
Portugal	**174**	**193**	**6**	**7**	**195**	**190**
Public sector	127	171	–	–	155	176
Corporates/Other	47	22	6	7	40	14
Italy	**569**	**595**	**289**	**100**	**288**	**480**
Public sector	19	23	–	–	20	24
Banks	3	–	–	–	3	–
Corporates/Other	547	572	289	100	265	456
Greece	**912**	**1,442**	**261**	**268**	**653**	**1,100**
Corporates/Other	912	1,442	261	268	653	1,100
Russia	**29**	**44**	**–**	**–**	**29**	**44**
Corporates/Other	29	44		–	29	44
Spain	**960**	**1,244**	**233**	**108**	**736**	**1,152**
Public sector	79	151	–	–	90	159
Corporates/Other	881	1,093	233	108	646	993
Cyprus	**418**	**1,144**	**40**	**524**	**381**	**519**
Corporates/Other	418	1,144	40	524	381	519
Croatia	**93**	**99**	**–**	**–**	**93**	**101**
Corporates/Other	93	99	–	–	93	101
Turkey	**232**	**389**	**80**	**7**	**152**	**344**
Banks	59	10	–	–	58	10
Corporates/Other	173	379	80	7	94	334
Total	**3,387**	**5,150**	**909**	**1,014**	**2,527**	**3,930**

FINANCIAL TRANSACTIONS ALLOCATED TO THE HOLDING CATEGORY

(€ m)	HfT		Hedge		DFV		AfS	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Portugal	**–**	**–**	**–**	**–**	**54**	**49**	**–**	**–**
Public sector	–	–	–	–	54	49	–	–
Italy	**9**	**6**	**–**	**–**	**–**	**402**	**–**	**–**
Public sector	–	–	–	–	–	402	–	–
Corporates/Other	9	6	–	–	–	–	–	–
Greece	**4**	**9**	**–**	**–**	**–**	**–**	**–**	**–**
Corporates/Other	4	9	–	–	–	–	–	–
Russia	**18**	**31**	**–**	**–**	**–**	**–**	**–**	**–**
Banks	1	2	–	–	–	–	–	–
Corporates/Other	17	29	–	–	–	–	–	–
Spain	**64**	**75**	**5**	**10**	**–**	**–**	**–**	**–**
Banks	32	37	5	10	–	–	–	–
Corporates/Other	32	38	–	–	–	–		–
Cyprus	**1**	**1**	**–**	**–**	**–**	**–**	**–**	**–**
Corporates/Other	1	1	–	–	–	–	–	–
Croatia	**1**	**1**	**–**	**–**	**–**	**–**	**–**	**–**
Corporates/Other	1	1	–	–	–	–	–	–
Total	**97**	**123**	**5**	**10**	**54**	**451**	**–**	**–**

57. CREDIT RISK ANALYSIS OF FINANCIAL ASSETS

I. Credit quality of financial instruments which are neither impaired nor overdue

The table below gives information on the credit quality of financial instruments which were neither impaired nor overdue as of the reporting date. The table provides a breakdown of the financial instruments by category and rating class of the respective counterparty.

CREDIT QUALITY

(€ m)	1(AAA) to 1(AA+)		1(AA) to 1(A–)		2 to 5		6 to 9	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Held for Trading (HfT)								
Trading assets	1,165	778	801	870	1,202	2,818	328	418
Credit derivative under the second loss guarantee	1,014	199	–	–	–	–	–	–
Designated at Fair Value (DFV)								
Loans and advances to customers	1,180	1,234	–	–	–	–	–	–
Financial investments	98	127	416	603	98	822	–	–
Available for Sale (AfS)								
Cash reserve	106	118	–	–	–	–	–	–
Loans and advances to banks	–	43	–	–	79	41	–	–
Loans and advances to customers	–	–	–	–	–	–	–	–
Financial investments	9,181	9,194	2,730	2,211	496	779	–	33
Non-current assets held for sale and disposal groups	–	15	–	3	–	1	–	–
Loans and Receivables (LaR)								
Cash reserve	6,519	3,373	–	–	–	–	–	–
Loans and advances to banks	1,242	1,463	1,127	1,440	1,315	1,167	–	27
Loans and advances to customers	2,778	4,227	4,614	4,646	10,648	12,459	9,301	10,533
Financial investments	106	527	129	251	56	149	269	350
Non-current assets held for sale and disposal groups	–	–	–	7	–	9	26	1
Other assets	–	–	–	–	–	–	–	–
No IAS 39 category								
Positive fair value of hedging derivatives	61	202	74	148	129	151	–	7
Receivables under finance leases	7	11	12	12	27	33	24	27
Value adjustments from the portfolio fair value hedge	–59	160	71	118	125	120	–	5
Total	**23,516**	**21,671**	**9,974**	**10,309**	**14,175**	**18,549**	**9,948**	**11,401**

CREDIT QUALITY

(€ m)	10 to 12		13 to 15		16 to 18	
	2017	2016	**2017**	2016	**2017**	2016
Held for Trading (HfT)						
Trading assets	–	27	109	250	36	272
Credit derivative under the second loss guarantee	–	–	–	–	–	–
Designated at Fair Value (DFV)						
Loans and advances to customers	–	49	75	16	–	22
Financial investments	–	–	–	1	–	1
Available for Sale (AfS)						
Cash reserve	–	–	–	–	–	–
Loans and advances to banks	–	–	–	–	–	–
Loans and advances to customers	–	–	–	–	–	–
Financial investments	–	5	–	127	–	–
Loans and Receivables (LaR)						
Cash reserve	–	–	–	–	–	–
Loans and advances to banks	75	11	–	–	–	–
Loans and advances to customers	1,450	1,934	1,236	3,184	148	680
Financial investments		–	–	49	–	36
Non-current assets held for sale and disposal groups	–	7	–	6	–	254
Other assets	35	–	–	50	–	–
No IAS 39 category						
Positive fair value of hedging derivatives	–	–	–	–	–	–
Receivables under finance leases	4	5	2	8	–	2
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	–
Total	**1,564**	**2,038**	**1,422**	**3,691**	**184**	**1,267**

II. Carrying amounts of overdue but unimpaired financial assets

The table below shows the financial assets which were overdue but unimpaired as of the reporting date. The assets are broken down by category. Categories not shown have no overdue assets.

CARRYING AMOUNTS OF OVERDUE BUT UNIMPAIRED FINANCIAL ASSETS

(€ m)	Overdue < 3 months		Overdue 3 to 6 months		Overdue 6 to 12 months		Overdue > 12 months	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Loans and Receivables (LaR)								
Loans and advances to customers	231	859	51	643	214	185	314	395
of which hedged by the second loss guarantee	28	631	29	498	192	99	288	338
Total	**231**	**859**	**51**	**643**	**214**	**185**	**314**	**395**

Payments of € 6 million (previous year: € 4 million) on transactions with a carrying amount volume of € 110 million (previous year: € 96 million) were received up to ten days after the reporting date of 31 December 2017. Payments are regarded as being in arrears when they are one day overdue.

The overdue, unimpaired credit portfolio is secured with collateral in the form of real estate liens, ship mortgages, aircraft mortgages, assignments and transfers of ownership by way of security. The transfers by way of security mainly comprise physical assets.

III. Impaired financial assets

The table below shows all impaired financial assets as of the reporting date. The financial assets are broken down by category.

IMPAIRED FINANCIAL ASSETS

(€ m)	Gross carrying amount of impaired financial assets		Impairment		Carrying amount of financial assets after impairment	
	2017	2016	**2017**	2016	**2017**	2016
Loans and Receivables (LaR)						
Loans and advances to banks	–	–	–	–	–	–
Loans and advances to customers	6,813	9,685	4,354	6,103	2,459	3,582
Financial investments[1]	–	302	–	166	–	136
Non-current assets held for sale and disposal groups	–	856	–	233	–	623
Available for Sale (AfS)						
Loans and advances to customers	82	90	38	29	44	61
Financial investments[1]	208	236	140	144	68	92
Total	**7,103**	**11,169**	**4,532**	**6,675**	**2,571**	**4,494**

[1] Financial investments classified as LaR and AfS are shown net in the statement of financial position, i.e., at their carrying amounts less impairment.

The impaired credit portfolio is secured with collateral in the form of real estate liens, ship mortgages, aircraft mortgages, assignments and transfers of ownership by way of security. The transfers by way of security mainly comprise physical assets.

€ 5,415 million (previous year: € 9,634 million) of the total carrying amount of impaired financial assets of € 7,071 million (previous year: € 11,169 million) is hedged by the second loss guarantee, of which € 5,415 million is attributable to Loans and advances to customers (previous year: € 8,637 million), € 0 million to Financial investments in the LaR and AfS holding categories (previous year: € 163 million) as well as € 0 million to Non-current assets held for sale and disposal groups (previous year: € 834 million).

€ 9 million (previous year: € 0 million) of the abovementioned total carrying amount of impaired financial assets is hedged by the synthetic securitisation transaction "Horizon". The impaired assets are attributable entirely to Loans and advances to customers.

Further information regarding the guarantees received can be found in Note 3.

IV. Credit risk exposure

With the exception of Loans and advances to banks and customers, credit risk exposure in accordance with IFRS 7.36 (a) as at the reporting date corresponds to the carrying amount of financial assets as presented in Note 51 as well as off-balance sheet liabilities as presented in Note 60.

In the case of Loans and advances to banks and customers, the credit risk exposure corresponds to the carrying amount after loan loss provisions as presented in Note 26. The maximum default risk of the loans and advances designated at fair value (DFV) is not reduced by associated credit derivatives.

Collateral and other risk-reducing agreements are not reflected in these amounts.

V. Collateral received

A) Collateral values of financial assets reducing default risk

The following information quantifies the extent to which the collateral retained and other loan collateralisation reduce the maximum default risk for financial instruments. The amount of risk reduction from the value of each form of collateral is indicated for each class of financial instruments.

The value of collateral received is determined directly on the basis of the objective market value, provided that such a value can be determined. The reliability of the collateral value is ensured by the fact that it is recognised as risk-reducing only up to the level of the applicable collateral-specific recovery ratio.

The following table shows the respective carrying amount for each class of financial instrument as well as the collateral value that reduces default risk.

FINANCIAL ASSETS AND ASSOCIATED COLLATERAL

(€ m)		Value of collateral received		
2017	**Carrying amount**	**Real estate and registered liens**	**Sureties and guarantees**	**Other collateral**
HfT				
Trading assets	3,641	329	26	422
Credit derivative under the second loss guarantee	1,014	–	–	–
DFV				
Loans and advances to customers	1,255	–	–	–
Financial investments	612	–	–	–
AfS				
Cash reserve	106	–	–	–
Loans and advances to banks	79	–	–	–
Loans and advances to customers	45	–	–	–
Financial investments	12,475	–	–	–
LaR				
Cash reserve	6,519	–	–	–
Loans and advances to banks	3,759	9	22	68
Loans and advances to customers	37,798	13,778	584	1,428
Financial investments	560	–	–	–
Non-current assets held for sale and disposal groups	26	12	–	–
Other assets	35	–	–	–
No IAS 39 category				
Positive fair value of hedging derivatives	264	–	–	–
Value adjustments from the portfolio fair value hedge	255	–	–	–
Receivables under finance leases	76	–	–	–
Contingent liabilities	1,862	101	7	142
Irrevocable loan commitments	6,367	840	64	152
Total assets	**76,748**	**15,069**	**703**	**2,212**

FINANCIAL ASSETS AND ASSOCIATED COLLATERAL

(€ m)		Value of collateral received		
2016	Carrying amount	Real estate and registered liens	Sureties and guarantees	Other collateral
HfT				
Trading assets	5,433	398	23	516
Credit derivative under the second loss guarantee	199	–	–	–
DFV				
Loans and advances to customers	1,321	–	–	–
Financial investments	1,554	–	–	–
AfS				
Cash reserve	118	–	–	–
Loans and advances to banks	84	–	–	–
Loans and advances to customers	61	–	–	–
Financial investments	12,441	–	–	–
Non-current assets held for sale and disposal groups	19	–	–	–
LaR				
Cash reserve	3,373	–	–	–
Loans and advances to banks	4,108	10	27	34
Loans and advances to customers	49,430	16,301	742	1,659
Financial investments	1,498	–	–	–
Non-current assets held for sale and disposal groups	1,140	465	78	8
Other assets	50	1	–	1
No IAS 39 category				
Positive fair value of hedging derivatives	508	–	–	–
Value adjustments from the portfolio fair value hedge	403	–	–	–
Receivables under finance leases	98	–	–	–
Contingent liabilities	2,189	145	21	136
Irrevocable loan commitments	6,654	602	65	197
Total assets	**90,681**	**17,922**	**956**	**2,551**

Above and beyond the collateral values shown in the table above, a sub-portfolio is secured by means of the guarantee facility provided by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg to HSH Nordbank AG and certain subsidiaries via HSH Finanzfonds AöR at the beginning of the realignment of the Bank (see Note 3). The same applies with regard to the protection provided by a synthetic securitisation transaction via the SPV "Horizon 2016 S.A." as part of a guarantee granted in 2016. Ultimately, reference is made to Note 3 II.

