KEEP GOING.

INTERIM REPORT
AS AT 30 JUNE 2017

HSH NORDBANK

HSH NORDBANK GROUP AT A GLANCE.

INCOME STATEMENT
in (€ m)

	January – June 2017	January – June 2016
Net income before restructuring	278	395
Net income before taxes	173	171
Group net result	158	160

BALANCE SHEET
in (€ bn)

	30.06.2017	31.12.2016
Equity	5.1	5.0
Total assets	79.3	84.4
Business volume	87.6	93.2

CAPITAL RATIOS[1] & LEVERAGE RATIO
(%)

	30.06.2017	31.12.2016
CET1 ratio	18.9	14.1
Tier 1 capital ratio	23.2	18.7
Regulatory capital ratio	30.4	24.8
Leverage ratio	7.9	7.0

EMPLOYEES
(computed on full-time equivalent basis)

	30.06.2017	31.12.2016
Total	2,030	2,164
Germany	1,936	2,068
Abroad	94	96

LONG-TERM RATINGS

	Unguaranteed liabilities	Guaranteed liabilities[2]	Public-sector Pfandbriefe	Mortgage Pfandbriefe	Ship Pfandbriefe
Moody's	Baa3 dev.[3]	Aa1 stable	Aa2	Aa 3	Baa 2
Fitch	BBB– neg.	AAA stable	–	–	–

[1] According to the same period calculation under the CRR rules.
[2] Liabilities covered by guarantor's liability (Gewährträgerhaftung).
[3] dev.: Developing

Due to rounding, numbers presented throughout this document may not add up precisely to the totals provided and percentages may not precisely reflect the absolute figures.

GOALS ACHIEVED. KEEP GOING.

HSH NORDBANK'S figures for the first half of 2017 constitute a positive interim result: pre-tax profit amounted to € 173 million in the first six months; new business was up by 25 percent year on year to € 4.4 billion. Precisely this demonstrates HSH Nordbank's strong position in the fiercely contested German market as well as the Bank's capabilities ahead of its privatisation scheduled for 2018.

Yet not only the key figures are right: HSH Nordbank has significantly improved its internal processes and raised its efficiency in the past few years – the Core Bank is well-positioned in all respects. At the same time, the Bank has succeeded in drastically reducing legacy assets dating back to the time before 2009. With the Bank having shed legacy assets of ten billion euros in 2016 alone, it managed to cut this portfolio already by a further € 4.2 billion in the first half of 2017 and has further plans for the second half as well.

In a nutshell, HSH Nordbank is now a bank that is as dependable as it is profitable – and it's ready for a **SUCCESSFUL PRIVATISATION.**

CONTENT

Stefan Ermisch
Chief Executive Officer

STRONG AT THE MARKET.

"STRONG POSITION AMONG CLIENTS AND IN THE MARKETS"

HSH Nordbank is in a privatisation process that is drawing a lot of attention. How is business in this phase?
STEFAN ERMISCH It's going well. That's what our 2016 figures showed, which underpin our positive result for the first six months of 2017 with a pre-tax profit of € 173 million. Thereby, the 25 percent increase in new business to € 4.4 billion illustrates our strong position among clients and in the markets. Our CET1 ratio has reached a high level of 18.9 percent; our liquidity ratios are respectable. Disregarding the regulatory relief provided by the second loss guarantee, our indicative pro-forma CET1 ratio comes to 15 percent. In other words, our key ratios are at a good level, even without the guarantee. So it is evident that HSH Nordbank is increasingly becoming a normal, successful bank.

What do you mean by that?
STEFAN ERMISCH HSH Nordbank has now largely completed its restructuring – or, more accurately, its revamp – of the Core Bank; many tasks related to income and expenses are now ticked off, as we started tackling them at an early stage. Alongside our operating business, we are also continuing to develop the organisational side of the Bank.

What does that mean specifically?
STEFAN ERMISCH The Bank has become much more efficient; processes are secure and up to date. HSH Nordbank has developed tremendously. We can certainly be proud of what we have already achieved – privatisation is now the last step. HSH Nordbank is a forward-looking bank; it will prove to be a good business for an investor.

Is there already an investor?
STEFAN ERMISCH The sale process, which the federal states of Hamburg and Schleswig-Holstein are managing, is running on schedule; important key milestones have already been reached. There are a number of seriously interested parties, and we are currently providing them with a whole range of information. One thing should not be forgotten: in HSH Nordbank, there is a bank up for sale based in an economically attractive region in one of the world's most politically stable countries – this kind of opportunity does not come along very often.

What are the next steps in the sale process?
STEFAN ERMISCH Once the bidders have taken an in-depth look at our Bank, they will submit binding offers to the federal states by the end of October. The states will then negotiate with the interested parties to reach an outcome to this change of ownership, which is by no means a trivial matter, by the end of February 2018.

What makes HSH Nordbank appealing to a buyer?
STEFAN ERMISCH HSH Nordbank is broadly positioned; all its divisions offer potential for further expansion and have a very good customer base. A new owner will be able to take advantage of these good preconditions – freed from current restrictions due to EU requirements and exploit the potential of the bank. So there will be excellent opportunities for the buyer.

Which business areas do you mean specifically?
STEFAN ERMISCH With our high level of structuring expertise, we have been a major player in commercial real estate financing in Germany for a number of years. We have repositioned ourselves in our Corporate Clients division; we have reached very good market penetration and – this is important – we are equally successful in other parts of Germany. Our sector-by-sector approach is paying

off in this respect: in Renewable Energy, Infrastructure, Retail, Healthcare, Industry and Services, Wealth Management and other areas, clients value our outstanding expertise and industry knowledge. Another important part of the Bank is its Treasury & Markets division, in which its capital market functions are pooled — here we regard ourselves as service providers to our clients.

What about Shipping, in which the bank has traditionally been heavily involved?
STEFAN ERMISCH This division has become substantially smaller in the Core Bank, with a volume of € 6.1 billion, which makes it around half the size of the Real Estate Clients or Corporate Clients divisions. The weightings have shifted significantly. We are now only closing new business very selectively in this segment.

Why does Shipping no longer play such a big role?
STEFAN ERMISCH The shipping industry has been in a historic crisis for many years — a crisis of its own making, by over-expanding capacities. Nevertheless, shipping remains promising in the longer term because global trade, which is continuously growing, would be impossible without maritime transport. Furthermore, the sector is currently in a process of consolidation, which we support. We will remain faithful to shipping, though on entirely different foundations to the past — with keen risk awareness and a focus on successful domestic and foreign businesses with sustainable business models.

How difficult is it for a bank that is up for sale to gain new customers?
STEFAN ERMISCH Sure, this is a challenge for our sales department. We must address many — quite understandable — questions from our clients. We actively seek this dialogue and hold in-depth conversations — about the Bank's future, but also about our products. Of course, competitors are taking advantage of the situation to approach our clients. It is therefore all the more impressive that we increased our new business by about 25 percent to € 4.4 billion in the first six months of 2017 — the figure for the same period in 2016 was € 3.5 billion. 21 percent of this new business comes from new clients. That is an impressive proof of our operating strength and our good relationships with both new and existing clients, who are convinced by the Bank's performance and are remaining loyal to us. The same goes for our employees, who are doing excellent work.

Will HSH Nordbank be sold as a whole?
STEFAN ERMISCH The stated goal of our Majority shareholders, the federal states of Hamburg and Schleswig-Holstein, is to sell the bank as a whole. Most attention is certainly focused on the Core Bank, and the prospects for its sale are good. It is important to also find a solution for the Non-Core Bank, even though this is a tough undertaking that will test the limits of all parties involved. Generally speaking, the European Commission's requirements do provide for the possibility of partial sales.

STRONG AT THE CLIENT.

The Core Bank is profitable. But what about the Non-Core Bank, which has many loans in default on its books?
STEFAN ERMISCH It's true that the Non-Core Bank holds our legacy assets stemming from the period before 2009, and we are making good progress in reducing these assets. We cut ten billion euros' worth in 2016 alone. And we trimmed the portfolio by a further € 4.2 billion in the first half of 2017, which means we are already three quarters of the way towards our annual target after six months. The volume in the Non-Core Bank — and that does not only mean non-performing loans but also includes our non-strategic business portfolio — now stands at € 17.2 billion. We intend to reduce it to € 15.9 billion or even less by the end of the year. The NPE ratio in the Group dropped from 17.5 to 14.6 percent in the first six months of 2017. Another important point: We currently have slightly over 60 percent loan loss provisioning for our non-performing exposure (NPE) in the shipping business. That looks like a prudent amount for our present portfolio — not only to us, but also to rating agencies and analysts — and it allows us to forge ahead with the reduction of correlation risks from the past.

How do you rate the prospects of a successful change of ownership?
STEFAN ERMISCH Our profitable Core Bank is the bedrock of the privatisation. It will generate an appropriate purchase price. Yet any new owner will hardly wish to see a forward-looking bank weighed down by a synthetic capital guarantee dating back to 2009 and associated non-performing loans. I am in no doubt that our owners will fully assume their responsibility, as they too are striving to reach a positive and economically sustainable solution.

HSH NORDBANK EAD: EUR

NON-CORE BANK

- The Non-Core Bank includes non-strategic and non-performing assets (essentially legacy assets pre-2009), which are due to be wound down
- At present, loans from Shipping (51%), Real Estate Clients (16%) and Divestments (18%) dominate the Non-Core Bank's portfolio
- The NPE portion mainly comes under the guarantee
- High loan loss provisions for legacy assets of EUR -251 million and guarantee fees of EUR -70 million strain

EAD: EUR 17.2 BN
(net income before taxes: EUR -348 m)

OTHERS AND CONSOLIDATION

- Comprises segments not subject to reporting, staff functions and overall bank positions at group level
- Equity and liquidity portfolio (essentially the liquidity reserve)
- Result from restructuring and privatisation
- Allocation of material earnings components of the Transaction Banking product area to the market units

EAD: EUR 8.5 BN
(net income befor. taxes: EUR 15 m)

81.2 BN; (net income before taxes: EUR 173 million)

CORE BANK

- The Core Bank comprises the strategic market units and services of Treasury & Markets and Transaction Banking
- Major restructuring measures have created the present-day basis and organisational structure of the Core Bank, resulting in significant efficiency improvements
- Segments

CORPORATE CLIENTS
EaD EUR 14.2 bn

REAL ESTATE CLIENTS
EaD EUR 12.5 bn

SHIPPING
EaD EUR 6.1 bn

TREASURY & MARKETS
EaD EUR 22.6 bn

- Allocation of material earnings components of the Transaction Banking product area to the market units

EAD: EUR 55.5 BN (net income before taxes: EUR 506 m)

(EaD: Exposure at Default)

WORKS T

HSH Nordbank's success is based on a strong Core Bank in which our key business areas are pooled. As a bank for entrepreneurs, we are in especially close touch with our clients — which are mostly small and medium-sized enterprises.

REAL ESTATE CLIENTS

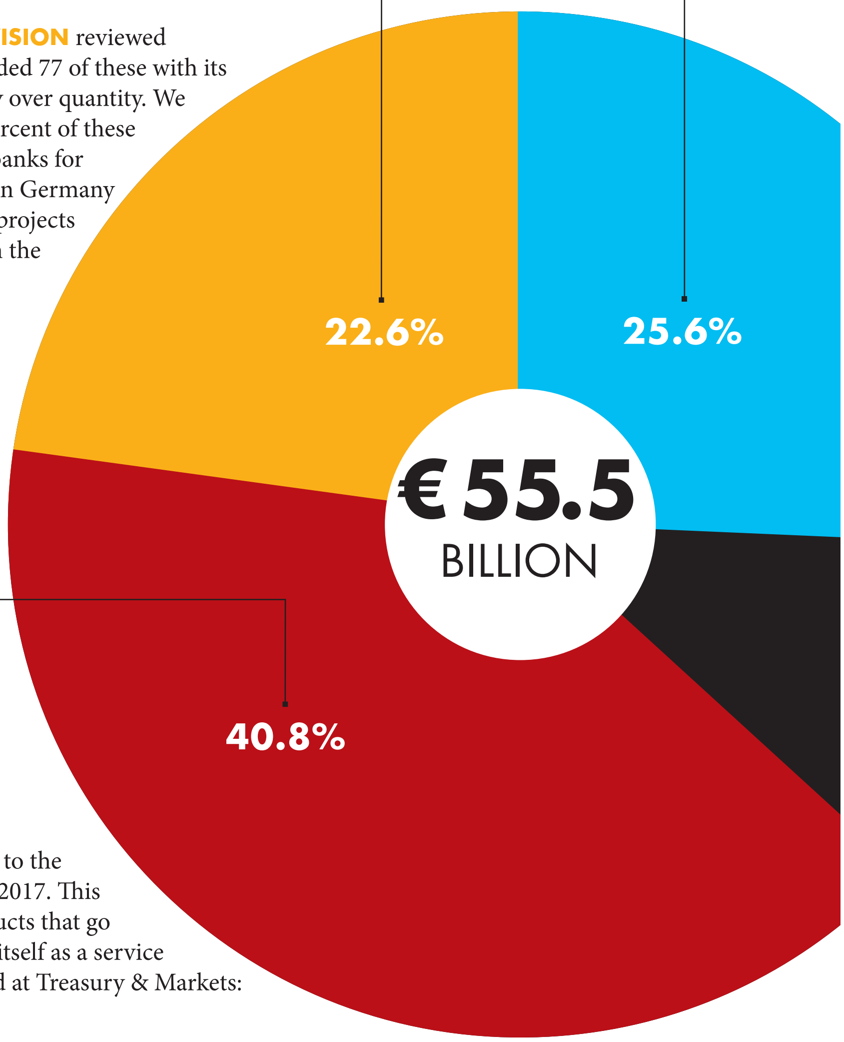
ON SECURE FOUNDATIONS

367 **TRANSACTIONS** our **REAL ESTATE DIVISION** reviewed merely in the first half of 2017 and concluded 77 of these with its eye on a good risk/return profile — quality over quantity. We succeeded in gaining new clients for 22 percent of these deals. All told, we are among the leading banks for financing commercial real estate projects in Germany and are frequently involved in innovative projects – such as the big Woodie accomodation in the Hamburg district of Wilhelmsburg and apartments for temporary living.