B) Thereof collateral received for which there are no restrictions on disposal or realisation even if there is no default in payment

HSH Nordbank has received collateral from counterparties with a total fair value of € 405 million (previous year: € 415 million). The collateral received is split up as follows: € 405 million (previous year: € 353 million) relate to OTC derivatives and structured transactions.

The Group did not receive any collateral within the framework of genuine repo transactions where it acted as the lender (previous year: € 62 million). This includes cash collateral in the amount of € 405 million (previous year: € 320 million). Collateral received was not resold or pledged (previous year: € 34 million). There are no restrictions on disposal or realisation. HSH Nordbank was obliged to return all collateral resold or pledged to the guarantor without exception.

HSH Nordbank carries out securities repurchase and lending transactions as well as tri-party repo transactions under standard master agreements with selected counterparties. The same conditions and collateralisation methods apply as for collateral transferred and received.

C) Other collateral received

In the reporting period no assets were recognised from the realisation of collateral (previous year: € 0 million).

For further information regarding the guarantees received (incl. the cash collateral received in connection with the synthetic securitisation transaction), reference is made to the comments in Note 3 II.

For information on the collateral transferred please refer to Note 63.

58. RESTRUCTURED OR MODIFIED LOANS

The following table shows the gross carrying amounts of loans and loan commitments that have been restructured or whose contractual terms and conditions have been modified in order to place the debtor in a position to continue to service or resume servicing its capital debt despite financial difficulties.

FORBEARANCE EXPOSURE

(€ m)	Core Bank		Non-Core Bank		
2017	Rating class 1–15	Rating class 16–18	Rating class 1–15	Rating class 16–18	**Total**
Loans and Receivables (LaR)	1,180	894	521	5,434	8,029
Loans and advances to customers	1,180	894	521	5,434	8,029
Irrevocable and revocable loan commitments	76	48	13	32	169
Total	**1,256**	**942**	**534**	**5.466**	**8,198**

FORBEARANCE EXPOSURE

(€ m)	Core Bank		Non-Core Bank		
2016	Rating class 1–15	Rating class 16–18	Rating class 1–15	Rating class 16–18	**Total**
Loans and Receivables (LaR)	1,804	677	801	10,238	13,521
Loans and advances to customers	1,804	677	801	9,676	12,958
Non-current assets held for sale and disposal groups	–	–	–	563	563
Irrevocable and revocable loan commitments	75	23	33	422	552
Total	**1,878**	**700**	**834**	**10,660**	**14,073**

Loan loss provisions in the amount of € 3,934 million (previous year: € 5,098 million) were already created for the volume of receivables stated here to which forbearance measures have been applied. The cover for the forbearance exposure by the second loss guarantee is about 77 % (previous year: about 83 %).

59. INFORMATION ON UNCONSOLIDATED STRUCTURED ENTITIES

I. Interests in unconsolidated subsidiaries

HSH Nordbank maintains business relationships with unconsolidated structured entities, within the meaning of an interest pursuant to IFRS 12, if HSH Nordbank is exposed to variable returns based on equity, debt instruments, derivatives, guarantees, etc.

These unconsolidated structured entities relate to ABS conduits, securitisation and refinancing vehicles, investment funds and other structured entities.

HSH Nordbank has a business relationship within the meaning of an interest with a total of 38 unconsolidated structured entities (previous year: 136). The following table shows the accumulated total assets of the unconsolidated structured entities with which HSH Nordbank maintains a business relationship within the meaning of an interest:

INFORMATION ON THE SIZE OF UNCONSOLIDATED ENTITIES

(€ m)	Number		Total assets	
	2017	2016	**2017**	2016
ABS investments	5	105	211	32,210
Investment funds	14	13	2,411	2,071
Securitisation and refinancing vehicles	15	14	672	845
Other	4	4	281	172
Total	**38**	**136**	**3,575**	**35,298**

During the fourth quarter of 2017 a major proportion of ABS investments was sold as part of reducing the non-strategic portfolio.

The function of refinancing and securitisation vehicles is to issue securities. These companies are involved in the (revolving) purchase and securitisation of receivables, including refinancing with investors. They are mainly financed through issuing debentures. These include ABS conduits used by HSH Nordbank for the purpose of risk diversification. ABS conduits are financed through the issuing of debt securities. These investments in ABS conduits are also secured with collateral. These companies undertake the (revolving) purchase and securitisation of loan receivables including refinancing with investors.

The main corporate purposes of investment funds are to finance assets, participate in non-listed companies and hold shares in real estate funds. The main activities of such investment funds are to carry out research for analysing markets, make decisions on investment and disinvestment in order to adjust portfolios and to attract investors. Investment funds raise their funds by the issuing of equity and debt instruments. The investment funds are funds launched by third parties, to which HSH Nordbank mainly grants loans.

II. Risks from interests in unconsolidated structured entities

The following information concerning risk refers not just to the current reporting period but also to risks which result from business relationships with unconsolidated structured entities in earlier reporting periods.

The risks from unconsolidated structured entities are presented in the form of the maximum potential loss which may arise from these business relationships based on an interest within the meaning of IFRS 12. HSH Nordbank discloses the carrying amounts of these transactions as a maximum potential loss. In the case of irrevocable loan commitments and contingent liabilities, the carrying amount matches the par value.

There are no credit derivatives relating to unconsolidated structured entities as of the balance sheet date.

The following table shows the IFRS carrying amounts of exposures involving unconsolidated structured entities as of 31 December 2017 broken down into the items of financial position.

TYPE OF BUSINESS RELATION

(€ m) **2017**	Investment funds	ABS	Refinancing and securitisation vehicles	Other structured entities	**Total**
Loans and advances to customers	143	–	171	80	394
Positive fair value of hedging derivatives	–	–	–	–	–
Trading assets	1	–	42	91	134
Financial investments	1	–	160	–	161
Total assets	**145**	**-**	**373**	**171**	**689**
Liabilities to customers	3	–	271	7	281
Total equity and liabilities	**3**	**-**	**271**	**7**	**281**

(€ m) 2016	Investment funds	ABS	Refinancing and securitisation vehicles	Other structured entities	**Total**
Loans and advances to customers	148	–	185	7	340
Positive fair value of hedging derivatives	1	–	–	–	1
Trading assets	1	–	43	88	132
Financial investments	–	671	227	–	898
Total assets	**150**	**671**	**455**	**95**	**1,371**
Liabilities to customers	36	–	250	11	297
Total equity and liabilities	**36**	**-**	**250**	**11**	**297**

The above table contains the loans, debentures, deposits and derivatives in respect of unconsolidated structured entities.

In addition, there are maximum potential losses from irrevocable loan commitments amounting to € 3 million (previous year: € 0 million), € 1 million of which result from investment funds (previous year: € 0 million) and € 0 million from securitisation and refinancing vehicles (previous year: € 0 million).

There are no business relationship risks based on an interest in unconsolidated structured entities as defined in IFRS 12, B26 that exceed the maximum potential loss, such as contractual terms under which HSH Nordbank would have to grant financial support, liquidity arrangements, guarantees extended or support provided by HSH Nordbank in the event of difficulties in refinancing unconsolidated structured entities.

Furthermore, HSH Nordbank has not entered into any loss-transfer agreements with unconsolidated structured entities. Mainly net interest income for granting loans and commission income were generated from business relationships with unconsolidated structured entities based on an interest within the meaning of IFRS 12.

III. Sponsoring

HSH Nordbank has sponsor relationships within the meaning of IFRS 12 if HSH Nordbank is exposed to variable return flows, although there is no business relationship in the form of an interest within the meaning of IFRS 12. HSH Nordbank is a sponsor if it was involved in establishing an unconsolidated structured entity, if it stands to gain the main profit from the entity or is the main collateral taker, if HSH Nordbank provides implicit guarantees or if the name of HSH Nordbank is part of the name of the structured entity or of the products issued by such entity.

Details of sponsored entities are only shown, if they are not already included in the disclosures under II, (Risks from interests in unconsolidated structured entities). This requirement is satisfied in the case of two structured entities. These companies were sponsored by HSH Nordbank, but there is no interest within the meaning of IFRS 12.

During the reporting period HSH Nordbank sponsored a public fund, HSH Nordbank was involved in the establishment of this fund and provided the advisory investment committee during the reporting year. HSH Nordbank received an immaterial consultancy fee for this service.

HSH Nordbank has also been sponsoring a securitisation vehicle since December 2016. The transaction is based on the transfer of default risks. HSH Nordbank was involved in the establishment process and transferred default risks relating to a mezzanine tranche to the structured entity in the amount of € 235 million by way of a financial guarantee. Further information on this transaction can be found in Note 3.

IV. Provision of support

During the current reporting period HSH Nordbank has not supported any unconsolidated structured entity financially or in any other way without a contractual commitment to do so. HSH Nordbank has also no intention of granting financial support to any unconsolidated structured entity or helping to procure financial support from third parties.

60. CONTINGENT LIABILITIES AND IRREVOCABLE LOAN COMMITMENTS

CONTINGENT LIABILITIES

(€ m)	2017	2016
Contingent liabilities from guarantees and warranty agreements		
Loan guarantees	189	169
Letters of credit	314	358
Other guarantees	1,359	1,662
Total	**1,862**	**2,189**

IRREVOCABLE LOAN COMMITMENTS

(€ m)	2017	2016
Irrevocable loan commitments for		
Open account loans to banks	–	1
Open account loans to customers	6,198	6,496
Guarantees	94	63
Other	75	94
Total	**6,367**	**6,654**

Information on collateral transferred is presented in Note 63.

An out-of-court settlement including reciprocal claims was developed in order to bring to an end legal disputes with former Management Board members. The settlement is not yet legally binding. HSH Nordbank AG expects the agreement to result, in net terms, in payment claims against the opposing parties. Provisions have been set up for the claims of the opposing parties.

The claims of HSH Nordbank constitute contingent assets. To avoid jeopardising the as yet unconcluded settlement process, the Bank has opted not to make any further disclosures.

In addition to the values shown in the table, there are other contingent liabilities arising from litigation in an amount of € 32 million (previous year: € 32 million). To determine for which claim the possibility of a loss is likely, or is less likely but still cannot be ruled out, and in order to estimate the amount of the potential payment obligations, HSH Nordbank takes a variety of factors into account. These include, among other things, the type of claim and the underlying facts of the case, the status of the individual proceedings, (provisional) decisions made by courts and arbitration bodies, the experience of HSH Nordbank and third parties in comparable cases (insofar as they are known to the Bank), prior settlement negotiations, as well as the expert opinions and assessments of the Bank's internal and external legal advisors and other professionals.

Please also refer to Note 42 and explanations set out in the Management of legal risks section in the Risk Report of the Management Report with respect to existing uncertainties regarding risks arising from legal disputes.

There are contingent liabilities with regard to tax risks in connection with the tax audits that are ongoing at present. In particular, there is uncertainty surrounding how the tax authorities will interpret current trends in the court decisions made by the fiscal courts on various tax-related issues. The Bank, however, deems its legal positions to be correct, meaning that there is no need to set up corresponding provisions in this regard.

Please refer to the explanations set out in the Forecast of loan loss provisions section of the Forecast, Opportunities and Risks Report in the Management Report with regard to uncertainties relating to the determination of loan loss provisions.

The fair value or irrevocable loan commitments with a nominal volume of € 6,367 million (previous year: € 6,654 million) comes to € 14 million as at the balance sheet date (previous year: € 12 million).

With regard to future premium expense for the synthetic securitisation transaction, we refer to our statements in Note 3 II.

OTHER DISCLOSURES

61. REPORT ON BUSINESS IN DERIVATIVES

Derivative financial instruments are used to a considerable degree in order to hedge risk efficiently, to take advantage of market opportunities and to cover special customer financing needs. The derivatives business of HSH Nordbank is predominantly transacted with banks based in OECD countries.

Positive and negative fair values are presented on the basis of gross values before offsetting in accordance with IAS 32.42.

I. Volumes

DERIVATIVE TRANSACTIONS WITH INTEREST RATE RISKS

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Interest rate swaps	123,800	147,582	3,490	4,455	3,663	5,070
FRAs	–	–	–	–	–	–
Swaptions						
Long positions	2,053	2,847	72	149	15	24
Short positions	2,660	3,564	7	2	114	217
Caps, floors	10,948	7,738	28	40	43	27
Exchange-traded contracts	219	2,892	–	–	–	–
Other forward interest rate transactions	591	324	15	16	35	33
Total	**140,271**	**164,947**	**3,612**	**4,662**	**3,870**	**5,371**

DERIVATIVE TRANSACTIONS WITH INTEREST RATE AND FOREIGN EXCHANGE RISKS

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Cross-currency interest rate swaps	10,529	15,417	156	244	110	396
Total	**10,529**	**15,417**	**156**	**244**	**110**	**396**

DERIVATIVE TRANSACTIONS WITH FOREIGN EXCHANGE RISKS

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Forward exchange transactions	7,232	11,468	58	80	53	132
Currency options						
Long positions	235	579	14	57	–	–
Short positions	213	785	–	–	6	59
Total	**7,680**	**12,832**	**72**	**137**	**59**	**191**

DERIVATIVE TRANSACTIONS WITH EQUITY AND OTHER PRICE RISKS

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Equity options						
Long positions	113	81	43	52	–	–
Short positions	96	60	–	–	43	51
Exchange-traded contracts	78	6	–	–	–	–
Equity/index-based swaps	80	84	14	11	–	–
Commodity-based transactions	–	–	–	–	–	–
Total	**367**	**231**	**57**	**63**	**43**	**51**

CREDIT DERIVATIVES

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Guarantor position	58	96	1	1	–	–
Collateral taker position	56	170	11	26	–	–
Total	**114**	**266**	**12**	**27**	**–**	**–**

CREDIT DERIVATIVE SECOND LOSS GUARANTEE

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Collateral taker position	1,019	1,107	1,014	199	–	–
Total	**1,019**	**1,107**	**1,014**	**199**	**–**	**–**

DERIVATIVE TRANSACTIONS WITH STRUCTURED PRODUCTS

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Structured products	3,912	5,355	289	376	395	587
Total	**3,912**	**5,355**	**289**	**376**	**395**	**587**

DERIVATIVE TRANSACTIONS IN FAIR VALUE HEDGE ACCOUNTING

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
Fair value hedges						
Interest rate swaps	22,942	25,208	431	683	236	423
Total	**22,942**	**25,208**	**431**	**683**	**236**	**423**

II. Counterparty classification

COUNTERPARTY CLASSIFICATION

(€ m)	Nominal values		Positive market values		Negative market values	
	2017	2016	**2017**	2016	**2017**	2016
OECD banks	81,234	119,271	1,918	3,012	3,163	4,981
Non-OECD banks	96	88	2	3	1	–
Non-banks[1]	99,587	99,084	2,473	2,895	1,167	1,573
Public authorities	5,977	6,920	1,250	481	382	465
Total	**186,894**	**225,363**	**5,643**	**6,391**	**4,713**	**7,019**

[1] Including exchange-traded contracts

III. Maturities

MATURITIES

(€ m)	Positive market value of derivatives		Positive market value of derivatives from fair value hedging		Negative market value of derivatives		Negative market value of derivatives from fair value hedging	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Residual maturity								
Up to 3 months	174	129	–	–	154	236	–	–
3 months to 1 year	153	378	19	35	152	375	8	6
1 year to 5 years	922	1,237	182	375	1,057	1,700	147	251
Over 5 years	3,964	3,964	230	273	3,114	4,285	81	166
Total	**5,213**	**5,708**	**431**	**683**	**4,477**	**6,596**	**236**	**423**

62. LEASE RECEIVABLES AND LIABILITIES

Operating leases where HSH Nordbank acts as a lessee serve the purpose of leasing technical facilities and equipment required to operate IT networks, among other purposes. In addition, HSH Nordbank is a lessee of real estate and motor vehicles.

In operating leases HSH Nordbank acts as lessor for aircraft and real estate.

In the case of finance leases on the US market HSH Nordbank acts as lessor under sale-and-lease-back leasing arrangements to finance photovoltaic installations.

I. Lessee under operating leases

MINIMUM LEASE PAYMENTS UNDER OPERATING LEASES

(€ m)	**2017**	2016
Minimum lease payments due		
Up to 1 year	30	31
1 year to 5 years	80	62
More than 5 years	–	5
Total	**110**	**98**

Out of the minimum lease payments to be paid, multi-element arrangements that include both leasing and service payments account for: € 28 million (previous year: € 30 million) for up to one year and € 78 million (previous year: € 60 million) for one year to five years.

EXPENSES FOR LEASE PAYMENTS

(€ m)	**2017**	2016
Expenses for		
Minimum lease payments	30	32
Total	**30**	**32**

The expenses for minimum lease payments in the reporting year include € 27 million (previous year: € 31 million) that is attributable to multi-element arrangements that include both leasing and service payments.

Expenses on assets used under operating leases are disclosed in Administrative expenses (cf. Note 15).

II. Lessor under operating leases

MINIMUM LEASE PAYMENTS TO BE EXPECTED UNDER OPERATING LEASES

(€ m)	**2017**	2016
Minimum lease payments to be received		
Up to 1 year	8	21
1 year to 5 years	27	39
More than 5 years	11	16
Total	**46**	**76**

Income from conditional leasing payments was neither recorded in the reporting period nor in the previous year.

III. Lessor under finance leases

FINANCE LEASES

(€ m)	**2017**	2016
Outstanding lease payments	51	71
+ Guaranteed residual values	14	15
= Minimum lease payments	65	86
+ Non-guaranteed residual values	17	19
= Gross investment	82	105
– Unearned finance income	6	7
= Net investment	76	98
– Net present value of non-guaranteed residual values	12	13
= Net present value of minimum lease payments	**64**	**85**

The gross investments amount and the net present value of the minimum lease payments break down by maturity as follows.

BREAKDOWN OF RESIDUAL MATURITIES

(€ m)	Gross investments in the lease		Net present value of the minimum lease payments	
	2017	2016	**2017**	2016
Minimum lease payments to be received				
Up to 1 year	8	12	6	11
1 year to 5 years	30	37	27	33
More than 5 years	44	56	31	41
Total	**82**	**105**	**64**	**85**

Income from conditional lease payments was neither recorded during the year nor in the previous year.

63. DISCLOSURES ON COLLATERAL TRANSFERRED AND FINANCIAL ASSETS TRANSFERRED WITH RETENTION OF RIGHTS AND/OR OBLIGATIONS

I. Collateral transferred

As at 31 December 2017 HSH Nordbank had transferred assets as collateral which do not meet the requirements of derecognition under IAS 39. The assets transferred as collateral continue to be recognised in the Group statement of financial position as the interest rate risk, credit risk and other material risks as well as the prospects of appreciation and interest income largely reside with HSH Nordbank.

The following table mainly shows the collateral used to collateralise OTC derivative transactions and funds raised at central banks and other credit institutions. Notes on repurchase agreements are separately disclosed below. A small amount of collateral has been transferred in the course of securities lending business.

CARRYING AMOUNTS OF TRANSFERRED COLLATERAL

(€ m)	**2017**	2016
Loans and advances	7,690	8,555
Loans and advances to banks	2,254	3,218
Loans and advances to customers	5,436	5,337
Trading assets/Financial investments	341	10
Non-current assets held for sale and disposal groups	–	100
Total	**8,031**	**8,665**

Money market borrowing generally involves pledging and transferring securities lodged with the European Central Bank. Promissory notes and other receivables from lending are not pledged to the European Central Bank or other banks, but are assigned without this being disclosed. It is not possible to resell or pledge in the interim.

In addition, HSH Nordbank concludes repurchase agreements under repo master agreements both on a national and international scale. The associated liabilities are recognised under Liabilities to banks or Liabilities to customers. At the end of the reporting period, the carrying amount of the securities transferred as collateral in the framework of repo transactions was € 1,284 million (previous year: € 949 million). The fair value amounts to € 1,284 million (previous year: € 899 million). The corresponding liabilities are recognised in the amount of € 1,692 million (previous year: € 833 million) with the fair value corresponding to the carrying amount. Taking account of the netting of receivables and liabilities with our business partners, a net position of € –408 million arose from the fair values of the assets transferred and the associated liabilities (previous year: € 66 million). Collateral transferred under repo transactions can be resold or repledged.

Repo and securities lending transactions are monitored by measuring transactions on a daily basis. If there is a shortfall in collateral the counterparty may require HSH Nordbank to provide additional securities to increase collateral. Where HSH Nordbank has provided collateral and the market situation changes such that the cover provided is excessive, it is entitled to require the counterparty to release collateral. The collateral provided is subject to a full transfer of rights, i.e. the party receiving collateral may act like an owner and in particular may transfer or pledge such collateral. In the case of securities collateral, securities of the same type and quality ('the same sort') must be delivered or returned unencumbered. Where collateral has been provided in the form of securities, it may not be returned in cash.

With regard to further collateral provided in the form of securities (under the "Financial investments" balance sheet item), reference is made to Note 3 II.

The above conditions and collateral modalities apply to tri-party repo transactions between HSH Nordbank and its counterparties accordingly. The transactions are executed via a tri-party agent.

II. Financial assets transferred with retention of rights and/or obligations

HSH Nordbank has transferred assets to third parties outside the Group that meet the conditions for full derecognition. The rights and obligations retained under these transfers were of an overall immaterial nature. The risks become transparent by recognition of provisions and/or recording of contingent liabilities. There is a hypothetical repurchase option relating to the sale of an equity holding, which the Bank, however, can only exercise based on the occurrence of certain biometric events. The option has a time value of € 0; it entails no risk.

64. TRUST TRANSACTIONS

The table below shows the volume of trust transactions not recognised in the statement of financial position.

TRUST TRANSACTIONS

(€ m)	**2017**	2016
Loans and advances to customers	4	5
Trust assets	**4**	**5**
Liabilities to customers	4	5
Trust liabilities	**4**	**5**

65. RELATED PARTIES

HSH Nordbank does business with related parties and companies.

These include HSH Beteiligungs Management GmbH, Hamburg; as the direct parent company and, at the same time, the top-level parent company of HSH Nordbank AG, which prepares Group financial statements, HSH Finanzfonds AöR as the top-level parent company of the Group, hsh portfoliomanagement AöR, as well as the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg, which each hold a stake of 50% in the two aforementioned companies. Furthermore, business relations exist with subsidiaries which are controlled but not included in the Group financial statements for reasons of materiality, associates, joint ventures, individuals in key positions and their relatives and companies controlled by these individuals. Individuals in key positions comprise exclusively the members of the Management and Supervisory Boards of HSH Nordbank AG.

In the course of the normal business operations transactions are entered into at arm's length with companies and parties that are related parties. These transactions include loans, call and fixed-term deposits, derivatives and securities transactions.

I. The parent company and companies with joint management or significant influence on the company

For transactions with HSH Beteiligungs Management GmbH and HSH Finanzfonds AöR as well as with the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg, which each participate in HSH Finanzfonds AöR at 50%, the Bank makes use of IAS 24.25. Accordingly, HSH Nordbank is exempt from the disclosure requirement regarding public authorities, unless transactions are involved that have a significant impact on the Group financial statements.

The guarantee amount with regard to the guarantee facility provided by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg to HSH Nordbank AG and certain subsidiaries via HSH Finanzfonds AöR is identified as a significant transaction within the meaning of IAS 24. Please refer to Notes 3 and 19 for more details.

In addition, a loan portfolio was sold to the resolution institution (hsh portfoliomanagement AöR) formed by the federal states of Hamburg and Schleswig-Holstein as part of the implementation of the EU Commission's decision of 2 May 2016.

With effect from 30 June 2016, HSH Nordbank AG transferred a portfolio of non-performing shipping loans with a volume of €5 billion (reporting date: 31 December 2015) to hsh portfoliomanagement AöR, which belongs to the federal states.

Within this context, the Bank received the market price set by the EU Commission of € 2.4 billion from hsh portfoliomanagement AöR. The losses of € 2.6 billion incurred were settled as part of the loss settlement under the guarantee. The transaction involved first of all transferring a portfolio of transactions from HSH Nordbank AG to hsh portfoliomanagement AöR by way of a cash sub-participation relating to the loans with a contractual trust agreement, including a cash flow pass through arrangement (known as a "synthetic transfer"). On 19 May 2017, following this synthetic transfer, the in rem transfer is performed by way of partial universal succession as part of a spin-off pursuant to Section 123 (3) of the German Transformation of Companies Act (UmwG). In addition, parts of the credit portfolio were transferred to hsh portfoliomanagement AöR by way of singular succession.

In 2016, for certain current accounts and derivatives in connection with the above-mentioned loan portfolio a "guarantee and standstill agreement" was concluded between HSH Nordbank AG and hsh portfoliomanagement AöR. The "guarantee and standstill agreement" gave hsh portfoliomanagement AöR the option of making a decision on the assumption of current accounts and derivatives in connection with the abovementioned loan portfolio at a later date (purchase option). In return, any increases in risk at HSH Nordbank AG in the meantime were to be largely assumed and secured by hsh portfoliomanagement AöR. hsh portfoliomanagement AöR made use of its right under the guarantee and standstill agreement with regard to the current accounts with effect from 31 December 2016 and declared that it would not be exercising its purchase option.

During the 2017 reporting period, HSH Nordbank AG and hsh portfoliomanagement AöR entered into new sales negotiations for the purpose of transferring part of the originally envisaged current accounts; these negotiations were concluded in March 2018, following which the transfer is due to take place in 2018. The exercise of the call option by hsh portfoliomanagement AöR for part of the derivatives resulted in the transfer of a small number of derivatives during 2017.

Other contractual service relationships are in place between hsh portfoliomanagement AöR und der HSH Nordbank AG, e.g. the servicing of the loans transferred and the provision of IT systems paid for at normal market terms.