TREASURY & MARKETS

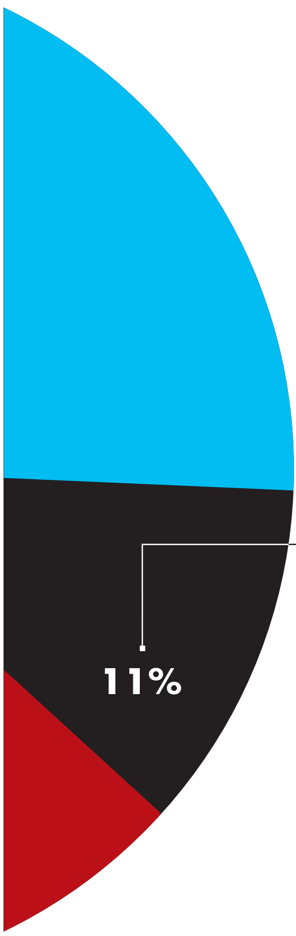
IDEAS FOR ALL

ABOUT EURO 100 **MILLION TREASURY & MARKETS.** contributed from its primary business to the Bank's total income in the first half of 2017. This division develops capital market products that go beyond pure loans and it also regards itself as a service provider within the Bank. Also located at Treasury & Markets: the activities involving our funding.



TOTAL VOLUME OF THE CLIENT BUSINESS OF THE CORE BANK
Percentage distribution on business divisions

OGETHER.



CORPORATE CLIENTS

FOCUSSED, SPECIALISED

EURO 1.64 BILLION of new business our **CORPORATE CLIENTS** division concluded in the first half of 2017 — an increase of 16 percent year on year. The new customers share thereby being 21 percent. In other words, our strategy with clearly defined focus sectors, including project finance involving Renewable Energy and Infrastructure, is paying off.

SHIPPING

NEW STANDARDS

70% of the Shipping portfolio in our Core Bank comprises foreign counterparties, 30 percent are domestic. Although **SHIPPING** is still an important division in our Core Bank with a volume of about six billion euros, this figure is sharply lower than it was in the past. At new business we are extremely conservative and put value on diversification and in-depth risk control. Shipping has good prospects in the long term — maritime transport is the backbone of growing global trade.

INTERIM MANAGEMENT REPORT

ECONOMIC REPORT

UNDERLYING MACROECONOMIC AND INDUSTRY-RELATED CONDITIONS

FIRST SIX MONTHS OF 2017 CHARACTERISED BY ELECTIONS IN EUROPE, A FRIENDLY ECONOMY AND ROBUST FINANCIAL MARKETS

The global economy made a good start to 2017. Growth is likely to have increased compared to the previous year, when the global growth rate was 3.1%. A higher pace of growth was seen in the USA, especially in the second quarter, whilst the upturn in the eurozone continued over the entire first six months of the year. China was able to slightly exceed the growth rate recorded in the first quarter of the previous year. The trend in most emerging countries was also positive, although crude oil prices decreased over the course of the year. The situation in the eurozone was eased by the pro-Europe outcome of the parliamentary elections in the Netherlands and parliamentary and presidential elections in France held in the first months of the year. However, heightened uncertainty still prevails regarding the Brexit process, after this was triggered in March 2017, and the Conservative Party in Great Britain has only a fragile basis on which to govern following its re-election. Political discussions were dominated by speculations regarding the economic and trade policy direction of the US President, Donald Trump, who took office in January 2017. The consolidation in the European banking sector has meanwhile continued with takeovers and resolutions of banks in Spain and Italy. The US Federal Reserve Bank used the good economic situation to increase the key interest rate a further two times. Trends in the financial markets have been generally favourable. Stock markets in particular recorded gains worldwide. There was no clear trend in government bond yields in the first half of the year, and they remained on balance at a low level. However, the euro appreciated against the US dollar.

STEADY GLOBAL ECONOMIC GROWTH

GDP in the USA increased by around 2% in the first half of the year, an acceleration compared to the previous year (1.6%). The growth was primarily driven by investments in plant and housing, which recorded a double-digit increase in the first quarter of 2017. Export trends were also good, whilst a decrease in public spending curtailed the growth rate. Employment increased by over 1 million and the unemployment rate decreased to 4.4% in the first six months of 2017. However, wage growth is only slowly recovering. Accordingly, inflation, which temporarily reached 2.7% due to the sharp increase in the oil price compared to the previous year, is currently below the inflation target of 2%.

China's GDP increased by 7.1% in the first half of 2017 according to preliminary information, a noticeably higher rate than in the previous year (2016: 6.6%). The high rate of growth is inter alia the result of government investment programmes and rapidly increasing real estate prices. India's growth increased at a similar rate in the first quarter of 2017. Russia's and Brazil's economies are again showing signs of a recovery following two years of a partially deep recession, even though the political situation, especially in Brazil, remains fragile.

The euro area has been experiencing a broad-based upswing. The four large national economies in the European Monetary Union grew in the first quarter of 2017 at rates between 0.4% and 0.8% compared to the previous quarter. The Purchasing Managers Indices (PMI) indicate that this trend has also continued in a similar vein in the second quarter. Compared to the previous year this represents a growth rate of just under 2% (previous year: 1.7%). The unemployment rate declined slightly from 9.5% in March 2017 to 9.3% in May 2017 and inflation pressure remained subdued, which is demonstrated by a reduction in the inflation rate in June 2017 to 1.3%. The political uncertainty was not able to visibly slow economic growth in the eurozone. The elections in the Netherlands in March and in France in the months of April to June ultimately resulted in greater political stability, as populist parties did not win majorities contrary to widespread fears, but rather pro-Europe parties and candidates were able to secure the most votes. The greatest uncertainty still surrounds Great Britain, which submitted its application to exit the EU at the end of March. However, the surprising call for a new general election in June 2017 weakened the government of Prime Minister Theresa May, such that it still remains unclear as to what institutional framework for the relationship between Great Britain and the EU is envisaged after the end of the negotiations.

Germany's robust growth in the first half of 2017 – evidenced by data for the first quarter and the most recent monthly indicators – was stimulated by brisk investment activity and a sharp increase in exports. In the first five months of the current year the amount of loans granted to non-finance companies was on average 3.4% higher than in the comparable period in the previous year.

SURPRISINGLY RESILIENT FINANCIAL MARKETS AND TO SOME EXTENT INCREASING INTEREST RATES

The US Federal Reserve continued to normalise its monetary policy and further raised its key interest rate in March 2017 and June 2017. The targeted fed funds rate is now in the range between 1.00% and 1.25%. The US Federal Reserve announced at the same time that it would soon start with the careful reduction of its total assets as part of its objective to normalise monetary policy. Following the sharp increase in government bond yields in the USA and eurozone at the yearend as a result of the election of Donald Trump as US President yields did not subsequently move in any clear direction despite the good economic situation. Ten-year US government bonds moved in a range between 2.12% and 2.63% (30 June 2017: 2.30%).

The trend in Europe was also volatile, even though the increasing optimism was reflected in higher yields in the middle of the year. The yield on ten-year German government bonds fluctuated in the first half of 2017 between 0.15% and 0.48%. The yield was 0.47% at the end of June. The nervousness in the run-up to the elections in the European Union, uncertainty regarding the direction of US economic policy and the monetary policy of the European Central Bank (ECB) are likely not least to have been responsible for the directionless trading, particularly in the spring.

The ECB purchased a monthly amount of EUR 80 billion of securities until March 2017, but reduced as planned the monthly purchases to EUR 60 billion from April 2017, which is to be continued to at least until the end of 2017. According to statements made by the ECB further reductions in interest rates are not expected, and there are also now increasing signs in Europe of a turnaround in monetary policy in light of the strong showing economy. There was a clear upward trend in the stock markets during the year. Since the beginning of the year the DAX has increased from 11,481 to 12,325 points on 30 June 2017 or by 7.4%. There had been discussions in the meantime regarding whether the technology sector, especially in the USA, may be overpriced, which resulted in temporary corrections. However, the political uncertainty this side and the other side of the Atlantic has hardly had any impact to date on the stock markets.

In the currency markets the euro appreciated sharply by 8.2% against the US dollar compared to the 2016 year end and was quoted at US dollar 1.14 at the end of June 2017. This also reflects the greater degree of political stability in the eurozone in addition to the good economic situation. The gradual progress made in consolidating the European banking sector is also likely to have helped the common currency. The oil price (Brent) has decreased by 14% over the first six months of the year. This is an evident reflection of the loss of power of OPEC to set pricing policies, which has so far not been able to stabilise prices despite significant output cutback measures.

UNEVEN TRENDS IN RELEVANT MARKETS

The first signs of of a recovery in the shipping markets became apparent in the first half of 2017. The trend in the container ship and bulker markets was above the low expectations. However, charter rates continued to decrease in the oil tanker market. The incipient recovery in charter rates was also reflected in an increase in ship values, although with some delay and to a lesser extent. Second-hand prices increased slightly especially in the container and bulker segment, which are not least relevant for the valuation methods to be applied to the restructuring portfolios.

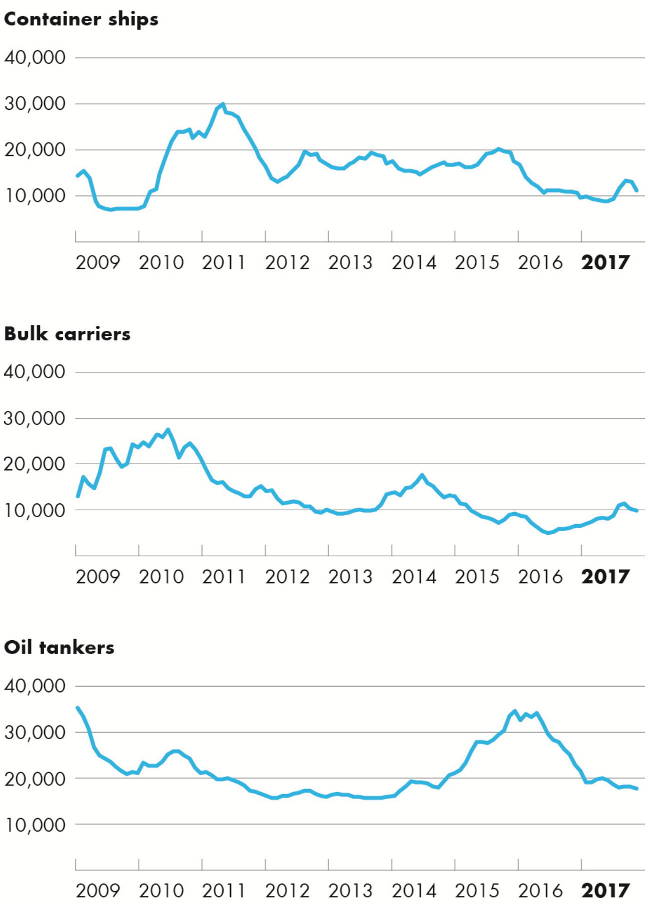
Charter rates in the container ship market recorded moderate increases in the spring and have left behind their all-time lows. Ship values have bottomed out with a slightly positive trend. The demand trend for container transport has been very dynamic in the first months of the year in line with the improved macroeconomic environment and was significantly better than in the previous year. This applies inter alia to both the important Asia-Europe route and trans-Pacific traffic. The ongoing consolidation on the part of shipping lines and the new alliance landscape that has been in place since April put the networks and timetables in the liner shipping service on a new basis and paves the way for a more efficient use of the fleet. On the supply side the growth in the fleet was pleasingly weak, as scrapping activities were brisk and the number of deliveries only slowly increased again in the early part of the year. There were also hardly any new orders in the first half of 2017. The number of laid-up ships has decreased markedly.

The upturn in the bulker sector, which was already apparent at the end of 2016, continued during 2017. Following the seasonal decrease in the spring rates and prices recovered and stabilised quickly. In general, the demand trend for iron ore and coal was encouragingly positive in the Asian region. A key factor driving this is the high level of demand in China, which is attributable to increasing steel production and the substitution of its own coal production. The growth in the bulker fleet has remained relatively constant due to the low level of new orders and a stable level of scrapping during the year. New orders for ships again decreased so that hardly any orders were observed in the recent past. Charter rates in all sub-segments were above the operating costs, but in many cases below the level required to service debt. Utilisation of both smaller and larger ships has risen due to the increase in transport volume in the bulker segment since the beginning of the year and the stable fleet development.

As expected, charter rates for oil tankers declined further in the first half of 2017. The production cutback implemented by the OPEC countries put a brake on the demand side, although the expansion of oil production via fracking in the USA counteracted a significant increase in the oil price. The fleet also continued to grow strongly. More and particularly large oil tankers were nonetheless again ordered over the last few months.

TREND OF TIME CHARTER RATES IN THE SHIPPING INDUSTRY

(Market average, USD/day)



Developments in the real estate markets in Germany continued to be mostly very positive in the first half of 2017. Rents and real estate prices continued to increase, primarily in the housing markets in large cities. Real estate prices in turn rose more sharply than rents due to the sustained low level of interest rates. Restrictions on rent increases for new lettings remained ineffective with respect to these.

Housing completions have increased sharply in the meantime and are close to meeting the still high demand for housing. The reduction in the already very low housing vacancy rates therefore slowed. Nevertheless, the markets in large cities were still characterised by excess demand. Demand for space in the office real estate markets remained high in the first half of 2017. Besides the growth in the number of office employees, this was also largely due to the increasing relocation of companies to more attractive properties. Office completions have not kept pace with demand, so that vacancy rates have decreased further. Rents – following the high level of increases in the previous year – rose only moderately at the beginning of the year and also not everywhere. However, high investor demand caused real estate prices to continue to increase sharply. At the beginning of 2017, rental growth in retail real estate markets remained mostly weak and rents stagnated in not infrequent cases. This also applied to prime rents in central 1a locations in large cities. Although retail stores continued to benefit from strong levels of private consumption, the sales growth generated was significantly less than the sustained above-average growth in e-commerce. This structural change was also reflected in the real estate prices. Although demand in the investment markets remained high, the price trend was for the most part only stable.

Trends in European office real estate markets in foreign markets were very mixed in the first half of 2017. Whilst some markets such as Stockholm and Madrid continued to recover, rent levels stagnated in many other regions due to the persistent high level of vacancies. Although the demand for space in the London office real estate market weakened compared to the previous year, it has remained relatively robust despite the fears regarding the effects of Brexit. Nevertheless, the vacancy rate increased due to the increase in completions. Rents and market values stagnated. However, market values increased significantly in the majority of the other European markets in view of the even higher investor demand.

Further progress has been made in the first half of 2017 in developing renewable energies. In Germany, new installations of onshore wind energy turbine generators in the first five months were nearly a quarter above that of the same period in the previous year, whilst there was a return to normal levels in the offshore sector.

Developments in the photovoltaic segment in Germany were very mixed in the first months of the year. Following a year-end rally in December 2016, the building of new installations collapsed at the beginning of 2017, but already recovered again in February.

The global project financing volume recorded a decrease for 2016 as a whole and, at around USD 400 billion, was (according to Dealogic) approximately 9% below the previous year's level. The downwards trend continued both globally and in Europe in the first quarter of 2017, whereby Germany and Great Britain were able to record – against the trend – a higher project financing volume compared to the same period in the previous year. Investment in transport infrastructure accounted for around 15% of the project financing volume in Europe. The major institutional investors include pension funds and insurance companies, which regard infrastructure investments as an investment alternative in the low interest rate environment. Revenues in the logistics sector were significantly stronger in the first three months of 2017 than in the same period of the previous year. Although the economic climate in the German logistics sector, which reached its best value in the first quarter of 2017 since the autumn of 2011, cooled down somewhat in the second quarter of 2017, and the business outlook has become significantly bleaker, the measured economic climate continues to remain above the long-term average and therefore still shows an expansive underlying trend.

The upswing in the German economy also continued at the beginning of 2017: production growth in the manufacturing industry in the period from January to April 2017 was almost at the same level of the same period in the previous year. Trends were uneven in the individual sectors. Whilst the chemicals and automotive sectors recorded a slight decrease in production volume, electronics, the metal and mechanical engineering sectors and companies in the pharmaceutical industry were even able to report strong growth in part. Production in the food industry also increased, albeit only moderately.

Companies in the wholesale sector recorded increases in sales in the first four months of 2017 compared to the same period in the previous year, in which a significant decrease was reported. The business-to-business sector comprising primary products and materials saw increases in sales in both nominal and real terms for the first time at the beginning of the year. Wholesalers for consumer-related goods also recorded growth. The sales trend in the retail sector also remained positive. Both the food retail trade and the other key segments of the retail sector increased their sales, whereby the growth in the first four months was less pronounced than in the same period in the previous year. Retail clothing recorded significant decreases in sales.

The health market is growing constantly, as well as the hospital market, as a result of demographic trends and medical advances. The financial situation of many hospitals remains strained despite increasing revenues. The Hospital Structures Act (Krankenhausstrukturgesetz), which entered into force at the beginning of 2016, should result in an increase in the profitability of hospitals over the medium term.

ENVIRONMENT FOR BANKS CONTINUES TO BE DOMINATED BY CHALLENGES

INDICATIONS OF AN IMPROVEMENT IN THE MARKET ENVIRONMENT

There are more and more signs of a gradual improvement in the market environment despite the continuing existing geopolitical uncertainties, particularly with regard to the future economic policy of the new US government, the associated fears of an increase in protectionism and the structure of Brexit under the EU exit negotiations. A more stable outlook for Europe was ensured by the encouraging election results in the Netherlands and France. The increasingly broad-based upturn in the global economy and the gradually growing indications for a steeper yield curve based on a future normalisation of the Fed's and ECB's monetary policy provide the basis for a recovery in the earnings prospects of banks – even though the path for a turnaround in monetary policy in Europe has so far not yet been taken. Against this backdrop share prices even of European banks continued to recover in the first half of 2017, but more moderately than those of US institutions due to the continuing low level of profitability.

In addition to the low interest rate phase that is lasting longer in Europe than in the USA, which puts pressure on the net interest income of banks due to lower earnings generated from the maturity transformation and lower interest earned on equity items, the European banking sector is also adversely impacted by structural weaknesses. These primarily include a continuing high volume of non-performing loans in Southern Europe, and among the large countries, particularly in Italy and Spain. Although the level of direct loan loss provisions recognised has decreased in the first half of the year given the gradual strengthening of the economy, the large portfolios of problem loans are putting pressure on the profitability and capital position of banks and may – in view of the associated uncertainty for investors – hinder consolidation efforts.

Nevertheless, there are also signs of movement here, which show that both the European banking regulator and political decision-makers want to drive forward the reduction in problem loans not least as part of constructive consolidation solutions. This resulted in takeovers of smaller banks by larger institutions in both Italy and Spain as part of resolution solutions. At the same time the interest, particularly on the part of financial investors, in playing an active role in the consolidation process seems to have increased. As, in the view of investors, the challenging market environment caused by the low level of interest rates, earnings weakness and intense competition also offers opportunities in addition to risks, which can be exploited by ongoing consolidation. This applies to both the purchase of problem loan portfolios and takeovers of smaller institutions. In total, these solutions should contribute in the future to a significant strengthening of the European banking market.

In view of the good macroeconomic situation in Germany the still challenging ship financing situation in particular, in addition to the earnings weakness, represented one of the key issues in the German banking market. Further charges had to be recognised by the providers of ship finance even after the high levels of loan loss provisions required in the previous year, as, despite the gradual signs of an upturn in parts of the shipping markets, the length of the crisis is draining the economic resources of borrowers.

Against the backdrop of the sustained profitability weakness the German banks in particular are under pressure to review their strategic direction, as the substantial pressure on earnings entails, in conjunction with the weak loan demand of German companies, the increasing risk that loan financing is not priced on a risk-commensurate basis. At the same time, expenses incurred in connection with the strict regulatory requirements in the form of high project and IT costs were reflected on the cost side. Against this backdrop many banks in addition to focusing their business models initiated comprehensive cost and efficiency programmes in order to be able to generate adequate returns on a sustained basis. In addition, consolidation within the sector may also be considered.

CORE ISSUES OF THE BANKING REGULATOR

Monitoring of banks by the banking supervisory authority has also been intensified by the expansion of the Banking Union and protection schemes. This applies particularly to the supervisory review and evaluation process (SREP) for banks directly supervised by the ECB. The ECB had already set out its priorities at the end of 2016 for the topics to be examined in detail in the 2017 SREP process based on the experience gained. The three areas of focus identified by the regulator are, firstly, a review of the business models and earnings drivers of banks, secondly, credit risk especially with regard to NPL portfolios, existing concentrations and the implications of the new IFRS 9 Accounting Standard and, thirdly, risk management. As part of its risk management the ECB has used elements from the reviews carried out in 2016 and combined them into new initiatives. These primarily concern the aggregation of risk data (BCBS 239), the use of internal risk models (TRIM), the appropriateness of capital and liquidity management processes (ICAAP and ILAAP) and the review of IT risks as part of 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.

Besides the challenging market environment, the banking market was also characterised 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 come into force as at 1 January 2016. This was due primarily to the different approaches applied to restructuring and resolution measures at Spanish and especially Italian banks. A harmonisation of national insolvency regulations is required in this regard, not least to provide greater transparency for investors and create in the future a uniform regulation in the European banking sector. However, the recent instances show, particularly with regard to the treatment of legacy assets, a rather pragmatic interpretation of the BRRD.

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 the first half of 2017. 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 is 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.

HSH NORDBANK'S BUSINESS IMPACTED BY UNDERLYING CONDITIONS

The demanding and highly competitive environment was also reflected in the Bank's business performance. Trends in markets relevant for the Bank were uneven in the first half of 2017. Whilst the real estate environment in Germany was largely positive, the situation in the shipping markets remained challenging. Even though there are increasing signs of an upturn, the length of the crisis is draining the economic resources of borrowers. In the Corporate Clients division, the solid liquidity base of clients and persistent low level of interest rates had a tangible impact in the continuing competitive environment. 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. Total new business concluded was significantly above that of the same period in the previous year. However, at the same time, lending margins also declined further in view of the highly competitive environment and are slightly below the previous year's and the planned ambition level.

The easing of the situation on the financial markets had an impact on the Bank's net assets and financial situation and particularly on net trading income. The significant depreciation and increased volatility of the US dollar against the euro since the beginning of the year also had an impact on earnings, net assets and the financial situation, even though the Bank's dependence on movements in the EUR/USD exchange rate has decreased significantly following the sale of non-performing loans primarily denominated in US dollars. This also tangibly relieved the pressure on the Bank's refinancing requirements and liquidity position.

As expected, the uneven trends in the relevant markets were also reflected not least in loan loss provisions. The Bank recognised high loan loss provisions in the first half of 2017 as planned for the legacy portfolios concerned due to the ongoing difficult sector trends in the shipping industry. On the other hand, the strong earnings situation, particularly in the real estate sector, 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 further reduced 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 substantial number of new regulatory requirements and charges incurred in 2016 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 PERFORMANCE – SIGNIFICANT DEVELOPMENTS AND EVENTS IN THE FIRST HALF OF 2017

POSITIVE INTERIM BALANCE AS AT 30 JUNE 2017

Developments of the HSH Nordbank in the first half of 2017 were marked in particular by the privatisation process, which is proceeding according to plan, and a satisfactory operating performance. The Bank has consistently continued its restructuring in line with the stated objectives and has thereby consequently created once again good underlying conditions for the ongoing privatisation. The good results of the Core Bank were again offset by high structural charges recognised in the Non-Core Bank. These structural charges were mitigated by the Bank through the realisation of unrealised gains.