II. Subsidiaries

The transactions with unconsolidated subsidiaries are shown below:

SUBSIDIARIES - ASSETS

(€ m)	2017	2016
Loans and advances to customers	10	24
Loan loss provisions	–	– 11
Financial assets	–	1
Total	**10**	**14**

SUBSIDIARIES - LIABILITIES

(€ m)	2017	2016
Liabilities to customers	–	2
Other liabilities	1	1
Total	**1**	**3**

SUBSIDIARIES - INCOME STATEMENT

(€ m)	2017	2016
Net interest income	1	1
Loan loss provisions in the lending business	–	10
Other operating income	4	4
Total	**5**	**15**

III. Associates

The following table shows the transactions with associates:

No asset transactions took place with associated companies during the year under review or the previous year.

ASSOCIATES - LIABILITIES

(€ m)	2017	2016
Liabilities to customers	–	1
Total	**-**	**1**

ASSOCIATES - INCOME STATEMENT

(€ m)	2017	2016
Net income from financial investments	–	– 2
Total	**-**	**- 2**

IV. Joint ventures

The following tables show the transactions with joint ventures:

JOINT VENTURES - ASSETS

(€ m)	2017	2016
Loans and advances to customers	16	178
Trading assets	–	13
Total	**16**	**191**

JOINT VENTURES - LIABILITIES

(€ m)	2017	2016
Liabilities to customers	15	25
Total	**15**	**25**

JOINT VENTURES - INCOME STATEMENT

(€ m)	2017	2016
Net interest income	–	1
Net trading income	1	– 4
Total	**1**	**- 3**

Irrevocable loan commitments to joint ventures amount to € 0 million (previous year: € 326 million).

V. Other related parties and companies

The following transactions had been entered into with individuals in key positions at HSH Nordbank AG and their close relatives or companies controlled by these individuals as at the balance sheet date:

ASSETS

(€ m)	2017	2016
Loans and advances to customers	–	–
Total	**-**	**-**

LIABILITIES

(€ m)	2017	2016
Liabilities to customers	1	1
Total	**1**	**1**

VI. Remuneration of persons in key management positions

The remuneration paid to the Management Board of HSH Nordbank AG is still limited to € 500,000 per year under the guarantee agreement (total fixed remuneration) as long as HSH Nordbank AG is not capable of making dividend distributions. Remuneration payable for secondary employment undertaken by the Management Board at the request of the Supervisory Board is set off against the remuneration entitlement set out in the employment contract. Furthermore, each board member receives a pension contribution in the amount of 20% of the annual fixed income, as well as reasonable benefits in kind.

Any variable remuneration extending beyond this is currently excluded under the terms of the guarantee agreement. The Management Board waived a premium for successful privatisation that was possible under the EU decision of 2 May 2016.

There are no other long-term incentives, such as share option schemes.

It is planned to revise the Management Board remuneration system after removal of the current restrictions, adapt it to match the legal and regulatory requirements and include a variable remuneration component.

The following table shows the remuneration of persons in key management positions. Remuneration of the Supervisory Board consists of additions to provisions for the activities of the Supervisory Board carried out during the financial year excluding value-added tax.

REMUNERATION OF PERSONS IN KEY MANAGEMENT POSITIONS

(€ k)	Management Board		Supervisory Board		**Total**	
	2017	2016	**2017**	2016	**2017**	2016
Short-term benefits	2,148	2,424	468	477	2,616	2,901
Termination benefits	–	1,004	–	–	–	1,004
Post-employment benefits	400	600	–	–	400	600
Total remuneration	**2,548**	**4,028**	**468**	**477**	**3,016**	**4,505**

VII. Additional disclosures under Section 315e HGB

HSH Nordbank is obliged to provide additional disclosures in its Group financial statements under Section 315e HGB. Several differences compared to the IFRS disclosures should be borne in mind in this regard: termination benefits payable are not included in the total remuneration of the active members of the Management Board. This remuneration is disclosed instead under total remuneration payable to former members of the Management Board.

REMUNERATION OF EXECUTIVE BODIES

(€ k)	**2017**	2016
Total remuneration of all active members of executive bodies		
Management Board	2,548	3,024
Supervisory Board	468	477
Total	**3,016**	**3,501**
Total remuneration of former members of executive bodies and their surviving dependants		
Management Board	2,787	3,708

As at 31 December 2017, a total amount of €k 56,115 (previous year: €k 57,833) was shown in provisions for pension obligations relating to former members of the Management Board and their surviving dependants.

As was the case in the previous year, there were no advances, loans and other liabilities to members of the Management Board as at 31 December 2017. For members of the Supervisory Board they amounted to €k 54 (previous year: €k 150). In the 2017 reporting year no new loans were granted to members of the Supervisory Board.

The loans granted to members of the Supervisory Board relate to real estate financings. Loans to members of the Supervisory Board were granted with maturities from variable to final maturity in 2019. Loans to members of the Supervisory Board were at arm`s length conditions with an interest rate of 3%.

Collateral for loans is in the form of land charges for real estate financing. Repayments of loans by members of the Supervisory Board totalled €k 96 in total in 2017 (previous year: €k 319).

VIII. Disclosure of Supervisory Board remuneration

The members of the Supervisory Board receive remuneration for their service during a financial year in an amount determined by the Annual General Meeting of the following year. The remuneration for the Supervisory Board for the 2016 financial year was therefore paid in the 2017 reporting period. Appropriate provisions have been recognised in the 2017 Annual Accounts for the 2017 reporting year.

The remuneration system is based on the requirements of the German Corporate Governance Code and is organised as follows after the resolution of the Annual General Meeting of HSH Nordbank AG on 23 May 2014 and applies to the term of office of the Supervisory Board that has started on 23 May 2014:

REMUNERATION SYSTEM

(€) Executive body	Function	Fixed component	Attendance fee
Supervisory Board	Chair	25,000	250
	Deputy Chair	18,000	250
	Member	11,000	250
Risk Committee	Chair	15,000	250
	Member	7,000	250
Executive Committee	Chair	15,000	250
	Member	7,000	250
Audit Committee	Chair	15,000	250
	Member	7,000	250
Remuneration Monitoring Committee	Chair	12,000	250
	Member	5,000	250

The Mediation Committee to be formed under the German Codetermination Act of 1976 (Mitbestimmungsgesetz) does not receive any separate remuneration. Members of the Supervisory Board are also reimbursed for any value-added tax payable and for their expenses.

€k 564 of the amount provided for in the 2016 financial year (€k 567, thereof VAT: €k 91) were paid out to the members of the Supervisory Board in the reporting period. This includes €k 87 of value-added tax.

€k 557 have been provided for activities of the Supervisory Board in the year under review (thereof value-added tax: €k 89), which will be disbursed after the Annual General Meeting provided a corresponding resolution is passed by the Annual General Meeting 2018. Remuneration (excl. VAT) is expected to be distributed among the members of the Supervisory Board as follows:

(in €)	Fixed remuneration		Attendance fee		Total	
Members of the Supervisory Board	**2017**	2016	**2017**	2016	**2017**	2016
Dr Thomas Mirow, Chair	59,000	59,000	6,000	7,250	65,000	66,250
Olaf Behm, Deputy Chair	44,000	44,000	6,500	8,000	50,500	52,000
Stefanie Arp[1)]	15,682	18,000	3,000	2,750	18,682	20,750
Sabine-Almut Auerbach[2)]	–	2,712	–	500	–	3,212
Peter Axmann	18,000	18,000	3,250	3,000	21,250	21,000
Simone Graf	30,000	30,000	5,250	7,250	35,250	37,250
Silke Grimm	16,000	16,000	2,250	2,000	18,250	18,000
Cornelia Hintz[3)]	11,000	6,841	2,500	1,500	13,500	8,341
Stefan Jütte	26,000	26,000	3,500	3,250	29,500	29,250
Dr Rainer Klemmt-Nissen	30,000	30,000	5,750	7,250	35,750	37,250
Rieka Meetz-Schawaller	18,000	18,000	3,500	3,750	21,500	21,750
Bert Michels[4)]	2,049	–	250	–	2,299	–
Dr David Morgan[5)]	18,000	25,000	1,750	5,250	19,750	30,250
Dr Philipp Nimmermann	37,000	30,000	5,500	6,500	42,500	36,500
Stefan Schlatermund	18,000	18,000	3,750	3,500	21,750	21,500
Klaus-Dieter Schwettscher	11,000	11,000	2,500	2,250	13,500	13,250
Elke Weber-Braun	26,000	26,000	3,500	3,500	29,500	29,500
Jörg Wohlers	25,000	25,000	4,500	5,750	29,500	30,750
Total	**404,731**	**403,553**	**63,250**	**73,250**	**467,981**	**476,803**

1) until 14 November 2017
2) until 31 March 2016
3) from 18 May 2016
4) from 14 November 2017
5) Amounts before deduction of Supervisory Council tax and solidarity surcharge

The members of the Supervisory Board have again not provided any advisory or brokerage services or any other personal services to the Bank in the year 2017. Accordingly no additional remunerations were granted.

66. OTHER FINANCIAL OBLIGATIONS

The transactions listed below include payment obligations under pending contracts or continuing obligations that cannot be recognised in the balance sheet as well as other financial obligations that could have a material effect on the future financial position of HSH Nordbank.

There are shareholder liabilities of less than € 1 million for outstanding payments on subscribed nominal capital that have not yet been called in, as in the previous year.

A new calculation methodology for determining target volumes in the guarantee scheme was approved as part of the implementation of the German Law on Deposit Insurance (EinSiG) that came into effect on 3 July 2015. The target amount to be calculated annually on the basis of the data as at 31 December of the previous year is to be raised by the member institutions by 3 July 2024 (build-up phase). The annual premium required for this is determined by 31 May of the current year by the German Savings Banks Association (DSGV) as the association responsible for the guarantee scheme. The premium is collected before 30 September of each year. HSH Nordbank AG contributed 30 % of its premium obligation (€ 6 million, previous year: € 4 million) as an irrevocable payment obligation. Special or additional contributions over and above those already paid may be levied, for instance, as part of a compensation case where support is provided. The obligation to pay contributions until 2024 and any special or additional contributions represent a risk with regard to HSH Nordbank AG's financial position.

With the transposition of the Bank Recovery and Resolution Directive (BRRD) into German law a new legal basis for determining the bank levy came into force as at 1 January 2015. The target amount of the EU-wide Single Resolution Fund (SRF) is to be achieved by 1 January 2024 through contributions paid by European banks. The current levy is determined by the supervisory authorities as at 31 May of each year and is payable by 30 June. Subsequent assessments are not provided for.

Obligations amounting to € 105 million (previous year: € 89 million) result from leasing agreements for IT services.

Long-term rental agreements for office space result in annual obligations of approximately € 1 million (previous year: € 5 million).

Under a sale of an equity holding the Bank has undertaken to purchase fund units at the market price up to a nominal amount of € 8 million (previous year: € 8 million).

In a decision dated 24 June 2016, BVV Versicherungsverein des Bankgewerbes a.G. and BVV Versorgungskasse des Bankgewerbes e.V. reached a decision to reduce the pension payments to employees. In the decision of 1 November 2016, the Management Board of HSH Nordbank AG reached a resolution to make additional contributions for old-age pensions to BVV Versorgungskasse des Bankgewerbes e.V. in order to maintain the original benefit amount based on the individual pension commitments for these employees and to prevent any pension gaps. Under this voluntary commitment, as in the previous year additional annual contributions of less than € 1 million are expected. In this situation the estimated payments to BVV Versorgungskasse des Bankgewerbes e.V. come to € 2 million (previous year: € 2 million).

As part of its former guarantor function the Bank also has a general liability towards Deka Bank Deutsche Girozentrale together with other former shareholders. It applies to liabilities entered into until 18 July 2001 regardless of their term.

For information on premium obligations resulting from the provision of guarantee facilities (second loss guarantee and synthetic securitisation transaction), we refer to our comments in Note 3.

There is no material other financial obligations apart from those listed above.

67. LIST OF SHAREHOLDERS

The following information is based on German commercial law.

CONSOLIDATED SUBSIDIARIES WITH A SHARE OF VOTING RIGHTS OF THE BANK OF MORE THAN 50 %

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
1	Avia Management S.à.r.l., Luxembourg, Luxembourg	100.00	100.00	EUR	– 16,591.15	10,241.88
2	BINNENALSTER-Beteiligungsgesellschaft mbH, Hamburg	100.00	100.00	EUR	261,810.02	–7,931.13
3	Bu Wi Beteiligungsholding GmbH, Hamburg	100.00	100.00	EUR	18,980.04	1,092.08
4	CAPCELLENCE Dritte Fondsbeteiligung GmbH, Hamburg[1)]	100.00	100.00	EUR	6,447,604.90	1,078,745.96
5	CAPCELLENCE Erste Fondsbeteiligung GmbH, Hamburg[1)]	100.00	100.00	EUR	875,245.13	173,515.05
6	CAPCELLENCE Holding GmbH & Co. KG, Hamburg[1)]	100.00	100.00	EUR	111,969,111.75	5,328,794.48
7	Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG, Hamburg[1)]	83.33	99.91	EUR	119,931.09	1,750.16
8	Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG, Hamburg[1)]	90.91	99.99	EUR	906,332.53	918,304.58
9	CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG, Hamburg[1)]	83.33	99.99	EUR	4,864,568.60	117,781.76
10	CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG, Hamburg[1)]	90.91	99.47	EUR	1,050,920.78	108,152.65
11	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG, Hamburg[1)]	83.33	99.99	EUR	15,276,780.00	–347,031.65
12	CAPCELLENCE Zweite Fondsbeteiligung GmbH, Hamburg[1)]	100.00	100.00	EUR	4,969,406.32	1,715,603.48
13	Chasms Navigation Limited, Douglas, Isle of Man[16)]	100.00	100.00	USD	– 12,691,856.00	–35,995,987.00
14	Cregneash Navigation Limited, Douglas, Isle of Man[16)]	100.00	100.00	USD	– 12,640,977.00	–36,842,992.00
15	Curragh Navigation Limited, Douglas, Isle of Man[16)]	100.00	100.00	USD	–20,342,908.00	–47,634,414.00
16	FSL Asset Management Pte. Ltd., Singapore, Singapore[1)]	100.00	100.00	USD	792,573.00	982,222.00
17	FSL Holdings Pte. Ltd., Singapore, Singapore[1)]	100.00	100.00	USD	– 13,119,359.00	– 10,454,757.00
18	FSL Trust Management Pte. Ltd., Singapore, Singapore[1)]	100.00	100.00	USD	994,737.00	290,623.00
19	GODAN GmbH, Hamburg	100.00	100.00	EUR	– 1,193,578.03	–68,738.53
20	HSH Auffang- und Holdinggesellschaft mbH & Co. KG, Hamburg	100.00	100.00	EUR	1,958,365.58	–39,597,753.52
21	HSH Care+Clean GmbH, Hamburg[1) 4)]	51.00	51.00	EUR	25,000.00	–4,512.33
22	HSH Facility Management GmbH, Hamburg[2)]	100.00	100.00	EUR	205,600.00	6,451,827.30
23	HSH Gastro+Event GmbH, Hamburg[1) 4)]	100.00	100.00	EUR	25,000.00	791,895.28
24	HSH Move+More GmbH, Kiel[1) 4)]	51.00	51.00	EUR	25,000.00	323,453.36
25	HSH N Finance (Guernsey) Limited, St. Peter Port, Guernsey	100.00	100.00	EUR	486,467.00	52,396.00
26	HSH N Funding II, George Town, Cayman Islands	56.33	100.00	USD	654,305,988.00	36,276,800.00
27	HSH Nordbank Securities S.A., Luxembourg, Luxembourg	100.00	100.00	EUR	201,004,327.84	2,381,598.00
28	HSH N Residual Value Ltd., Hamilton, Bermuda	100.00	100.00	USD	3,915,732.00	339,668.00
29	HSH Private Equity GmbH, Hamburg[2)]	100.00	100.00	EUR	550,000.00	– 1,817,346.83
30	Ilex Integra GmbH, Hamburg[1)]	100.00	100.00	EUR	–23,241,426.21	–2,265,426.20
31	ISM Agency, LLC, New York, USA[1)]	100.00	100.00	USD	[6)]	[6)]
32	Mooragh Navigation Limited, Douglas, Isle of Man[16)]	100.00	100.00	USD	–22,527,311.00	–45,050,925.00

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
33	Neptune Finance Partner S.à.r.l., Luxembourg, Luxembourg	100.00	100.00	USD	73,894.70	0.00
34	Neptune Finance Partner II S.à.r.l., Luxembourg, Luxembourg[13]	100.00	100.00	USD	62,763.63	0.00
35	RESPARCS Funding Limited Partnership I, Hong Kong, Hong Kong[1]	0.01	100.00	USD	–8,534,938.00	–1,294,326.00
36	RESPARCS Funding II Limited Partnership, St. Helier, Jersey[1]	0.01	100.00	EUR	–346,251,935.00	217,422.00
37	Soderick Navigation Limited, Douglas, Isle of Man[16]	100.00	100.00	USD	–13,037,951.00	–36,074,966.00
38	2200 Victory LLC, Dover (Kent County), USA	100.00	100.00	USD	50,208,605.00	–521,121.00

CONSOLIDATED SUBSIDIARIES WITH A SHARE OF VOTING RIGHTS OF THE BANK OF 50 % OR LESS

– of which subsidiaries due to a principal-agent relationship

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
39	Amentum Aircraft Leasing No. Five Limited, Dublin, Ireland[1]	49.00	49.00	USD	4,910,713.00	22,008,813.00
40	Amentum Aircraft Leasing No. Seven Limited, Dublin, Ireland[1]	49.00	49.00	USD	377,198.00	–3,484,891.00
41	Amentum Aircraft Leasing No. Six Limited, Dublin, Ireland[1]	49.00	49.00	USD	16,538.00	10,158,437.00
42	Next Generation Aircraft Finance 2 S.à.r.l.,Findel, Luxembourg[1]	49.00	49.00	EUR	–9,434,111.00	–239,838.00
43	Next Generation Aircraft Finance 3 S.à.r.l., Findel, Luxembourg[1]	49.00	49.00	EUR	–10,672,196.00	–241.00
44	RDM Limited, George Town, Cayman Islands	0.00	0.00	USD	–191,905,272.00	–14,711,043.00

– of which subsidiaries due to contractual rights

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
45	Adessa Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG, Mainz	0.00	0.00	EUR	–438,524.45	45,261.35
46	Castellum ABF S.A., Luxembourg, Luxembourg	0.00	0.00	EUR	22,253.00	0.00
47	GmbH Altstadt Grundstücksgesellschaft, Mainz[1]	50.00	50.00	EUR	–519,005.46	–453,805.30
48	Life Insurance Fund Elite LLC, New York, USA	0.00	0.00	USD	[6]	[6]
49	Life Insurance Fund Elite Trust, Minneapolis, USA	0.00	0.00	USD	[6]	[6]
50	OCEAN Funding 2013 GmbH, Frankfurt am Main	0.00	0.00	EUR	28,811.93	1,328.94
51	Senior Assured Investment S.A., Luxembourg, Luxembourg	0.00	0.00	EUR	31,000.00	0.00
52	Senior Preferred Investments S.A., Luxembourg, Luxembourg	0.00	0.00	EUR	31,000.00	0.00
53	Stratus ABF S.A., Luxembourg, Luxembourg	0.00	0.00	EUR	31,002.00	0.00

ASSOCIATES NO LONGER CONSOLIDATED UNDER THE EQUITY METHOD DUE TO THE CLASSIFICATION OF THE SHARES AS NON-CURRENT ASSETS HELD FOR SALE (IFRS 5)

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
54	First Ship Lease Trust, Singapore, Singapore[1]	24.82	24.82	USD	247,454,000.00	–30,995,000.00

UNCONSOLIDATED SUBSIDIARIES WITH A SHARE OF VOTING RIGHTS OF THE BANK OF MORE THEN 50 %

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
55	Asian Capital Investment Opportunities Limited, Hong Kong, Hong Kong[1)]	51.00	51.00	USD	115.00	0.00
56	Aviation Leasing OpCo France III, Paris, France[1)]	100.00	100.00	EUR	–338,764.00	–198,445.00
57	Aviation Leasing OpCo France IV, Paris, France[1)]	100.00	100.00	EUR	–61,818.00	–22,672.00
58	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH, Hamburg[1)]	100.00	100.00	EUR	257,608.93	–4,148.18
59	European Capital Investment Opportunities Limited, St. Helier, Jersey[1)]	51.00	51.00	EUR	328.00	218.00
60	HSH N Structured Situations Limited, St. Helier, Jersey[7)]	100.00	100.00	USD	351,241.00	10,805.00
61	NORDIC BLUE CONTAINER V LIMITED, Majuro, Marshall Islands	100.00	100.00		[6)]	[6)]
62	PERIMEDES GmbH, Hamburg	100.00	100.00	EUR	28,483.61	2,230.08

UNCONSOLIDATED SUBSIDIARIES WITH A SHARE OF VOTING RIGHTS OF THE BANK OF 50 % OR LESS

– of which subsidiaries due to a principal-agent relationship

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
63	AGV Irish Equipment Leasing No. 7 Limited, Dublin, Ireland[1)]	49.00	49.00	USD	41,796.00	–35,008.00
64	Amentum Aircraft Leasing No. Ten Limited, Dublin, Ireland[1) 8)]	49.00	49.00	USD	–6,521,915.00	–2,858,784.00
65	Amentum Aircraft Leasing No. Three Limited, Dublin, Ireland[1) 11)]	49.00	49.00	USD	–15,046,554.00	–1,175,030.00
66	TEAL FUNDING NO 1 LTD, Dublin, Ireland[10)]	0.00	0.00	GBP	–42,435.00	0.00

– of which subsidiaries due to contractual rights

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
67	Lyceum Capital Fund 2000 (Number Five) GmbH & Co. KG, Stuttgart[1)]	80.00	0.00	EUR	–240,902.29	0.00

UNCONSOLIDATED JOINT VENTURES

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
68	AGV Irish Equipment Leasing No. 4 Limited, Dublin, Ireland[11)14)]	100.00	100.00	USD	500.00	– 17,382.00
69	Fosse Way Shipping Limited, London, Great Britain[15)]	58.85	58.85	EUR	– 20,504,132.00	– 164,193.00
70	Infrastructure Holding S.à.r.l., Luxembourg, Luxembourg[11)]	0.00	0.00	EUR	12,500.00	0.00
71	Lagan Viking Limited, Hong Kong, Hong Kong[15)]	58.85	58.85	EUR	– 16,216,032.00	–78,464.00
72	Mersey Viking Limited, Hong Kong, Hong Kong[15)]	58.85	58.85	EUR	– 15,842,721.00	– 132,621.00
73	Watling Street Shipping Limited, London, Great Britain[15)]	58.85	58.85	EUR	– 36,857,222.00	– 144,749.00

UNCONSOLIDATED ASSOCIATES

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
74	FSP CAPCELLENCE Beteiligungs GmbH, Hamburg[1)]	100.00	40.00	EUR	15,000,493.84	– 171,506.86
75	Global Format GmbH & Co. KG, Munich	28.57	28.57	EUR	1,991,526.98	170,098.26
76	HGA New Office Campus-Kronberg GmbH & Co. KG, Hamburg	56.44	56.44	EUR	11,122,855.95	793,635.61
77	KAIACA LLC, New York, USA[15)]	55.30	55.30	USD	20,112.12	0.00
78	4Wheels Management GmbH, Düsseldorf[1) 12)]	68.75	40.00	EUR	6,203,896.79	320,426.03

EQUITY HOLDINGS IN NON-AFFILIATED COMPANIES

Serial. no.	Name/Place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
79	AKA Ausfuhrkredit-Gesellschaft mbH, Frankfurt am Main	1.33	1.33	EUR	231,752,103.15	22,885,000.00
80	Aprel Shipping (MI) Inc., Majuro, Marshall Islands	15.00	15.00	USD	8,364,000.00	4,291,000.00
81	Arzel Shipping (MI) Inc., Majuro, Marshall Islands	15.00	15.00	USD	3,523,000.00	3,972,000.00
82	BRINKHOF Holding Deutschland GmbH, Erfurt1)	100.00	0.00	EUR	5)	5)
83	CapVis Equity III L.P., St. Helier, Jersey1)	2.50	0.00	EUR	330,702,444.00	121,046,857.00
84	CVC European Equity Partners V (A) L.P., St. Helier, Jersey1)	0.45	0.00	EUR	2,957,430,366.00	72,152,377.00
85	Deutsche WertpapierService Bank AG, Frankfurt am Main	2.51	2.51	EUR	180,187,783.45	8,724,744.89
86	EDD AG (formerly Börse Düsseldorf AG), Düsseldorf	0.89	0.89	EUR	32,244,559.01	–542,351.26
87	EURO Kartensysteme GmbH, Frankfurt am Main	2.82	2.82	EUR	11,635,404.22	172,979.08
88	GB Deutschland Fund GmbH & Co. KG, Hamburg1)	4.69	0.00	EUR	14,036,312.97	277,601.15
89	GLB GmbH & Co. OHG, Frankfurt am Main	15.77	15.77	EUR	6,235,539.93	494,038.34
90	GLB-Verwaltungs-GmbH, Frankfurt am Main	15.80	15.80	EUR	51,742.97	1,990.81
91	Hamburgische Grundbesitz und Anlage GmbH & Co. Objekte Hamburg und Potsdam KG, Hamburg	5.15	5.16	EUR	9,842,394.16	1,080,534.31
92	HAMMONIA Schiffsholding AG (formerly HCI Hammonia Shipping AG), Hamburg	6.60	6.60	EUR	2,285,268.02	–11,231,986.10
93	HGA Objekt Frankfurt GmbH & Co. KG, Hamburg	5.97	5.97	EUR	52,696,461.66	36,624,547.52
94	HGA Objekt München GmbH & Co. KG, Hamburg	5.23	5.23	EUR	18,934,865.30	7,557,306.77
95	HGA Objekt Stuttgart GmbH & Co. KG, Hamburg	7.25	7.26	EUR	10,089,147.27	633,303.33
96	HGA Objekte Hamburg und Hannover GmbH & Co. KG, Hamburg	5.10	5.09	EUR	8,747,109.32	10,914,722.72
97	Hines European Development Fund Limited Partnership, Wilmington, USA1)	9.90	9.90	EUR	63,440,000.00	–2,806,000.00
98	Liquiditäts-Konsortialbank GmbH i.L., Frankfurt am Main9)	1.68	1.68	EUR	230,536,114.28	–5,996,151.33
99	Next Commerce Accelerator Beteiligungsgesellschaft mbH & Co. KG, Hamburg	16.39	16.39	EUR	3)	3)
100	Next Commerce Accelerator GmbH, Hamburg	16.67	16.67	EUR	3)	3)
101	RSU Rating Service Unit GmbH & Co KG, München	13.60	13.60	EUR	14,946,085.78	1,825,230.73
102	Scan Energy, Frederikshavn, Denmark	7.61	7.61	EUR	5)	5)
103	Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T. SCRL), La Hulpe, Belgium	0.04	0.04	EUR	415,332.00	26,219.00
104	True Sale International GmbH, Frankfurt am Main	7.69	7.69	EUR	4,808,895.86	179,702.41
105	UNI-ASIA GROUP LIMITED, Singapore, Singapore	2.66	2.66	USD	110,286,000.00	1,196,000.00
106	Vofü-Fonds I Hamburgische Grundbesitz und Anlage GmbH & Co. KG, Hamburg	5.10	5.09	EUR	–895,289.44	824,696.46

1) Indirect holding.
2) A profit transfer agreement with the company is in place.
3) No information available due to newly established company.
4) There is a profit transfer agreement with HSH Facility Management GmbH.
5) No information available due to insolvency of the company.
6) No data available.
7) Only data as at 31 December 2010 is available.
8) Only data as at 31 December 2014 is available.
9) Only data as at 2 November 2015 is available.
10) Only data as at 30 November 2015 is available.
11) Only data as at 31 December 2015 is available.
12) Only data as at 31 July 2016 is available.
13) Only data as at 9 December 2016 is available.
14) Joint control was explicitly agreed by contract, therefore the company is not a subsidiary despite a voting majority.
15) This is not a subsidiary due to the requirement for a qualified voting majority for important decisions.
16) The shares are held via a trustee.