The following topics should be highlighted with regard to the business performance in the first half of 2017:

- Privatisation: The Bank has strongly supported its owners in the privatisation process in the first six months of the year. Another important milestone was reached with the submission of expanded indicative bids as at 30 June 2017.
- Core Bank: New business volume was in line with the plan in the first half of 2017 and, with a +25% increase as at 30 June 2017, is significantly above that of the same period in the previous year, which is also attributable to a stable customer base as at the reporting date. The Bank was again successful in this current challenging phase in expanding client relationships and thereby further strengthening the Core Bank's operating base. The focus was on acquiring new business with an earnings and risk profile appropriate in the current competitive environment.
- Wind-down portfolio: The implementation of the winding down strategy is progressing rapidly within the narrow limits set by the second loss guarantee. As part of the restructuring and termination of onerous legacy exposures the Bank is systematically reducing its NPE volume and to some extent existing concentration risks. As expected, the high NPE ratio caused by the legacy assets decreased to 14.6%. Based on the previous progress made the Bank is confident that it can at least achieve the winding-down target set for legacy assets of around € 5.5 billion (EaD in the Non-Core Bank) in 2017.
- Cost programme: The planned potential for cost savings is being leveraged consistently within the guidelines; administrative expenses were reduced noticeably by 11% to € 246 million as at 30 June 2017.
- Capital and liquidity: Key management indicators for capital and liquidity are still at a high level. The Bank anticipates in its reporting any future developments in the privatisation process and possible regulatory requirements and discloses an indicative Pro-Forma CET 1 ratio, which is calculated excluding the regulatory effect of the relief under the second loss guarantee (see explanatory comments set out in the "Capital and funding" section). This amounted to 15% as at the reporting date and was therefore significantly above the ambition level of 13%.

Overall, the Bank closed the first half of 2017 satisfactory with a net income before taxes of € 173 million for the first half of 2017. At the same time, operating activities were expanded and targeted potential cost savings achieved. In this way, the necessary conditions are created to provide optimal support to the inherently complex privatisation process, which is taking place in a delicate balance between the forward-looking Core Bank and the considerable burdens resulting from the legacy loans held in the Non-Core Bank as well as the associated second loss guarantee.

THE PRIVATISATION PROCESS IS PROGRESSING RAPIDLY

Under the formal decision reached in the EU state aid proceedings HSH Nordbank is to be sold by 28 February 2018. Against the backdrop of this privatisation the Bank has been systematically implementing structural, organisational and personnel measures for about a year. All these measures contribute to an improvement in the Bank's financial and risk situation and should form the basis for a sustainable structure and viable business model to be characterised by increasing capital ratios, good liquidity indicators and increased efficiency.

The official part of the privatisation of HSH Nordbank started with the announcement of the sale by the federal state owners, which was published on 23 January 2017. Since then the privatisation process has been proceeding at a rapid pace in line with the plan. After an initial data room phase on 30 June 2017 interested investors submitted expanded indicative bids, thereby reaching a decisive milestone in the privatisation process. In this regard, the federal state owners stated in its announcement of 2 July 2017 that bids expected by the federal states had been submitted on time and, after an initial review, form a good basis for successfully continuing the sale process.

After determining the bidders, who would go forward to the next stage of the privatisation, these received more detailed information in the data room. Binding bids are to be submitted in the autumn of 2017, on the basis of which the final agreement negotiations are to be conducted.

The present exchange between potential investors and the federal state owners will be further intensified over the coming weeks. Of particular importance in this regard are key issues such as important aspects of the capital structure, the guarantee and related legacy assets on the one hand and a sustainable outlook for the Core Bank on the other, which will need to be discussed between potential investors and the federal state owners.

If the sale of the Bank as a whole cannot be achieved, a large number of possible privatisation solutions, which could include structured sub-bank solutions in addition to the envisaged sale of the Bank as a whole, will therefore have to be assessed in the discussions between the federal state owners and interested investors to achieve a successful privatisation from the viewpoint of all stakeholders. This also applies not least given the requirement that the viability review of the new corporate structure carried out by the EU Commission at the end of the privatisation process is positive.

SUSTAINED POSITIVE DEVELOPMENT OF NEW BUSINESS

The Bank has vigorously driven forward its operating business in the reporting period in line with the plan The focus was on acquiring new business with an appropriate risk/return profile in a market environment that continues to face challenges. New business in the Core Bank performed well in the first six months of 2017 and is still in line with expectations. It amounted to € 4.4 billion and substantially exceeded the volume generated in the same period in the previous year (€ 3.5 billion).

Broken down by segment, new business generated in the Real Estate division was markedly higher than in the same period in the previous period and the plan amount due to its good market positioning. New business generated in the Corporate Clients division also increased compared to the same period in the previous year. However, it has not yet been possible to fully achieve the planned development due to the continuing intense competition. The targeted management of the risk profile in the Shipping segment generally results in extremely selective new business being transacted in this division.

The ratio of new loans disbursed to new business concluded (disbursement ratio) improved slightly compared to the previous quarter. Interest margins achieved in the highly competitive environment decreased slightly and are currently still below the ambition level. Cross-selling net income generated by various banking services over and above loan financing was at a satisfactory level in the first half of 2017 and once again well above expectations. Investment products, loan commissions and income arising from the client derivatives business made a significant contribution to this.

STRINGENT ENFORCEMENT OF THE WINDING-DOWN STRATEGY

Following the sharp reduction in the previous year the winding-down of the legacy assets was also rigorously continued in the first half of 2017. Compared to 31 December 2016 the NPE volume was reduced significantly in line with the focussed winding-down strategy, which provides for a decrease of € 5.5 billion in the legacy asset portfolio (EaD in the Non-Core Bank). This also resulted in a marked reduction in the NPE ratio.

In addition to the active winding down of the portfolio by sales of single financing transactions portfolio transactions were also executed in the reporting period. The focus remains in particular on winding down the non-performing shipping financing transactions in a continuing very difficult market environment. Different strategic options – also for reducing risk concentrations – are considered and implemented as part of the restructuring measures.

With regard to the portfolio sales in the market, which were agreed as part of the EU structural measures and can amount to up to € 3.2 billion (EaD), around € 2.5 billion of the selected portfolio has been actually sold or repaid, of which € 1.64 billion was attributable to the first tranche of the market portfolio, which mainly included aircraft financing transactions and continental European commercial real estate loans. A further € 0.7 billion was achieved as part of other portfolio sales (energy financing transactions) and by the winding down of a large real estate commitment. Further sales of around € 0.2 billion have been signed after the reporting date.

In general, HSH Nordbank manages the consistent and sustained reduction in the non-performing loan in accordance with its winding-down strategy, which includes numerous underlying conditions. In addition to regulatory and portfolio-specific aspects, these also include the restrictive provisions of the guarantee agreement that limit in principle HSH Nordbank's options for managing the NPE. In the Non-Core Bank – in which the legacy loans covered by the second loss guarantee are primarily bundled – the Bank pursues a clearly defined strategy for the non-strategic and for the most part non-performing old business that is separated from the core business. The Bank sets realistic, but at the same time ambitious, targets for the reduction in the NPE portfolio with a view to the underlying conditions to be taken into account. This is also still too high due to the complex settlement conditions under the guarantee agreement and the low level of relief provided by the EU decision in relation to the total NPE volume; the systematic winding down of the NPE portfolio will be continued.

Depending on the individual case HSH Nordbank has different strategic options at its disposal for implementing the winding-down strategy:

- Recovery strategies: Under these, the NPE commitments are worked on with the objective of transferring them back from the default to the non-default business. Different restructuring instruments such as deferrals, waivers of receivables and strengthening of collateral are used to improve the risk profile over the medium and long term.
- Active winding down of the portfolio: The focus here is on the full derecognition of the NPE commitment. This is achieved at the level of individual commitments mainly by repayments made by clients or sales of loans or assets. Alternatively, portfolio sales transactions are executed, to which the implementation of portfolio sales in the market belong.
- Structured solutions: These are strategy options for asset-based financing transactions, which generally result in a change in the ownership of the assets and are used especially in the shipping sector. The objective is, among other things, to support the necessary market consolidation through creating marketable entities.

Further details on the EU decision and the EU structural measures as well as their impact on HSH Nordbank are set out in the Group Management Report as at 31 December 2016 and in the "Forecast report including opportunities and risks" subsection of the "Forecasts, opportunities and risks report" section in this Interim Management Report.

CONSISTENT PURSUANCE OF THE COST PROGRAMME

The increasing pressure on earnings in the highly competitive banking market and increasing costs for regulatory requirements are being countered by the ongoing cost reduction programme. Furthermore, significant additional costs incurred in connection with the privatisation (including legal and advisory services, data rooms) and the restructuring of material commitments in the Non-Core Bank have to be currently born.

The Bank made progress in the first half of 2017 in line with the plan in implementing measures for controllable operating expenses. The expected potential for cost savings based on the optimisation of the organisation and processes that has been implemented was realised accordingly. The targeted management of operating expenses contributed to the reduction, in particular in project costs, building costs and other personnel-related operating expenses. In the case of personnel expenses, the planned reduction in headcount has already been contractually agreed for the most part with the employees and the ambitious personnel expense targets achieved.

EQUITY HOLDINGS AND SCOPE OF CONSOLIDATION

The Bank has sharply reduced its equity holding portfolio over the past years. As at 30 June 2017 the scope of consolidation for the Group financial statements included, in addition to the parent company, HSH Nordbank AG, 55 fully consolidated subsidiaries compared to 57 fully consolidated subsidiaries as at 31 December 2016.

Major additions to the scope of consolidation relate to five single-ship companies included in the 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 result from the realisation of collateral as part of restructuring measures carried out for a loan commitment. As part of this realisation of collateral HSH Nordbank transferred the shares in the five single-ship companies pledged to it to another party, which holds such shares on behalf of HSH Nordbank on a fiduciary basis.

Disposals relate to DEERS Green Power Development Company S.L., Madrid, and Solar Holding S.à.r.l., Luxembourg, companies no longer included in the consolidated financial statements and 6 companies from the Micro Group (single-property companies in the real estate sector). These disposals result from the sale of shares and loan receivables as part of the market portfolio transaction.

Further details on the scope of consolidation are set out in Note 4 (Consolidation Principles) in the Group explanatory notes.

MANAGEMENT SYSTEM AND DEFINED MANAGEMENT INDICATORS OF THE IFRS GROUP

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. The Bank uses a risk-adjusted key indicator and ratio system for this purpose that ensures that the Overall Bank, Core Bank and Non-Core Bank are 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) and the relevant prudential rules, respectively.

Within the management reporting framework the Bank focuses on the most important management indicators for the individual value drivers of the IFRS Group. On the one hand, the focus is placed on the change in these key indicators compared to the same period in the previous year and, on the other, on their expected change over the remainder of 2017.

Further information on the management system and defined management indicators of the HSH Nordbank Group, Core Bank and Non-Core Bank is set out in HSH Nordbank's Group Management Report for the 2016 financial year in the "Management System" subsection in the "Basis of the Group" section.

EARNINGS, NET ASSET AND FINANCIAL POSITION

NET INCOME OF CORE BANK EXCEEDED EXPECTATIONS

The Core Bank, which comprises the strategic portfolios of the Corporate Clients, Real Estate, Shipping and Treasury & Markets segments, generated net income before taxes of € 506 million for the first half of 2017, which is significantly above that of the previous year (same period in the previous year: € 342 million). All segments made a positive contribution to the overall good earnings performance.

Total income of the Core Bank amounted to € 684 million and is significantly above the previous year's value of € 571 million. On the one hand, the increase in net interest income to € 538 million, which reflects in particular the slightly above-plan trend in net interest income from operating interest income and the planned effects of the realisation of unrealised gains through the sales of promissory note loans of € 307 million (thereof € 271 million disclosed under net interest income, € 21 million under net trading income and € 15 million under net income from financial investments), contributed to this. On the other hand, net trading income, which includes earnings contributions from the operating client business, the management of key liquidity and market price risks and measurement effects arising on client derivatives and assets measured at fair value, made a significant contribution of € 93 million.

The good quality of the Core Bank portfolio with a low NPE ratio of 1.6 % is the reason behind the low loan loss provision expense, which amounted in total to € 1 million (same period in the previous year: € – 33 million) after taking account of reversals of loan loss provisions recognised in previous periods. Taking account of the compensation and including currency effects income of € 9 million (same period in the previous year: € – 12 million).