FOREIGN EXCHANGE RATES FOR € 1 AS AT 31.DECEMBER 2017

Great Britain	GBP	0.8872
USA	USD	1.1993

68. OTHER DISCLOSURES IN ACCORDANCE WITH GERMAN COMMERCIAL LAW

I. Basic principles

Under the terms of Section 315e (1) HGB, HSH Nordbank AG, which has its registered office in Hamburg (Hamburg commercial register number HRB 87366) and Kiel (Kiel commercial register number HRB 6127 KI) is required to observe the standards of the German Commercial Code in preparing and presenting the annual financial statements, as well as the IFRS standards. You may request the unabridged IFRS Group financial statements by following this link: www.hsh-nordbank.com. The complete list of equity holdings is set out in Note 67.

HSH Facility Management GmbH, Hamburg, and its subsidiaries HSH Care+Clean GmbH, Hamburg, HSH Gastro+Event GmbH, Hamburg, and HSH Move+More GmbH, Kiel, make use of the exemption from disclosure obligations in accordance with Section 264 (3) HGB.

II. Number of employees

The average number of employees as of the reporting date is calculated on the basis of staff figures at quarter-end for all fully consolidated companies:

NUMBER OF EMPLOYEES

	2017			2016
	Male	Female	**Total**	Total
Full-time employees	1,156	427	1,583	1,801
Part-time employees	128	508	636	698
Total	**1,284**	**935**	**2,219**	**2,499**
Apprentices/trainees	19	17	36	36

III. Corporate governance code

HSH Nordbank AG supports the aims of the German Corporate Governance Code and has recognised the Code's rules on a voluntary basis as an unlisted company. The Management Board and Supervisory Board of HSH Nordbank AG have given a declaration of conformity pursuant to Section 161 of the German Stock Corporation Act (AktG) that the recommendations of the German Corporate Governance Code Commission together with the restrictions have been complied with and will be complied with until the subsequent declaration is made. The declaration of conformity is published on HSH Nordbank AG's website. The declaration of conformity does not form part of the Group financial statements.

IV. Fees and activities of the auditor

Auditor's activities

KPMG AG Wirtschaftsprüfungsgesellschaft audited the annual financial statements and Group financial statements of HSH Nordbank as at 31 December 2017 and conducted various audits of annual financial statements at subsidiaries. In addition, reviews of the half-year financial report as at 30 June 2017 and certain services in accordance with the requirements of the guarantee scheme of the Landesbanken and Girozentralen were performed as part of the audit. Quality assurance controls were also performed, in particular with regard to accounting-specific issues, including the quality assurance of selected technical concepts for the implementation of IFRS 9 and of certain regulatory issues, directly as a result of the audit of the annual financial statements and Group financial statements as at 31 December 2017 or within the context of this audit. Furthermore, audits were conducted in accordance with Section 36 of the German Securities Trading Act (WpHG) and services were provided in connection with enforcement proceedings.

In addition, two comfort letters were issued, investigations were performed in connection with the requirements of the guarantee scheme of the Landesbanken and Girozentralen and the charging of the European banking levy, and other contractually agreed services (including audits of certain parts of the internal control system pursuant to IDW PS 951 (new version) were performed. Other activities related to various project-related quality assurance measures in connection with the implementation of regulatory and banking industry requirements, and in connection with the privatisation process, technical assistance with a project to implement future banking supervisory requirements and the preparation of expert opinion. Support services were also provided in connection with the preparation of tax returns.

Auditor's fees within the meaning of IDW AcPS HFA 36 (new version)

AUDITOR'S FEES

(€ m)	**2017**	2016
Audits KPMG AG	6	6
Other certification and valuation services provided by KPMG AG	1	1
Other services provided by KPMG AG	2	3
Total	**9**	**10**

The change in the prior-year figures is due to the application of IDW AcPS HFA 36 (new version).

V. Seats on supervisory bodies

On the reporting date, the following seats are held by members of the Management Board on statutory supervisory bodies of major corporations or financial institutions:

Ulrik Lackschewitz
HSH Nordbank Securities S.A., Luxembourg
Chairman of the Supervisory Board

69. NAMES OF BOARD MEMBERS AND DIRECTORSHIPS HELD

I. The Supervisory Board of the HSH Nordbank Group

Dr Thomas Mirow, Hamburg
Chair
Former President of the European Bank for Reconstruction and Development, London

Olaf Behm, Hamburg
Deputy Chair
Employee of HSH Nordbank AG

Stefanie Arp, Norderstedt
(until 14 November 2017)
Employee of HSH Nordbank AG

Peter Axmann, Hamburg
Employee of HSH Nordbank AG

Simone Graf, Altenholz
Employee of HSH Nordbank AG

Silke Grimm, Reinbek
Member of the Board of Euler Hermes Deutschland AG

Cornelia Hintz, Dortmund
Federal state secretary ver.di district North Rhine-Westphalia

Stefan Jütte, Bonn
Former Chairman of the Management Board of Deutsche Postbank AG

Dr Rainer Klemmt-Nissen, Hamburg
Managing Director, HGV Hamburger Gesellschaft für Vermögens- und Beteiligungs Management mbH

Rieka Meetz-Schawaller, Kiel
Employee of HSH Nordbank AG

Bert Michels, Hamburg
(from 15 November 2017)
Employee of HSH Nordbank AG

Dr David Morgan, London
Managing Director J.C. Flowers & Co UK Ltd.

Dr Philipp Nimmermann, Kiel
Secretary of State at the Schleswig-Holstein Ministry of Finance

Stefan Schlatermund, Hamburg
Employee of HSH Nordbank AG

Klaus-Dieter Schwettscher, Reinbek
Representative of ver.di's federal management board

Elke Weber-Braun, Hamburg
Independent chartered accountant

Jörg Wohlers, Rellingen
Former Member of the Board of Hamburger Sparkasse AG and HASPA Finanzholding

II. Members of the Risk Committee

Stefan Jütte
Chair

Olaf Behm

Simone Graf

Dr Rainer Klemmt-Nissen

Rieka Meetz-Schawaller

Dr Thomas Mirow

Dr Philipp Nimmermann

Stefan Schlatermund

III. Members of the Audit Committee

Elke Weber-Braun
Chair

Stefanie Arp
(until 14 November 2017)

Peter Axmann

Olaf Behm

Bert Michels
(from 28 November 2017)

Dr Philipp Nimmermann

Jörg Wohlers

IV. Members of the General/Nomination Committee

Dr Thomas Mirow
Chair

Olaf Behm

Simone Graf

Dr Rainer Klemmt-Nissen

Dr David Morgan

Dr Philipp Nimmermann

Jörg Wohlers

V. Members of the Remuneration Monitoring Committee

Dr Thomas Mirow
Chair

Olaf Behm

Simone Graf

Silke Grimm

Dr Rainer Klemmt-Nissen

Dr Philipp Nimmermann

VI. Members of the Mediation Committee

Dr Thomas Mirow
Chair

Olaf Behm

Dr Rainer Klemmt-Nissen

Rieka Meetz-Schawaller

VII. The Management Board of the HSH Nordbank Group

Stefan Ermisch
Born in 1966

Chair

Oliver Gatzke
Born in 1968
Chief Financial Officer

Ulrik Lackschewitz
Born in 1968
Chief Risk Officer

Torsten Temp
Born in 1960
Management Board member responsible for the Market divisions

ANNEX TO THE GROUP FINANCIAL STATEMENTS

COUNTRY BY COUNTRY REPORTING 2017

Basic principles

The requirements for country-specific reporting, referred to as country-by-country reporting in Article 89 of the Directive 2013/36/EU (Capital Requirement Directive, CRD IV), have been transposed into German law in Section 26a (1) of the German Banking Act (KWG).

Disclosure at HSH Nordbank

HSH Nordbank country-by-country reporting includes the necessary information for all the subsidiaries fully consolidated in the Group financial statements as of this reporting date. Entities that were deconsolidated during the reporting year are not included in the figures presented. The geographical allocation is made on the basis of the location of a company's registered office. Branches are disclosed as independent companies. Representative offices are not listed. All accounting-related information is based on IFRS accounting.

In this report, HSH Nordbank defines the required size of turnover as the sum of total income as presented in the income statement and Other operating income (gross amounts before consolidation). The consolidated non-bank entities in particular report their turnover in Other operating income.

The profit or loss before tax disclosed in this report corresponds to the result before taxes of the individual entities presented. The tax position also corresponds to the definition under IFRS standards in the income statement.

HSH Nordbank has been granted a guarantee facility of € 10 billion by its owners. It is a second loss guarantee in which rating-induced actual payment defaults are secured. Please refer to Note 3 for more details.

The figure for the number of employees corresponds to the arrangement of Section 267 (5) of the German Commercial Code (HGB) for the entities still included in the Group financial statements as of the reporting date.

The information on the type of activities of the relevant companies is presented in line with the definitions used in Article 4 (1) CRR once the CRR came into effect.

The return on capital to be disclosed as at 31 December 2017, calculated as the quotient of net profit (Group net result after taxes) and total assets, is – 0.8 %.

Reporting

COUNTRY-SPECIFIC DETAILS OF TURNOVER, PROFIT OR LOSS AND TAXES AS WELL AS EMPLOYEE NUMBERS

(€ m/number) **2017** Country	Turnover	Profit or loss before tax	Tax on profit or loss (+) expense/ (-) income	Number of employees
EU				
Germany	1,583	–355	90	2,108
Luxembourg	219	84	–	57
Ireland	9	–27	–	–
Greece	2	–	–	8
Third countries				
USA	2	–13	–	4
Singapore	27	–111	–12	42
British Channel Islands	1	–	–	–
Isle of Man	60	39	–	–
Hong Kong	6	6	–	–
Bermuda	1	1	–	–
Cayman Islands	77	69	–	–

COUNTRY-SPECIFIC DETAILS OF THE HEDGING EFFECT OF THE SECOND LOSS GUARANTEE AS STATE AID RECEIVED

	Country		
	EU		Third countries
(€ m) **2017**	Germany	Luxembourg	Singapore
Balance sheet amounts			
Compensation under the second loss guarantee	4,726	277	178
Compensation under the credit derivative second loss guarantee	924	90	0

	Country		
	EU		Third countries
(€ m) **2017**	Germany	Luxembourg	Singapore
P&L amounts			
Hedging effect of the second loss guarantee	–602	–90	–36
Hedging effect of credit derivative under the second loss guarantee	775	54	–19
Expenses for government guarantees	–131	–15	–3