The ongoing cost reduction programme was also implemented in the Core Bank in line with the plan. Administrative expenses amounted to € – 160 million and were significantly below the same period in the previous year (€ – 172 million). The Core Bank results were adversely impacted by expenses for the bank levy and deposit guarantee fund as well as for government guarantees totalling € – 35 million. Around € – 10 million or 12.5 % of the total guarantee expenses is attributable to the Core Bank, as the portfolios in the Core Bank covered by the second loss guarantee only have a low capital commitment.

CONTINUING HIGH LEVEL OF LOAN LOSS PROVISIONS IN THE NON-CORE BANK

As expected for structural reasons, the Non-Core Bank, in which non-performing loans earmarked for winding down are combined, disclosed a net loss of € – 348 million as at 30 June 2017 (same period in the previous year: € – 41 million). As expected, high loan loss provision expense of € – 381 million (same period in the previous year: € – 488 million) contributed in particular to this result. This expense is mainly accounted for shipping loans held in the legacy loan portfolio and by a few individual cases in the energy wind-down portfolio. They were compensated for in the guaranteed portfolio up to the full balance sheet utilisation. On the other hand, loan loss provisions recognised in the Non-Core Bank's real estate portfolio were reversed. After taking account of the compensation as well as including currency effects and the hedging effect of the credit derivative, loan loss provision expense recognised in the Non-Core Bank amounted to € – 251 million after the guarantee effect (same period in the previous year: € 157 million). Due to the full balance utilisation of the second loss guarantee loan loss provisions recognised were no longer fully compensated, which made a significant contribution to the increase in the loss in the Non-Core Bank.

The net loss also includes administrative expenses of € – 95 million (same period in the previous year: € – 100 million) and expenses for the second loss guarantee of € – 70 million (same period in the previous year: € – 113 million). This loss is also attributable to the continued winding down of the portfolio, the related loan loss provisions and setting of loans to a non-accrual basis as part of the recognition of loan loss provisions. This resulted in a further reduction in the interest-bearing loan volume and a corresponding sharp fall in net interest income. Total income of the Non-Core Bank amounted to € 49 million (same period in the previous year: € 14 million).

OVERALL SATISFACTORY GROUP PERFORMANCE

Group net income 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, was satisfactory in overall terms in the first half of 2017. It amounted to € 173 million as at 30 June 2017 and was at the previous year's level (30 June 2016: € 171 million) and in line with expectations. Group net income after taxes amounted to € 158 million (same period in the previous year: € 160 million).

The Core Bank's strategic business divisions including the effects arising from the realisation of unrealised gains on the sale of promissory note loans made a relevant positive contribution to this result. It was therefore possible to more than offset the considerable financial burdens in the Non-Core Bank, which stem from the legacy assets originating in years prior to 2009 and the high level of guarantee, restructuring and privatisation expenses.

A high amount of impairment losses also had to be recognised again in the first half of 2017 for loans held in the Non-Core Bank to take account of the continuing difficult market conditions, especially in the shipping industry. Loan loss provision expense including the hedging effect under the second loss guarantee and credit derivative (as a component of the second loss guarantee) amounted in total to € –241 million (same period in the previous year: € 151 million). Due to the full balance sheet utilisation of the second loss guarantee in the first quarter of 2017 loan loss provisions recognised in the reporting period were no longer fully compensated.

Administrative expenses amounted to € –246 million as at 30 June 2017 (same period in the previous year: € –277 million). The cost-saving potential planned as part of the ongoing cost reduction programme continued to be realised as expected. In addition, earnings were adversely impacted by increased restructuring and privatisation expenses of € –25 million, (same period in the previous year: € –98 million), which were incurred due to the planned personnel measures and as a result of the preparations for the privatisation process, primarily for legal and advisory services and data rooms.

The return on equity for the Group calculated on the basis of net income before taxes amounted to 6.9%, which is appreciably above plan (31 December 2016: 2.5%). The cost/income ratio was 30.5% (31 December 2016: 64.8%) and is therefore at a significantly better level compared to the plan.

Besides the difficult shipping markets, the complex settlement conditions under the guarantee agreement has had a detrimental effect on the rapid winding down of non-performing legacy loans. As expected, the NPE ratio decreased significantly in the first half of 2017. It amounted to 14.6% as at 30 June 2017 compared to 17.5% as at 31 December 2016. This decrease is mainly attributable to the disposal of a part of the NPE portfolio sold in the market by the Bank in the first half of 2017. Market portfolio sales outstanding and further winding-down measures should further reduce the NPE portfolio and thereby the NPE ratio, which overall is still too high, in the second half of 2017.

As expected, the coverage ratio increased to 55.6% as a result of the loan loss provisions recognised in the first half of 2017 (31 December 2016: 48.4%). It reflects a continuing solid coverage of the total NPE portfolio. However, the Bank expects that the coverage ratio will decrease moderately again during the course of the NPE winding-down measures to be taken in the second half of 2017. The coverage ratio in the shipping portfolio was 61.1% (31 December 2016: 59.8%).

The core Tier 1 capital ratio (CET 1 ratio) amounted to 18.9% as at 30 June 2017 (31 December 2016: 14.1%) and has therefore reached a high level. The change compared to 31 December 2016 mainly reflects the successful NPE winding down of real estate commitments as part of the market portfolio sales, the weak USD exchange rate, which is significantly below expectations, and the results for the first half of the year. Excluding the regulatory effect of the relief provided under the second loss guarantee the indicative Pro-Forma CET1 ratio is 15% (see explanatory comments set out in the "Capital and funding" section), which is therefore also above the ambition level of around 13%. The liquidity ratios (survival period: 9 months, LCR: 208% and NSFR: 109%) are above the plan amounts and are once again at a very good level.

Further details underlying the business performance are given below in the "Earnings, net assets and financial position" and "Segment results" sections.

KEY GROUP MANAGEMENT INDICATORS

	30.06.2017	31.12.2016 (30.06.2016)
Net income before taxes (€ m)	173	121 (171)
CIR	30.5%	64.8% (47.4%)
RoE	6.9%	2.5% (7.0%)
NPE ratio	14.6%	17.5%
Coverage ratio	55.6%	48.4%
CET1 ratio	18.9%	14.1%
Survival period	9 months	10 months
LCR	208.0%	229.0%
NSFR	109.0%	111.0%

EARNINGS SITUATION

INCOME STATEMENT

(€ m)	**January – June 2017**	January – June 2016	Change in %
Interest income	1,786	1,846	– 3
Negative interest on investments and derivatives	– 147	– 79	86
Interest expense	– 1,175	– 1,399	– 16
Positive interest on borrowings and derivatives	149	69	> 100
Net income from hybrid financial instruments	– 56	– 63	11
Net interest income	**557**	**374**	**49**
Net commission income	32	50	– 36
Result from hedging	– 9	2	> – 100
Net trading income	151	40	> 100
Net income from financial investments	26	74	– 65
Net income from financial investments accounted for under the equity method	2	1	100
Total income	**759**	**541**	**40**
Loan loss provisions in the lending business	– 152	559	> 100
Hedging effect of credit derivative under the second loss guarantee	– 89	– 408	78
Administrative expenses	– 246	– 277	– 11
Other operating income	47	43	9
Expenses for bank levy and deposit guarantee fund	– 41	– 63	– 35
Net income before restructuring and privatisation	**278**	**395**	**– 30**
Net income from restructuring and privatisation	– 25	– 98	74
Expenses for government guarantees	– 80	– 126	– 37
Net income before taxes	**173**	**171**	**1**
Income tax expenses	– 15	– 11	36
Group net result	**158**	**160**	**– 1**
Group net result attributable to non-controlling interests	–	–	–
Group net result attributable to HSH Nordbank shareholders	158	160	– 1

Total income increased, net interest income from operating activities and realisation of unrealised gains have positive effect

Total income increased significantly to € 759 million in the first half of 2017 compared to € 541 million in the same period in the previous year. Interest income from operating activities as well as the realisation of unrealised gains totalling € 307 million (thereof € 271 million disclosed under net interest income, € 21 million under net trading income and € 15 million under net income from financial investments) made a considerable positive contribution. The following developments in the individual income line items were significant:

Net interest income of € 557 million (same period in the previous year: € 374 million) contributed to total income. On the one hand a noticeably positive contribution was made by slightly above planning interest income from operating activities and, on the other hand, by effects in line with planning of realisation of unrealised gains on the sale of promissory note loans of around € 271 million (same period in the previous year: € 106 million). This means that a large part of the sales of securities planned for the whole of 2017 has already been concluded in the first half of the year. The interest-bearing loan volume fell short of the previous year's volume due to anticipated developments in the Non-Core Bank.

Net commission income amounted to € 32 million as at 30 June 2017 compared to € 50 million in the same period in the previous year. This reduction was primarily due to the premium expense for the synthetic securitisation transaction executed in the fourth quarter of 2016. However, cross-selling income was positive and well above the pro-rata plan.

Net trading income made a significant contribution of € 151 million to total income in the first six months of 2017 (same period in the previous year: € 40 million). It was positively impacted by net foreign currency income (€ 46 million), increases in value in the credit investment portfolio (€ 42 million), operating successes achieved in the client business (€ 53 million including hedging effects) and measurement effects in the derivatives area (€ 32 million). Net trading income was adversely impacted by € – 19 million relating primarily to the measurement of EUR/USD basis swaps. In accordance with the list of conditions and commitments of the first EU decision of 20 September 2011 the Bank does not engage in proprietary trading.

Net income from financial investments amounted to € 26 million and mainly comprises increases in value in the credit investment portfolio (€ 20 million). This amounted to € 74 million in the same period in the previous year and was mainly driven by the gains realised on the sale of securities.

Continuing high level of loan loss provisions

Loan loss provisions for the first six months of 2017 continued to be dominated by a high level of additions in the legacy loan portfolio, which, as the reference portfolio, falls under the second loss guarantee. This additional loan loss provision expense was recognised for legacy portfolio in the shipping portfolio to take further account of the very difficult market developments, which were reflected in even lower charter rates and ship values. Furthermore, loan loss provisions were recognised in the Non-Core Bank's energy portfolio, whereas the risk trend in the other segments remained insignificant. The real estate customer portfolio was characterised by reversals of loan loss provisions based on loan principal repayments and improved risk assessments.

In total, loan loss provision expense amounted to € – 379 million as at 30 June 2017 (same period in the previous year: € – 520 million) before taking account of the compensation under the guarantee. Additions to loan loss provisions were significantly below the previous year, but nevertheless are still at a high level and within expectations.

The additional loan loss provisions recognised in particular for legacy portfolios were no longer fully compensated for as at the reporting date 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 under the second loss guarantee of € – 89 million (same period in the previous year: € – 408 million) and including currency effects and after compensation through the second loss guarantee the total loan loss provision expense amounted to € – 241 million (same period in the previous year: income of € 151 million).

The second loss guarantee of € 10 billion has been fully utilised 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 € 3.4 billion.

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 accordingly represented a significant burden for the capital base in the restructuring period.

Further reduction in administrative expenses

Administrative expenses amounted to € –246 million in the first half of 2017 (same period in the previous year: € –277 million). The marked reduction is attributable to savings realised in line with the plan under the ongoing cost reduction programme for controllable personnel and operating expenses.

Personnel expenses, which decreased significantly from € –129 million to € –113 million, were impacted by the further decrease in the number of employees as part of the planned headcount reduction. Compared to the end of 2016, the number of employees within the Group declined further by 134 to 2,030 (calculated on a full-time equivalent (FTE) basis).

Operating expenses (excluding depreciation/amortisation) decreased to € –124 million compared to € –132 million in the same period in the previous year. Savings resulted mainly from the reduction in project costs, building and other personnel-related expenses. These savings continued to be offset by high costs incurred in implementing regulatory and accounting requirements.

Depreciation of property, plant and equipment and amortisation of intangible assets amounted to € –9 million (same period in the previous year: € –16 million). of which € –3 million is accounted for by unplanned impairment losses recognised as part of the revaluation of aircraft included in the consolidation against the backdrop of the sale relating to the market transaction.

Other earnings line items

Other operating income amounted to € 47 million (same period in the previous year: € 43 million) and mainly includes income from cost reimbursements and reversals of provisions. It also includes effects arising from the change in the scope of consolidation. Details on the scope of consolidation are set out in Note 4 (Consolidation Principles) in the Group explanatory notes.

The results for the first half of the year were adversely impacted by the 2017 annual contributions of € –41 million for the bank levy and deposit guarantee fund (same period in the previous year: € –63 million).

High restructuring and privatisation expenses

Earnings were adversely impacted to a noticeable extent by restructuring and privatisation expenses of € –25 million (same period in the previous year: € –98 million), incurred in connection with planned personnel measures and charges relating to the privatisation process (including costs for advisory services, data rooms and audit activities).

Reduction in base premium expense

The base premium expense for the second loss guarantee amounted to € –80 million for the first six months of 2017 (same period in the previous year: € –126 million). The reduction in the base premium is attributable to the increase in the drawdown of the second loss guarantee. As part of the EU decision the base premium was reduced from 4 % to 2.2 % and the calculation basis changed from 1 January 2016. Under this, 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.

Overall satisfactory Group net income

After taking account of the operating performance and against the backdrop of the realisation of unrealised gains HSH Nordbank generated positive net income before taxes of € 173 million as at 30 June 2017, which was in line with the expectations (same period in the previous year: € 171 million). After deducting tax effects there remains a Group net income of € 158 million (same period in the previous year: € 160 million).

The income taxes line item comprised current tax expense of € 15 million and deferred tax expense of € –30 million.

NET ASSETS AND FINANCIAL POSITION

MATERIAL ITEMS ON THE STATEMENT OF FINANCIAL POSITION

(€ m)	30.06.2017	31.12.2016	Change in %
Assets			
Cash reserve	6,544	3,491	87
Loans and advances to banks	3,404	4,192	– 19
Loans and advances to customers	46,001	50,910	– 10
Loan loss provisions	710	1,142	– 38
Credit derivative under the second loss guarantee	113	199	– 43
Trading assets	4,331	5,433	– 20
Financial investments	15,323	15,493	– 1
Non-current assets held for sale and disposal groups	1,021	1,382	– 26
Other assets	1,863	2,123	– 12
Total assets	**79,310**	**84,365**	**– 6**
Liabilities			
Liabilities to banks	9,515	9,501	–
Liabilities to customers	39,928	40,172	– 1
Securitised liabilities	14,306	16,624	– 14
Trading liabilities	4,705	5,981	– 21
Liabilities relating to disposal groups	45	65	– 31
Subordinated capital	2,569	3,536	– 27
Equity	5,111	4,950	3
Other liabilities	3,131	3,536	– 11
Total equity and liabilities	**79,310**	**84,365**	**– 6**

Reduction in total assets

Total assets decreased significantly in the first six months of 2017 to € 79,310 million (31 December 2016: € 84,365 million).

All material line items on the asset side of the balance sheet decreased. Compared to the previous year end the cash reserve increased to € 6,544 million (31 December 2016: € 3.491 million). Liquidity inflows from portfolio sales and maturities of securities contributed to this. Loans and advances to banks decreased and amounted to € 3,404 million (31 December 2016: € 4,192 million). This mainly reflected the reduction in overnight deposits placed by other banks. Loans and advances to customers also declined to € 46,001 million (31 December 2016: € 50,910 million). New business concluded in the Core Bank was more than offset primarily by the planned reduction in the Non-Core Bank, which also included portfolio sales.

Loan loss provisions of € 710 million (31 December 2016: € 1,142 million) disclosed on the balance sheet (after taking account of compensation effects) are also positive as at 30 June 2017 due to the existing payment claims against the guarantor, HSH Finanzfonds AöR. The hedging effect of partial guarantee Two is disclosed under the “Credit derivative under the second loss guarantee” line item in the statement of financial position. The fair value of the credit derivative amounted to € 113 million as at the reporting date (31 December 2016: € 199 million). The decrease is caused by the reduction in the hedged portfolio and the related progress made in settling losses.

Trading assets decreased to € 4,331 million (31 December 2016: € 5,433 million). In addition to the securities position the positive fair value of derivatives in trading assets also decreased. Financial investments recorded a slight decrease to € 15,323 (31 December 2016: € 15,493 million), which was mainly attributable to the reduction in securities portfolios.

Around € 2.3 billion of the € 3.2 billion portfolio sales in the market originally agreed with the EU Commission was sold or repaid in the first half of 2017. Around € 2 billion of this amount had been derecognised as at the 30 June 2017 reporting date. The following individual transactions were executed:

– Aircraft financing transactions (of around € 0.8 billion EaD) and continental European commercial real estate loans (of around € 0.5 billion EaD) were sold (signing) in January 2017.
– Additional relief of around € 0.8 billion (mainly real estate) was generated by HSH Nordbank by individual sales to other investors and principal repayments within the portfolio originally held for sale.
– Real estate transactions of around € 0.5 billion (EaD) and a portion of the aircraft financing transactions of € 0.5 billion (EaD) were closed in March 2017 and April 2017, respectively.
– A portfolio transaction relating to the sale of solar financing transactions of around € 0.2 billion (EaD) was signed in May. The closing took place in June 2017.
– A further transaction was realised in August 2017, which is described in detail in the Report on events after the reporting period and in Note 2 .

The Non-Core Bank's portfolio was also further reduced in line with the plan, whereas new business developments were satisfactory, especially in the Real Estate division, and had an offsetting effect.

On the liabilities side, liabilities to banks remained virtually stable at € 9,515 million (31 December 2016: € 9,501 million). Whereas repurchase agreements increased slightly, overnight deposits held at other banks decreased in particular. Liabilities to customers decreased slightly to € 39,928 million (31 December 2016: € 40,172 million). Liabilities repayable on demand decreased in particular, whereas fixed-term deposits increased slightly. Securitised liabilities recorded a decrease to € 14,306 million (31 December 2016: € 16,624 million). This is attributable to new issues exceeding repayments and maturities. Trading liabilities also decreased significantly to € 4,705 million (31 December 2016: € 5,981 million). Subordinated capital at € 2,569 million was lower than at the previous year end (31 December 2016: € 3,536 million), which was due to maturities of profit participation capital and subordinated liabilities.

Reported equity capital increased slightly to € 5,111 million (31 December 2016: € 4,950 million). This was positively impacted by the Group net income as at the June 30 reporting date and an increase in the revaluation reserve.

Business volume also decreased

Business volume decreased in parallel with total assets to € 87,569 million (31 December 2016: € 93,208 million). Off-balance sheet business also decreased: sureties and guarantees decreased to € 1,932 million (31 December 2016: € 2,189 million), irrevocable loan commitments to € 6,327 million (31 December 2016: € 6,654 million).

STRUCTURE OF LIABILITIES BY FINANCIAL INSTRUMENT

(€ m)	30.06.2017		31.12.2016	
	Total	**of which > 1 year**	Total	of which > 1 year
Secured: Covered bonds and asset-based funding	15,430	11,992	16,031	13,208
Covered bonds	8,951	7,870	10,076	8,616
Other secured funding	6,479	4,122	5,955	4,592
Unsecured liabilities	32,871	3,425	32,534	2,937
Unsecured (senior unsecured)	14,783	10,757	17,073	13,464
Profit participation certificates and other subordinated liabilities	1,154	1,069	2,123	1,085
Silent participations	2,081	2,081	2,072	2,072
Total	**66,319**	**29,324**	**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 can be reconciled to the "Liabilities to customers", "Liabilities to banks", "Securitised liabilities" and "Subordinated capital" balance sheet line items. 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 funding 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 € 15,430 million as at 30 June 2017 (31 December 2016: € 16,031 million).

Unsecured liabilities include call and time deposits comprising mainly client deposits, bearer and registered bonds and other unsecured financing instruments and amounted to € 32,871 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 € 14,783 million as at the 30 June 2017 (31 December 2016: € 17,073 million).

The total of the two line items – profit participation certificates and other subordinated liabilities – of € 1,154 million (31 December 2016: € 2,123 million) and silent participations of € 2,081 million (31 December 2016: € 2,072 million) represent subordinated capital. € 666 million (31 December 2016: € 660 million) of the silent participations (Resparc I and Resparc II) is disclosed under the securitised liabilities balance sheet line item.

Capital and funding

REGULATORY CAPITAL RATIOS
(SAME PERIOD CALCULATION)

(%)	**30.06.2017**	31.12.2016
Total capital ratio	30.4	24.8
Tier 1 capital ratio	23.2	18.7
CET1 ratio	18.9	14.1
CET1 ratio (full implementation of Basel III)	18.5	13.4
Leverage Ratio	7.9	7.0

ELIGIBLE CAPITAL
(SAME PERIOD CALCULATION)

(€ bn)	**30.06.2017**	31.12.2016
Regulatory capital	7.8	7.1
thereof: Tier 1 capital	5.9	5.4
thereof: CET1 capital	4.8	4.0
thereof: additional Tier 1 capital	1.1	1.3
thereof: supplementary capital	1.9	1.7
Risk assets (RWA)	25.7	28.6
thereof: risk assets counterparty default risk	22.7	23.4
Leverage Exposure	74.9	77.0

CET1 ratio of 18.9 % at high level

The core Tier 1 capital ratio (CET 1 ratio, under the Basel III transitional arrangements, phase-in) increased to 18.9% as at 30 June 2017 and is therefore well above the 2016 year end value and the forecast ambition level of around 13% for the 2017 year end, despite the charges arising on the phasing in of the Basel III transitional arrangements. RWA have decreased compared to 31 December 2016 (€ 28.6 billion) by around € 2.9 billion to € 25.7 billion.

The sharp increase in the capital ratio compared to 31 December 2016 (14.1%) exceeded our expectations and is mainly attributable to the successful NPE reduction in real estate commitments as part of the market portfolio sales as well as the noticeable positive impact of the half-year results on the capital ratio, decrease in RWA due to the active management of foreign currency risk, the further reduction in the Non- Core Bank's portfolio and weak USD exchange rate, which was significantly below expectations.

HSH Nordbank has determined a Pro-Forma CET1 ratio without taking account of the regulatory effect of the relief provided under the second loss guarantee. "Without taking account of the regulatory effect of the relief" shall be understood that the RWA for the positions held in the reference portfolio of the second loss guarantee are determined in accordance with the credit risk framework and not with the regulations applicable to securitisations, whereas loan loss provisions recognised continue to be favourable applied in accordance with the regulatory requirements. Based on this hypothetical assumption the Pro-Forma CET1 ratio is indicative 15.0%, which is therefore also above the ambition level of around 13%. By determining this Pro-Forma CET1 ratio the Bank anticipates in its reporting any future developments in the privatisation process and possible regulatory requirements.

There was no free regulatory guarantee buffer available as at the 2016 year end nor as at 30 June 2017 (free capacity for expected and unexpected losses). A portion of the regulatory charge is accounted for by the creation of a virtual so-called "sub-senior tranche" as part of the regulatory recognition of the federal state guarantee. The senior tranche of the Sunrise guarantee is split into two (virtual) sub-tranches for this purpose. The first sub-tranche ("sub-senior tranche") receives a risk weight of 1,250% and is deducted from regulatory capital (equity deduction item). The equity deduction item amounted to approximately € 0.0 billion as at 30 June 2017 and has decreased by approximately € 0.6 billion compared to 31 December 2016. The reason for this decrease is the relief provided by the progress made in winding down the portfolio through, inter alia, market portfolio sales and restructuring or sales of non-performing commitments. The residual senior tranche, whose risk weight is currently around 24%, is to be backed by regulatory capital. The RWA attributed to the "senior tranche" of the federal state guarantee decreased significantly in the first half of 2017 as a result of the active winding down of the legacy portfolio and thereby contributed to the increase in the CET1 ratio.

Under the assumption of full implementation of the Basel III rules (fully loaded) HSH Nordbank's CET1 ratio increased to 18.5% compared to 31 December 2016 (13.4%).

As part of the supervisory process in the Banking Union, HSH Nordbank was assigned an individual minimum ratio by the ECB that is reviewed annually in the SREP process. This capital ratio was maintained at all times during the reporting period. A CET1 capital ratio of 10.5% (phase-in) including a regulatory early warning threshold (Pillar 2 Guidance "P2G") is applicable to HSH Nordbank since 1 January 2017. This is composed of the SREP minimum requirement of around 8.9% (Pillar 2 Requirement "P2R" including the combined capital buffer requirements) plus an early warning buffer of 1.6%. (Pillar 2 Guidance "P2G").

As part of the supervisory process in the Banking Union, the financial holding group was assigned an individual minimum ratio by the ECB, which is in line with the statutory regulations and reviewed annually in the SREP process. In this regard, a core Tier 1 capital ratio of 4.5 % plus capital buffer requirements of around 5.8 % in total has applied to the financial holding group since 1 January 2017. The same period CET1 capital ratio amounted to 11.4 % as at 30 June 2017 (31 December 2016: 7.9 %).