NATURE OF ACTIVITIES AND GEOGRAPHICAL LOCATION OF THE BRANCHES AND FULLY CONSOLIDATED SUBSIDIARIES

Serial. no.	Name of the company	City	Country	Nature of activities
1	HSH Nordbank AG	Hamburg, Kiel	Germany	Bank
2	HSH Nordbank AG, Luxembourg branch	Luxembourg	Luxembourg	Bank
3	HSH Nordbank AG, Singapore branch	Singapore	Singapore	Bank
4	HSH Nordbank AG, Athens branch	Athens	Greece	Bank
5	Adessa Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG	Mainz	Germany	Miscellaneous activities
6	Amentum Aircraft Leasing No. Five Limited	Dublin	Ireland	Miscellaneous activities
7	Amentum Aircraft Leasing No. Seven Limited	Dublin	Ireland	Miscellaneous activities
8	Amentum Aircraft Leasing No. Six Limited	Dublin	Ireland	Miscellaneous activities
9	Avia Management S.à.r.l.	Luxembourg	Luxembourg	Financial Institution
10	BINNENALSTER-Beteiligungsgesellschaft mbH	Hamburg	Germany	Financial Institution
11	Bu Wi Beteiligungsholding GmbH	Hamburg	Germany	Financial Institution
12	CAPCELLENCE Dritte Fondsbeteiligung GmbH	Hamburg	Germany	Financial Institution
13	CAPCELLENCE Erste Fondsbeteiligung GmbH	Hamburg	Germany	Financial Institution
14	CAPCELLENCE Holding GmbH & Co. KG	Hamburg	Germany	Financial Institution
15	CAPCELLENCE Zweite Fondsbeteiligung GmbH	Hamburg	Germany	Financial Institution
16	Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG	Hamburg	Germany	Financial Institution
17	Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG	Hamburg	Germany	Financial Institution
18	CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG	Hamburg	Germany	Financial Institution
19	CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG	Hamburg	Germany	Financial Institution
20	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG	Hamburg	Germany	Financial Institution
21	Castellum ABF S.A.	Luxembourg	Luxembourg	Miscellaneous activities
22	Chasms Navigation Limited	Douglas	Isle of Man	Miscellaneous activities
23	Cregneash Navigation Limited	Douglas	Isle of Man	Miscellaneous activities
24	Curragh Navigation Limited	Douglas	Isle of Man	Miscellaneous activities
25	FSL Asset Management Pte. Ltd.	Singapore	Singapore	Provider of ancillary services
26	FSL Holdings Pte. Ltd.	Singapore	Singapore	Financial Institution
27	FSL Trust Management Pte. Ltd.	Singapore	Singapore	Provider of ancillary services
28	GmbH Altstadt Grundstücksgesellschaft	Mainz	Germany	Financial Institution
29	GODAN GmbH	Hamburg	Germany	Financial Institution
30	HSH Auffang- und Holdinggesellschaft mbH & Co. KG	Hamburg	Germany	Financial Institution

Serial.no	Name of the company	City	Country	Nature of activities
31	HSH Care+Clean GmbH	Hamburg	Germany	Miscellaneous activities
32	HSH Facility Management GmbH	Hamburg	Germany	Provider of ancillary services
33	HSH Gastro+Event GmbH	Hamburg	Germany	Miscellaneous activities
34	HSH Move+More GmbH	Kiel	Germany	Miscellaneous activities
35	HSH N Finance (Guernsey) Limited	St. Peter Port	Guernsey	Financial Institution
36	HSH N Funding II	George Town	Cayman Islands	Financial Institution
37	HSH N Residual Value Ltd.	Hamilton	Bermuda	Insurance company
38	HSH Nordbank Securities S.A.	Luxembourg	Luxembourg	Bank
39	HSH Private Equity GmbH	Hamburg	Germany	Financial Institution
40	Ilex Integra GmbH	Hamburg	Germany	Financial Institution
41	ISM Agency, LLC	New York	USA	Miscellaneous activities
42	Life Insurance Fund Elite LLC	New York	USA	Miscellaneous activities
43	Life Insurance Fund Elite Trust	Minneapolis	USA	Miscellaneous activities
44	Mooragh Navigation Limited	Douglas	Isle of Man	Miscellaneous activities
45	Neptune Finance Partner S.à.r.l.	Luxembourg	Luxembourg	Financial Institution
46	Neptune Finance Partner II S.à.r.l.	Luxembourg	Luxembourg	Financial Institution
47	Next Generation Aircraft Finance 2 S.à.r.l.	Findel	Luxembourg	Miscellaneous activities
48	Next Generation Aircraft Finance 3 S.à.r.l.	Findel	Luxembourg	Miscellaneous activities
49	OCEAN Funding 2013 GmbH	Frankfurt am Main	Germany	Miscellaneous activities
50	RDM Limited	George Town	Cayman Islands	Miscellaneous activities
51	RESPARCS Funding Limited Partnership I	Hong Kong	Hong Kong	Financial Institution
52	RESPARCS Funding II Limited Partnership	St. Helier	Jersey	Financial Institution
53	Senior Assured Investment S.A.	Luxembourg	Luxembourg	Miscellaneous activities
54	Senior Preferred Investments S.A.	Luxembourg	Luxembourg	Miscellaneous activities
55	Soderick Navigation Limited	Douglas	Isle of Man	Miscellaneous activities
56	Stratus ABF S.A.	Luxembourg	Luxembourg	Miscellaneous activities
57	2200 Victory LLC	Dover	USA	Miscellaneous activities

DATE OF RELEASE FOR PUBLICATION

The Management Board of HSH Nordbank has prepared the Group financial statements on 17 April 2018 and released these for forwarding to the Supervisory Board. The Supervisory Board is responsible for reviewing the Group financial statements and approving of these.

Hamburg/Kiel, 17 April 2018

Stefan Ermisch Oliver Gatzke

Ulrik Lackschewitz Torsten Temp

INDEPENDENT AUDITOR'S REPORT

To HSH Nordbank AG, Hamburg and Kiel

Report on the Audit of the Consolidated Financial Statements and of the Group Management Report

Opinions

We have audited the consolidated financial statements of HSH Nordbank AG, Hamburg and Kiel, which comprise the consolidated statement of financial position as at 31 December 2017, the Group statement of income, the consolidated statement of comprehensive income and consolidated statement of cash flows for the financial year from 1 January 2017 to 31 December 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies. In addition, we have audited the group management report at HSH Nordbank AG, Hamburg and Kiel, for the financial year from 1 January 2017 to December 31, 2017. In accordance with the German legal requirements, we have not audited the content of the Management Declaration pursuant to Section 289f (2) nos. 4 and 6 of the German Commercial Code (*Handelsgesetzbuch* – HGB), which is included in the group management report.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying consolidated financial statements comply, in all material respects, with the IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to Section 315e (1) HGB and, in compliance with these requirements, give a true and fair view of the assets, liabilities, and financial position of the Group as of 31 December 2017 , and of its financial performance for the financial year from 1 January 2017 to 31 December 2017 and
- the accompanying group management report as a whole provides an appropriate view of the Group's position. In all material respects, this group management report is consistent with the consolidated financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the group management report does not cover the content of the Management Declaration mentioned above.

Pursuant to Section 322 (3) sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the consolidated financial statements and of the group management report.

Basis for the Opinions

We conducted our audit of the consolidated financial statements and of the group management report in accordance with Section 317 HGB and the EU Audit Regulation No. 537/2014 (referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements, principles and standards are further described in the "Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report" section of our auditor's report. We are independent of the group entities in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the consolidated financial statements and on the group management report.

Material uncertainty in connection with the ability to continue as a going concern

We refer to the discussion in the Group management report in the section entitled "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" as well as to Note 1 to the Group financial statements, "Accounting principles", in which the management states that the going concern assumption for accounting and measurement purposes, as well as the continued survival of HSH Nordbank and major group companies is based, in particular, on the share purchase agreement concluded on 28 February 2018, in which HSH Beteiligungs Management GmbH sold 94.9% of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG (hereinafter referred to as the "bidders") being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) grants the necessary approvals,
- the European Commission grants its approval for the acquisition following a viability assessment of the new corporate structure,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

It is further required that acceptance by market participants and other relevant stakeholders necessary for the successful implementation of HSH Nordbank AG's future business model is maintained or gained.

As set out in the Group management report in the section entitled "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" as well as in to Note 1 to the Group financial statements, "Accounting principles", this indicates material uncertainty that may cast significant doubt on the ability of the HSH Nordbank and major Group companies to continue as a going concern, as well as a risk that threatens the company's survival within the meaning of Sec. 322 (2) sentence 3 HGB. Our audit opinions are not modified with regard to this matter.

OTHER KEY AUDIT MATTERS IN THE AUDIT OF THE CONSOLIDATED FINANCIAL STATEMENTS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements for the financial year from 1 January 2017 to 31 December 2017. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, we do not provide a separate opinion on these matters.

Appropriateness of the specific loan loss provisions set up on loans and advances to customers resulting from ship financing

For information on the accounting and measurement principles used by HSH Nordbank for specific loan loss provisions, we refer to section "7. Accounting policies" section and section "26. Loan loss provisions" in the notes to the Group financial statements. For information on the forecast uncertainties associated with the loan loss provisions, we refer to the sections entitled "Forecast for loan loss provisions" and "Opportunities and risks in the loan loss provision forecast" of the group management report.

THE FINANCIAL STATEMENT RISK

HSH Nordbank has activities in the ship financing business. A substantial part of the specific loan loss provisions on receivables in the ship financing business relates to receivables from the loan portfolio whose sale has been agreed as part of a portfolio transaction in connection with the privatisation process (see audit matter "Impact of privatisation on accounting"). Another part of the specific loan loss provisions on receivables in order to take account of acute default risks relates to specific loan loss provisions for ship financing in the Bank's portfolio which does not form part of the portfolio transaction and is subject to the comments set out below.

Calculating the necessary specific loan loss provisions for ship financing is subject to discretion. The process requires forward-looking estimates of expected contractual cash flows and/or the expected cash flows from the realisation of loan collateral or the sale of loan exposures. The cash flows are estimated taking into account the probable development of essential value assumptions and parameters. These include, in particular, the commitment strategy (continuation or realisation strategy), the future development of charter rates and operating costs of the vessels financed, as well as the anticipated proceeds that can be generated from the realisation of collateral. These estimates are subject to considerable uncertainty.

Incorrect assumptions regarding the amount of the expected cash flows (among other things depending on forecasts on the future development of charter rates, operating costs and ship values) can mean that the receivables are not valued correctly, meaning that the counterparty default risks are not taken into account in an appropriate amount. As a result, it was of particular importance in the context of our audit to ensure that the assumptions regarding the above-mentioned parameters had been properly derived and applied in accordance with applicable accounting principles.

OUR AUDIT APPROACH

Using the risk-based audit approach, we based our audit opinion on both control-based audit procedures, as well as on statement-related audit procedures.

The first step involved gaining an overview of the development of the shipping markets, an insight into the development of the Bank's shipping loan portfolio, the associated counterparty default-related risks, the methods used to calculate specific loan loss provisions, as well as the internal control system in respect of the calculation of specific loan loss provisions on ship financing. We conducted interviews and consulted the written regulations in order to assess the adequacy of the internal control system with regard to the determination of specific loan loss provisions on ship financing.

We then verified the implementation and effectiveness of the relevant controls designed to ensure the appropriate determination of specific loan loss provisions in accordance with the accounting regulations. In respect of the IT system used in this regard, we assessed the effectiveness of the system and application control with the involvement of our IT specialists.

Our audit activities with regard to the parameters for the calculation of loan loss provisions also related to the validations performed by HSH Nordbank with regard to its estimates of future charter rates, operating costs and the development of ship values.

On the basis of a conscious selection of single exposures from the ship financing business, which was made based on materiality and risk-related aspects, we reviewed the adequacy of the loan loss provisions set up with regard to these receivables and the value-determining factors on which the recognition of specific loan loss provisions was based. In this regard, we verified whether the restructuring and workout strategy on which the valuation was based is consistent with the actual conditions and is plausibly justified. Based on this, we assessed, in particular, the adequacy of the estimate of the contractual cash flows still to be expected and/or the expected cash flows from the realisation of loan collateral or the sale of loan exposures. This includes, in particular, reviewing whether the future development of charter rates and operating costs of the vessels, as well as the anticipated proceeds that can be generated from the realisation of collateral, have been taken into account appropriately.

When reviewing the anticipated proceeds that can be generated from the realisation of collateral, insofar as this was significant for the purposes of the valuation scenario being audited, our opinion was based on valuation reports prepared by independent experts commissioned by the Bank. Finally, we checked whether the required specific loan loss provision had also been calculated correctly.

OUR OBSERVATIONS
The assumptions and parameters used to calculate the amount of the specific loan loss provisions in the ship financing business were properly selected and were used in accordance with the accounting principles to be applied to the calculation of specific loan loss provisions.

Impact of the implementation of structural measures on accounting
For information on the impact of structural measures on accounting, we refer to the section entitled "Successful winding-down strategy and winding-down by the Bank itself" in the Group management report. For information on the accounting and measurement principles used, we refer to the comments made in the notes to the Group financial statements in sections "7. Accounting policies, G) Derecognition" and "33. Non-current assets held for sale and disposal groups."

THE FINANCIAL STATEMENT RISK
In order to implement the structural measures provided for as part of the 2016 decision of the EU Commission on the replenishment of the second loss guarantee, the legal transfer of the loan portfolio sold to HSH portfoliomanagement AöR in the 2016 financial year ("federal state portfolio transaction") was largely completed in the reporting year, and further loan portfolio sales were executed on the market ("market portfolio transactions").

With regard to the completed structural measures, there is a risk for the Group financial statements in particular in the sense that sold assets may not have been accounted for correctly with regard to the requirements for, or the timing of, derecognition.

OUR AUDIT APPROACH
Using the risk-based audit approach, we based our audit opinion on both control-based audit procedures, as well as on statement-related audit procedures.