HSH Nordbank's leverage ratio was a very solid 7.9 % as at 30 June 2017 (31 December 2016: 7.0 %). This includes the increase in regulatory capital in the first half of 2017. A statutory binding minimum leverage ratio value has not yet been defined. With the revision of the CRR the leverage ratio based on Tier 1 capital is to be determined as a binding minimum requirement for all institutions, probably at 3 %.

Detailed information on HSH Nordbank's capital and RWA forecast is set out in this Group Interim Management Report in the "Forecast including opportunities and risks report" subsection of the "Forecast, opportunities and risks report" section.

Continued refinancing successful

HSH Nordbank has successfully continued to implement its funding strategy in the first half of 2017 by using different sources of funding. Accordingly, the raising of net funding in the reporting period was substantially above the planned volume. A higher volume of placements with institutional investors in addition to bond issues in the retail segment contributed to this.

At the beginning of July 2017 the Bank successfully placed a public sector Pfandbrief and thereby continued its Pfandbrief benchmark strategy. The bond issue amount is EUR 500 million with a maturity of 3 years.

Besides the issuing activities, the level of deposits contributed to the implementation of the funding strategy. Total deposits amounted to € 28.3 billion as at 30 June 2017 (31 December 2016: € 29.7 billion). As at 30 June 2017 the Bank also held liquidity reserves in the form of credit balances at central banks in the total amount of € 6.4 billion and collateral eligible for refinancing at central banks in the amount of € 9.7 billion, which the Bank can access at any time.

Regulatory requirements regarding liquidity ratios as well as the assumptions made by the Bank in the forecast were adhered to in the reporting period. The liquidity ratio as defined in the German Liquidity Regulation (LiqV) of 1.87 as at 30 June 2017 (31 December 2016: 1.92) remained significantly above the minimum regulatory requirements. The liquidity coverage ratio (LCR, short-term minimum liquidity ratio) reached a very good level of 208 % as at 30 June 2017 (31 December 2016: 229 %) and was therefore also clearly above the minimum requirements. The NSFR (structural liquidity ratio) of 109 % as at 30 June 2017 (31 December 2016: 111 %) was in the upper range of the requirements stipulated in the EU's list of conditions and commitments.

As at 30 June 2017 the liquidity development report showed a minimum survival period of 9 months in the combined stress scenario (31 December 2016: 10 months). The regulatory requirement of 1 month was thereby clearly exceeded.

FINAL ASSESSMENT OF HSH NORDSBANK'S POSITION

The positive operating performance, effects from the realisation of unrealised gains, which were recognised to compensate the loan loss provisions incurred after the full balance sheet utilisation of the guarantee, and, as expected, the leveraging of the cost reduction potential made key contributions to the Bank's overall satisfactory performance in the first half of 2017. Together with the successful new business activities and the focussed winding down of legacy assets the Bank succeeded on the whole in achieving its stated objectives and thereby in fully supporting the change in ownership.

The key management indicators are moving at an overall good level and provide the Bank with sufficient scope to counter any unexpected developments that may arise in the complex sale process.

The Core Bank results show that the market successes and efficiency improvements achieved under demanding underlying conditions (including market conditions in the shipping industry, low level of interest rates, intense competition, EU proceedings) are continuing to have a noticeable effect in the segments. With the implementation of the Core Bank's business model, which can be expanded in the future, HSH Nordbank is well-positioned on the whole and is on the right track with regard to its operating business.

The Non-Core Bank mainly holds legacy loans that originate from the years prior to 2009 and are covered by the second loss guarantee as the reference portfolio. Shipping loans account for most of the portfolios. On the one hand, the continuing very difficult market conditions in the shipping industry and the resulting high additions to loan loss provisions for legacy assets in the reporting period once again had a clearly negative effect on the Bank's performance. On the other, the required acceleration in the winding down of non-performing loans is only possible to a limited extent due to the settlement conditions under the guarantee agreement, thereby putting additional pressure on the Bank's performance. The guarantee issued in favour of HSH Nordbank by the federal state owners, Hamburg and Schleswig-Holstein, in 2009 – as an essential element of the recapitalisation required at that time – is complex and makes the Bank's realignment and the privatisation process more difficult. From today's perspective, the improvements targeted at that time are partially suited to reduce the proportion of the high NPE volume on an early and significant basis. The second loss guarantee received at that time had no direct liquidity effect then, on the basis of which the necessary, accelerated winding down of non-performing loans could have been carried out on a timely basis. Instead, complex settlement conditions under the guarantee agreement mean that economically sound wind-down measures can only be taken to a limited extent. Furthermore, total guarantee premiums of € 3.2 billion paid to date to the guarantor have put considerable strain on the available capital base. From today's perspective and in retrospect, the recapitalisation of HSH Nordbank at the time of the financial crisis in the form of a second loss guarantee of € 10 billion has proved to be less advantageous from an economic point of view when compared to a strengthening of capital at that time that would have had an effect on liquidity.

In summary, HSH Nordbank assesses its performance in the first half of the 2017 as positive taking account of the ongoing privatisation process and operating progress achieved. Overall, the Bank's current financial and risk situation form a solid basis for the focussed driving forward of the sale process officially opened in January 2017.

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

SEGMENT RESULTS

SEGMENT OVERVIEW JANUARY TO JUNE 2017[1]

(€ m)		Corporate Clients	Real Estate	Shipping	Treasury & Markets	**Core Bank[3]**	Non-Core Bank	Other and Consolidation[4][5]	**Group**
Total income	**2017**	**117**	**111**	**47**	**409**	**684**	**49**	**26**	**759**
	2016	109	100	67	295	571	14	–44	541
Loan loss provisions (including credit derivative)[2]	**2017**	**4**	**–**	**4**	**1**	**9**	**–251**	**1**	**–241**
	2016	–	1	–13	–	–12	157	6	151
Administrative expenses	**2017**	**–66**	**–28**	**–22**	**–44**	**–160**	**–95**	**9**	**–246**
	2016	–69	–25	–28	–50	–172	–100	–5	–277
Net income before taxes	**2017**	**52**	**77**	**18**	**359**	**506**	**–348**	**15**	**173**
	2016	33	64	12	233	342	–41	–130	171
Segment assets (€ bn)	**30.06. 2017**	**12**	**11**	**6**	**22**	**50**	**18**	**11**	**79**
	31.12. 2016	12	11	6	19	48	22	14	84

[1] Following the change in the segment structure in the second half of 2016 previous year amounts were adjusted accordingly as at 30 June 2016.
[2] Summary of the loan loss provisions 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 includes the effects of different accounting treatment.

Change in the segment structure in the 2016 financial year

The Bank adjusted its segment structure in the second half of 2016 based on the organisational changes implemented. As a first step, a portfolio reallocation was made at the Bank in anticipation of these changes. Non-performing loan portfolios of € 6.2 billion were transferred mainly from the Core Bank's shipping recovery unit to the Non-Core Bank. These mainly included legacy assets from years prior to 2009, which are covered as the reference portfolio by the second loss guarantee of the federal state owners. This structurally relieved the Core Bank portfolio of loans earmarked for winding down. In return, € 4.5 billion of mainly cover pool portfolios was transferred from the Non-Core Bank to the Core Bank's Treasury & Markets segment. This resulted in the consistent allocation of loan portfolios to continuing operations in the Core Bank and the reduction in risk in certain non-performing portfolios in the Non-Core Bank.

In a second step, the Bank changed the segment structure on the basis of the portfolio reallocation and changes made to the internal reporting and management processes. This includes the structural adjustment of the segments and reallocation of the guarantee effects to the individual divisions. Segments not subject to reporting requirements (mainly overall bank positions) and reconciliation items were also combined under "Other and Consolidation". These changes are aimed specifically at increasing the external transparency of the Core Bank's strategic business divisions as well as the non-strategic wind-down portfolios and thereby also at establishing a rigorous and clear reporting process for each value creation structure.

The above-described changes in the internal management processes and organisational structure, which result in the described changes in segment reporting, furthermore enables HSH Nordbank's value creation structures to be presented in a more transparent manner as the basis for the privatisation process.

All previous year's amounts as at 30 June 2016 were adjusted accordingly for comparative purposes. Further details on the portfolio reallocation and changes to the segment structure can be found in HSH Nordbank's Group Management Report for the 2016 financial year in the "Segments" subsection of the "Economic Report" section.

Core Bank results exceed expectations

The Core Bank, in which HSH Nordbank's strategic activities are combined, increased its new business in the first half of 2017 in a partly very challenging environment and thus made further progress in implementing its client- and sector-based strategy in line with planning.

The Core Bank generated net income before taxes as a 30 June 2017 of € 506 million, which was significantly above plan and the same period in the previous year (€ 342 million). The good operating performance of all segments of the Core Bank and the realisation of unrealised gains contributed to this.

In addition to new business transacted, total income of the Core Bank, which increased significantly by € 113 million compared to the same period in the previous year (€ 571 million) to € 684 million, also reflects the planned and achieved effects of the realisation of unrealised gains of around € 307 million through the sales of promissory note loans.

The Core Bank results also benefited in comparison with the Non-Core Bank from lower loan loss provision expense, which amounted in total to income of € 9 million (same period in the previous year: expense of € – 12 million). Implementation of the ongoing cost reduction programme in line with planning also contributed to the improved results. Compared to the same period in the previous year, administrative expenses fell markedly from € – 172 million to € – 160 million. The Core Bank results include € – 10 million, and therefore about 12.5 %, of the total guarantee expense.

Based on these positive results the Core Bank generated a return of equity of 30.4 % (31 December 2016: 19.8 %). The Core Bank's cost/income ratio was 23.1 % (31. December 2016: 35.5 %). Both figures include the effects of the realisation of unrealised gains and, against this backdrop, also exceed the planned level.

Total assets of the Core Bank increased slightly to € 50 billion as at 30 June 2017 (31 December 2016: € 48 billion) mainly due to the increase in the cash reserve, which is allocated to the Treasury & Markets division. This increase is attributable among other things, to maturities of securities as well as payments received from portfolio sales and the settlement of losses. The overall dynamic new business concluded in the Core Bank has not resulted in an increase in segment assets due to scheduled, and in some cases unscheduled, principal repayments.

The NPE ratio fell slightly in the first half of 2017 primarily as a result of currency effects. It was within our expectations at 1.6 % (31 December 2016: 1.9 %). The low NPE ratio in the Core Bank continues to reflect a solid portfolio quality.

KEY MANAGEMENT INDICATORS OF THE CORE BANK

	30.06.2017	31.12.2016 (30.06.2016)
Net income before taxes (€ m)	506	639 (342)
CIR	23.1 %	35.5 % (30.1 %)
RoE	30.4 %	19.8 % (21.6 %)
NPE ratio	1.6 %	1.9 %
New business (€ bn)	4.4	8.9/ (3.5)

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

Segment results in the Core-Bank

The **Corporate Clients** segment is organised on a sector-specific basis, in which the Energy & Infrastructure, Trade & Food, Healthcare, Industry & Services and Wealth Management business areas are combined. The Corporate Clients segment generated net income before taxes of € 52 million for the first six months (same period in the previous year: € 33 million). This includes total income of € 117 million (same period in the previous year: € 109 million), which reflects the business performance across all sectors in a highly competitive environment. Compared to the same period in the previous year new business volume increased by € 0.2 billion to € 1.6 billion, although the pro rata plan was not fully met. The shortfall is mainly caused by trends in the project business, which are subject to seasonal fluctuations, which is why the Bank assumes that the plan target for the whole of 2017 will be achieved. Total loan volume has increased further compared to the previous year due to the continued good level of new business and stable client relationships. Structured project financing transactions have so far been concluded mainly in the railway transport and data infrastructure sectors; existing client relationships have been intensified. In the wind energy sector, significant financing transactions have been secured in addition to projects in Ireland and Scandinavia.

The **Real Estate** segment made a significant contribution of € 77 million to the Bank's earnings in the first half of 2017 (same period in the previous year: € 64 million). The division has again been successful in further expanding its good market position. New business increased at a rate better than planned in the first half of the year to € 2.3 billion despite the sustained highly competitive environment and also significantly exceeded the volume transacted in the same period in the previous year (€ 1.9 billion). The positive trend with regard to transactions in the West German metropolitan areas and with institutional investors has also continued in the first half of 2017. It was thus possible to maintain the high market penetration in the core region of North Germany.