The first step involved using ongoing surveys and discussions with the management, as well as consulting committee meeting minutes, Management Board minutes and documentation to identify the relevant transactions for the implementation of structural measures.

We also assessed the adequacy of the processes and controls established by the Bank in connection with the accounting of corresponding sale transactions, and reviewed the implementation and effectiveness of relevant controls designed to ensure the correct application of the accounting regulations with regard to corresponding transactions. On the basis of a conscious selection of transactions, which was made based on materiality and risk-related aspects, we reviewed the corresponding contractual agreements with regard to the requirements for, or the timing of, derecognition.

In addition, we verified the correct derecognition of the receivables in the Bank's accounting system.

OUR OBSERVATIONS
The asset derecognitions resulting from the implementation of structural measures were carried out in accordance with the applicable accounting principles.

Impact of privatisation on accounting
For information on the impact of privatisation on accounting, we refer to the sections entitled "Sale of HSH Nordbank AG on 28 February 2018" and "Additional elementary winding-down of legacy burdens as part of the privatisation process" of the Group management report. For information on the accounting and measurement principles used, we refer to the notes to the Group financial statements in section "26. Loan loss provisions."

THE FINANCIAL STATEMENT RISK
On 28 February 2018, HSH Beteiligungs Management GmbH concluded a share purchase agreement on the sale of its shares in HSH Nordbank to several investors. At the same time, HSH Nordbank concluded a portfolio transaction with a special-purpose entity from the sphere of the investors on 28 February 2018

relating to the sale of a loan portfolio earmarked for winding down and consisting largely of non-performing ship, real estate and corporate financing with an exposure at default (EAD) of € 6.3 billion. The closing and, as a result, the transfer of beneficial ownership with regard to the receivables affected by the portfolio transaction are subject, in particular, to the condition precedent that the share purchase agreement (SPA) is closed.

The change in shareholder and the sale of a loan portfolio earmarked for winding down could have a significant impact on accounting. As far as the Group financial statements are concerned, there is a risk that the loan portfolio sale for the loan portfolio earmarked for winding down has not been taken into account, either at all or sufficiently, within the context of the determination of the specific loan loss provisions. In addition, there is a risk for the Group financial statements that the tax-related consequences of the change in shareholder and the tax losses resulting from the sale of the loan portfolio earmarked for winding down have not been taken into account correctly for the purposes of calculating deferred taxes.

OUR AUDIT APPROACH

Using an risk-based audit approach, we based our audit opinion on both control-based audit procedures, as well as on statement-related audit procedures.

The first step involved using ongoing surveys and discussions with the management, as well as consulting committee meeting minutes, Management Board minutes and documentation, as well as consulting the agreement on the sale of the shares in HSH Nordbank and the agreement on the sale of a loan portfolio earmarked for winding down to a special-purpose entity to assess the fundamental impact of privatisation on the accounting as at 31 December 2017. Then, based on our understanding of the process, we assessed the implementation and effectiveness of the Bank's internal controls to take account of the impact of the sale of the loan portfolio within the context of the calculation of specific loan loss provisions on receivables.

On the basis of a conscious selection of individual exposures to be sold, which was made based on materiality and risk-related aspects, we verified that the agreed purchase price for the loan portfolio had been taken into account correctly in the context of calculating the loan loss provisions on these receivables. With regard to the appropriate allocation of the purchase price for the overall portfolio to the individual receivables, we used an expert opinion commissioned by HSH Nordbank, as well as a confirmation issued by another auditing firm, for the purposes of our review.

With regard to the tax-related consequences of the privatisation process, we first of all verified the implementation and effectiveness of relevant controls designed to ensure the correct accounting of deferred taxes.

Our audit activities with regard to the adequacy of the inclusion of the tax-related consequences of the change in shareholder and the tax losses resulting from the sale of the loan portfolio earmarked for winding down in the determination of deferred taxes involved using binding information issued by the tax authorities, as well as assessing whether deferred taxes on tax loss carryforwards had been valued correctly in light of the change in shareholder.

OUR OBSERVATIONS

The sale of the loan portfolio earmarked for winding down that was agreed on 28 February 2018 in the context of the portfolio transaction was taken into account in the calculation of specific loan loss provisions and the valuation of deferred taxes in accordance with the applicable accounting principles.

Other Information

Management is responsible for the other information. The other information comprises:

- the Management Declaration, and
- the remaining parts of the annual report, with the exception of the audited consolidated financial statements and group management report and our auditor's report.

Our opinions on the consolidated financial statements and on the group management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the consolidated financial statements, with the group management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

Responsibilities of Management and the Supervisory Board for the Consolidated Financial Statements and the Group Management Report

Management is responsible for the preparation of the consolidated financial statements that comply, in all material respects, with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB and that the consolidated financial statements, in compliance with these requirements, give a true and fair view of the assets, liabilities, financial position, and financial performance of the Group. In addition, management is responsible for such internal control as they have determined necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting unless there is an intention to liquidate the Group or to cease operations, or there is no realistic alternative but to do so.

Furthermore, management is responsible for the preparation of the group management report that, as a whole, provides an appropriate view of the Group's position and is, in all material respects, consistent with the consolidated financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, management is responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a group management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the group management report.

The supervisory board is responsible for overseeing the Group's financial reporting process for the preparation of the consolidated financial statements and of the group management report.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements and of the Group Management Report

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the group management report as a whole provides an appropriate view of the Group's position and, in all material respects, is consistent with the consolidated financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the consolidated financial statements and on the group management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements and this group management report.

We exercise professional judgment and maintain professional scepticism throughout the audit. We also

- identify and assess the risks of material misstatement of the consolidated financial statements and of the group management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit of the consolidated financial statements and of arrangements and measures (systems) relevant to the audit of the group management report 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 these systems.
- evaluate the appropriateness of accounting policies used by management and the reasonableness of estimates made by management and related disclosures.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the consolidated financial statements and in the group management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to be able to continue as a going concern.
- evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements present the underlying transactions and events in a manner that the consolidated financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Group in compliance with IFRSs as adopted by the EU and the additional requirements of German commercial law pursuant to Section 315e (1) HGB.
- obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express opinions on the consolidated financial statements and on the group management report. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our opinions.
- evaluate the consistency of the group management report with the consolidated financial statements, its conformity with German law, and the view of the Group's position it provides.
- perform audit procedures on the prospective information presented by management in the group management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by management as a basis for the prospective information, and evaluate the proper derivation of the pro-

spective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 18 May 2017 . We were engaged by the Chairman of the Supervisory Board on 21 November 2017 . We have been the group auditor of HSH Nordbank AG, Hamburg and Kiel, without interruption since the financial year 2008.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Rainer Thiede.

Hamburg, 18 April 2018

KPMG AG
Wirtschaftsprüfungsgesellschaft

Leitz	Thiede
Wirtschaftsprüfer	Wirtschaftsprüfer

RESPONSIBILITY STATEMENT BY THE MANAGEMENT BOARD

We hereby affirm that to the best of our knowledge the Group financial statements have been prepared in accordance with the applicable accounting principles and give a true and fair view of the net assets, financial position and results of operations of the HSH Nordbank Group and that the Group management report presents the course of business, including the results of the business and the HSH Nordbank Group's situation, in such a manner that it gives a true and fair view and describes the main opportunities and risks for the HSH Nordbank Group's foreseeable performance.

Hamburg/Kiel, 17 April 2018

Stefan Ermisch	Oliver Gatzke
Ulrik Lackschewitz	Torsten Temp

FURTHER INFO

ORMATION

HSH NORDBANK ADVIS

HSH Nordbank AG formed an Advisory Board to provide the Management Board with expert advice on performing its duties and to foster contact with the business community and the savings banks as well as any other Groups of public life. The members of the Advisory Board are being appointed by the Management Board.

MEMBERS OF THE ADVISORY BOARD

Ulrich Boike
Deputy Chairman of the Board of Management
Förde Sparkasse
Kiel

Reinhard Boll
President
of the Savings Banks Association of Schleswig-Holstein
Kiel

Prof. Dr. Wolfgang Drobetz
Universität Hamburg
Faculty for Business Administration
Chair for Corporate Finance und Ship Finance
Hamburg
(since 01.01.2018)

Dr. Johann Killinger
Managing Partner
Buss Group GmbH & Co. KG
Hamburg

Jochen Klösges
Chief Executive Officer
E.R. Capital Holding GmbH & Cie. KG
Hamburg

Max-Arnold Köttgen
Member of the Board of Management
REMONDIS SE & Co. KG
Hamburg

Angela Krüger-Steinhoff
Managing Partner
Steinhoff Familienholding GmbH
Westerstede
(until 31.12.2017)

Fritz Horst Melsheimer
President of the Hamburg Chamber of Commerce
Hamburg
(until 06.04.2017)

SORY BOARD

Thomas H. Eckelmann
Chairman of the Group Management Board
EUROKAI KGaA
Hamburg

Michael Eggenschwiler
Chairman of the Management Board
Hamburg Airport GmbH
Hamburg

Jutta Humbert
Managing Partner
NORD DRIVESYSTEMS Gruppe
Bargteheide
(until 31.12.2017)

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Managing Director
Kersig GmbH & Co. KG
Kiel

Dr. Ulrich Möhrle
Managing Partner
Möhrle Happ Luther
Hamburg
(since 26.03.2018)

Dr. Claus-Georg Nette
Member of the Board of Management
Marquard & Bahls AG
Hamburg
(until 31.12.2017)

Dr. Arend Oetker
Managing Partner
Dr. Arend Oetker Holding GmbH
Berlin
(until 31.12.2017)

Prof. Dr. med. Jens Scholz
Chairman of the Board
University Hospital Schleswig-Holstein
Kiel

Dr. Heinrich Schulte
Managing Partner and Group Chairman
Bernhard Schulte GmbH & Co. KG
Hamburg
(since 06.04.2018)

Frank Schumacher
Chairman of the Board of Management
Sparkasse zu Lübeck AG
Lübeck

MULTIYEAR

Dr. Fritz Süverkrüp
Honorary President
Kiel Chamber of Industry and Commerce
Kiel

Angela Titzrath
Chairman of the Management Board
Hamburger Hafen und Logistik AG
Hamburg
(seit 09.04.2018)

Prof. Dr. Henning Vöpel
Director
Hamburg Institute of International Economics
Hamburg

Pieter Wasmuth
Chairman of the Management Board
Vattenfall Wärme Hamburg GmbH
Chairman
Vattenfall Europe Nuclear Energy GmbH
General Executive (Generalbevollmächtigter)
of Hamburg and Northern Germany
of Vattenfall GmbH
Hamburg

Johannes Züll
Chairman of the Management Board
Studio Hamburg GmbH
Hamburg

Dr. Lorenz Zwingmann
Mitglied des Vorstandes, CFO
Marquard & Bahls AG
Hamburg
(since 09.04.2018)

OVERVIEW

		FOLLOWING ADJUSTMENT			
HSH NORDBANK GROUP 2013 - 2017	**2017**	2016	2015	2014	2013
INCOME STATEMENT (€ M)					
Net income before restructuring	**- 238**	445	954	883	- 48
Net income before taxes	**- 453**	121	450	278	- 518
Group net result for the year	**- 528**	69	98	160	- 769
BALANCE SHEET (€ M)					
Equity	**4.373**	4.950	4.885	4.672	4.579
Total assets	**70.382**	84.365	96.973	110.082	109.111
Business volume	**78.611**	93.208	106.176	119.880	118.729
CAPITAL RATIOS[1)] (%)					
Tier 1 capital ratio	**23,5**	18,7	16,4	14,4	15,3
Regulatory capital ratio	**30,6**	24,8	20,6	18,7	23,8
EMPLOYEES[2)]					
Total	**2.295**	2.613	2.838	3.072	3.391
Germany	**2.188**	2.497	2.702	2.897	3.150
Abroad	**107**	116	136	175	241

[1] After having established the annual financial statements 2017

[2] Headcount

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NOTE

If at times only the masculine form is used for certain terms relating to groups of people, this is not meant in a gender-specific manner, but occurs exclusively for the sake of better readability.

This Annual Report was published on 26 April 2018 and is available at www.annualreport2017.hsh-nordbank.com. This is an English translation of the original German version of the Annual Report.

FORWARD-LOOKING STATEMENTS

This Annual Report includes certain forward-looking statements. These statements are based on our beliefs and assumptions as well as on conclusions drawn from information currently available to us from sources which we consider to be reliable. A forward-looking statement involves information that does not simply reflect historical facts, including information relating to possible or anticipated future growth and future economic development.

Such forward-looking statements are based on a number of assumptions concerning future events and are subject to uncertainties, risks, and other factors, many of which are beyond our control. Therefore actual events may differ considerably from those forecast in the forward-looking statements. In view of this, you are advised never to rely to an inappropriate degree on forward-looking statements. We cannot accept any liability for the accuracy or completeness of these statements or for the actual realisation of forecasts made in this Annual Report. Furthermore, we are not obliged to update the forward-looking statements following publication of this information. In addition, information contained in this Annual Report does not represent any kind of offer for the acquisition or sale of any type of securities of HSH Nordbank AG.

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