Total income of the **Shipping** segment amounted to € 47 million was significantly below that for the same period in the previous year (€ 67 million). This is attributable to a decrease in net interest income resulting from the reduction in the volume of loans and advances. Net income before taxes amounted to € 18 million compared to € 12 million in the same period in the previous year and includes loan loss provision income of € 4 million (same period in the previous year: expense of € – 13 million) and guarantee expenses of € – 8 million (same period in the previous year: € – 8 million). The shipping market was characterised in the first half of 2017 by a continuing challenging market environment. New business transacted with various international shipping lines of good credit quality amounted to € 0.3 billion for the first six months of the year and was in line with the plan.

The **Treasury & Markets** segment generated net income before taxes of € 359 million (same period in the previous year: € 233 million) and includes the effect of the realisation of unrealised gains on the sale of promissory note loans, which also arose as part of the optimisation of the cover pools in the public sector Pfandbrief business. Client business excluding syndication activities continued to perform positively and achieved the previous year's results in the first six months of 2017. The derivatives business and Treasury were above plan and contributed to the good operating performance. Deposit business with savings banks and institutional investors remained at a high level.

The Transaction Banking product division generated product net income of € 9 million (same period in the previous year: € 8 million). After deducting allocable costs, this mainly includes income from the use of products by clients in the deposit business, account management, payment transactions and foreign trade and export financing documentary business. The division thus made a tangible contribution to the Bank's cross-selling income. The previous year's net commission income, which is strategically important for the Bank, was significantly increased, despite a challenging environment. Under the Bank's business unit steering process net income from the Transaction Banking product division is disclosed largely in the Core Bank's segments and to a lesser extent in the Non-Core Bank. The Product division is organisationally assigned to "Other and Consolidation".

Segment results of the Non-Core Bank

As expected for structural reasons, the Non-Core Bank, in which predominantly non-performing loans earmarked for winding down are combined, disclosed a net loss of € – 348 million as at 30 June 2017 (same period in the previous year: € – 41 million). The loss is mainly attributable to the continued winding down of the portfolio, setting of loans to a non-accrual basis and necessary additions to loan loss provisions, which were no longer fully compensated for by the guarantee in the first half of 2017.

Total income of the Non-Core Bank amounted to € 49 million (same period in the previous year: € 14 million). Net interest income of € – 6 million (same period in the previous year: € 28 million) and net trading income of € 32 million (same period in the previous year; € – 43 million) made a significant contribution to this. The sharp reduction in net interest income is mainly attributable to the decrease in the interest-bearing volume of loans and advances.

Net income before taxes was also adversely impacted by high loan loss provision expense of € – 381 million (same period in the previous year: € – 488 million). Loan loss provision expense recognised mainly for shipping loans and the energy wind-down portfolio was compensated for in the guaranteed portfolio by the guarantee up to its full balance sheet utilisation. After taking account of the compensation, which also includes the positive impact of the settlement of losses as well as currency effects and the hedging effect of the credit derivative, loan loss provision expense recognised in the Non-Core Bank amounted to € – 251 million after the guarantee effect (same period in the previous year: income of € 157 million) and was therefore a major reason for the loss incurred by the Non-Core Bank.

Administrative expense amounted to € – 95 million (same period in the previous year: € – 100 million) and includes unplanned impairment losses of € – 3 million relating to the revaluation of consolidated aircraft within the context of the market transaction. Expenses for the second loss guarantee amounted to € – 70 million (same period in the previous year: € – 113 million) and to € – 9 million (same period in the previous year: € – 20 million). The Non-Core Bank accounts for € – 70 million of this, which represents around 88 % of the total guarantee expense.

Total assets of the Non-Core Bank declined as a result of the portfolio reduction to € 18 billion as at 30 June 2017 (31 December 2016: € 22 billion). This decrease is attributable to reductions in the market portfolio and compensation effects.

The Non-Core Bank's NPE ratio is still very high due to structural reasons. The ratio remained at a constant level of 63.9% in the first half of 2017 (31 December 2016: 63.6%) due to the proportional decrease in the NPE volume and overall EaD. The Bank assumes in its planning that there will still be a marked reduction in the NPE volume based on the whole of 2017. This will occur over the remainder of the year and will also noticeably relieve the NPE ratio accordingly. As expected, the coverage ratio increased to 55.4% compared to 31 December 2016 (47.7%) and reflects an overall solid risk coverage in the NPE portfolio. It will again decrease slightly in the second half of 2017 in the course of the further reduction in the NPE on the simultaneous utilisation of the loan loss provisions. The coverage ratio increased from 59.2% to 61.5% in the Non-Core Bank's shipping portfolio.

KEY MANAGEMENT INDICATORS OF THE NON-CORE BANK

	30.06.2017	31.12.2016 (30.06.2016)
Net income before taxes (€ m)	–348	–299 (–41)
NPE ratio	63.9%	63.6%
Coverage ratio	55.4%	47.7%
Total assets (€ bn)	18	22

Results: "Other and Consolidation"

Administrative functions and overall bank positions are disclosed in "Other" under "Other and Consolidation" as segments not subject to reporting requirements. "Consolidation" also includes reconciliation 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.

Net income before taxes amounted to € 15 million as at 30 June 2017 (same period in the previous year: € –130 million) and include charges to total income and restructuring expenses of € –25 million (same period in the previous year: € –98 million) incurred in connection with the planned headcount reduction and privatisation. Income from the management of liquidity and capital positions made a positive contribution to net income.

Liquidity reserves are mainly disclosed in the segment assets of "Other and Consolidation". These amounted to € 11 billion as at 30 June 2017 (31 December 2016: € 14 billion). The decrease is in line with the increase in segment assets in Treasury & Markets and primarily relate to liquidity management measures and movements in the EUR/USD exchange rate.

EMPLOYEES

HUMAN RESOURCE FUNCTION AT HSH NORDBANK

The human resource function at HSH Nordbank supports the Bank's managers and employees in meeting their daily challenges. It is caught between cost objectives and the need to attract and retain motivated, committed and well-trained employees. Modern and reliable processes that take account of the constantly changing regulatory requirements form the basis for all topics covered by the human resource function.

EFFECTIVE RESOURCE MANAGEMENT

The programmes initiated by the Management Board in 2015/2016 to permanently reduce administrative expenses also continued to be successfully implemented in the first half of 2017.

The number of employees decreased to 2,030 based on full-time equivalents (FTE) in the first half of 2017 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 head-count. The number of full-time employees (FTE) at HSH Nordbank AG (single entity) decreased to 1,785 by 30 June 2017 (31 December 2016: 1.902)

FULL-TIME EMPLOYEES IN THE GROUP

	30.06.2017	31.12.2016
Full-time equivalents (FTE) in the Group1)	**2,030**	**2,164**
thereof: Women	769	820
Men	1,261	1,344
Employees in Germany	1,936	2,068
Employees abroad	94	96
Total number of employees in the Group2)	**2,441**	**2,613**
Employee key ratios and figures		
Part-time employment ratio (%)	27.4	27.2
Average age3) in years	45.7	45.3
Average length of employment in years	14.1	13.7

1) Total number of employees excluding trainees, temporary staff and interns (previous year adjusted).
2) Headcount (previous year's number adjusted).
3) Only headquarters, excluding branches and subsidiaries.

FOCUS ON MODERN STAFF DEVELOPMENT AND CLEAR COMMUNICATION STRUCTURE

Besides the introduction of modern staff development tools, one area of focus is the encouragement of agility in employees. Motivated and highly qualified employees as well as the ongoing development of management expertise provide the foundations for a forward-looking bank.

In addition to various health-related seminars, the multi-faceted programme offered is completed by coaching, change management, technical training courses and continuing IT education.

A clear communication culture creates trust and is essential for the Bank's success. This is why the management of HSH Nordbank AG has set itself the task of regularly reporting on the current status of the sales process in different formats and of openly exchanging information regarding the Bank's situation and current issues.

EQUAL OPPORTUNITIES AND WOMEN IN MANAGEMENT POSITIONS – MANAGEMENT DECLARATION PURSUANT TO SECTION 289F OF THE GERMAN COMMERCIAL CODE (HANDELSGESETZBUCH – HGB)

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. In 2015 the Bank had set 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).

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. This target has not yet been achieved by HSH Nordbank. With regard to the only new appointment made in this period of time, in which the Management Board was also reduced in size, the appointment of an existing, undoubtedly qualified internal successor to the Chief Financial Officer was considered preferable to searching for an external female successor. This was due to the great importance attached to and complexity of the accounting function, especially in connection with the guarantee and the Bank's specific situation in the ongoing privatisation process. Nevertheless, the Supervisory Board reaffirmed its objective of appointing a female member to the Management Board, which would be equivalent to a ratio of 25 % given the current size of the Board. The target is to be achieved by 30 June 2022.

HSH Nordbank has set a target of 16 % for the proportion of women in management positions reporting directly to the Management Board. With currently 15 % the target has almost been reached. On the other hand, the proportion of female department heads of 21 % (planned 15 %) has clearly exceeded the target.

The efforts made to promote young female professionals in particular allow the Bank in the future to fill positions that become vacant at the next higher level from the large group of female department heads. Against this backdrop, HSH Nordbank is confident that it will meet the targets set in this regard in the future.

PROPORTION OF WOMEN AS AT 30.06.2017[1)]

	Women	Men	Total	Women	Men
	Number			Ratio	
Direct reporting managers	3	17	20	15 %	85 %
Department heads	13	49	62	21 %	79 %
Total	**16**	**66**	**82**	**20 %**	**80 %**

1) Head Office excluding redundant employees

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 also to be agreed at the same time and reasons given if such targets are not met.

The Supervisory Board had already approved in 2011, based on the then new requirements of the German Corporate Governance Code (DCGC), the objective that the prevailing proportion of women should also not fall below 20 % in the future. The Supervisory Board considers a target of 30 % to be an appropriate proportion of women. With a current proportion of women of 37.5 % the Supervisory Board has already met the target set by itself, so that no further action is required. The proportion of women employed by the shareholders is currently 25 % and 50 % on the employer side.

EMPLOYEE REMUNERATION

The remuneration systems applied at HSH Nordbank are specifically designed to harmonise the interests of the Management Board, employees and shareholders and to motivate the Management Board as well as the employees to act in the interests of HSH Nordbank and to make full use of their personal potential.

The remuneration system for employees below the Management Board level is based on a total remuneration approach, counteracts any dependence on variable remuneration and thereby prevents the employees from taking excessively high risks for the purposes of realising the variable remuneration potential.

Up-to-date details on the qualitative and quantitative part of the remuneration are published – in accordance with the Ordinance on the Remuneration of Financial Institutions (Institutsvergütungsverordnung, IVV) – in the separate annual remuneration report for the 2016 financial year and on HSH Nordbank's website.

REPORT ON EVENTS AFTER THE REPORTING PERIOD

The sale of non-performing loans of up to € 3.2 billion in the market was approved as part of the implementation of the decision reached by the EU Commission on 2 May 2016 in the EU state aid proceedings regarding the replenishment of the second loss guarantee. In the first half of 2017 the Bank concluded inter alia transactions relating to five non-strategic legacy portfolios (aviation, continental European real estate (Scandinavia, Netherlands, Germany), energy and international real estate) in this connection. These have already been closed for the most part.

The sale of a further aviation portfolio was signed on 2 August 2017. The transaction volume amounts to approximately € 0.2 billion (EaD). The corresponding effects on the portfolio concerned were recognised in these interim financial statements. The closing is expected during the third or fourth quarter of 2017.

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 currently available to the Bank. The statements are based on a series of assumptions that relate to future events and are incorporated in HSH Nordbank's corporate planning. The occurrence of future events is subject to uncertainty, risks and other factors, many of which are beyond HSH Nordbank'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 in favour of HSH Nordbank AG based on a list of conditions and commitments and, among other things, stipulated that HSH Nordbank be sold until 28 February 2018. According to the list of conditions and commitments the sale of divisions or parts thereof is possible with the consent of the federal state owners. From the shareholders' standpoint, the sale of HSH Nordbank as a whole, i.e. the sale of all shares held by the seller including all assets and liabilities, is the objective of the sale process. It must be ensured that the list of conditions and commitments (primarily the existence of the required viability review included in this list) is fully complied with and all regulatory requirements, particularly the minimum capital requirements, are met.

Against this backdrop a key assumption used in the corporate planning with regard to the ongoing sale of HSH Nordbank is the total sale of HSH Nordbank AG as a whole bank. Nonetheless, it cannot be completely ruled out that, due to the delicate balance between the forward-looking Core Bank, the high charges incurred as a result of the legacy loans held in the Non-Core Bank and the complex guarantee structure in term of its settlement procedures and regulatory effect, structured sub-bank solutions are discussed, if the sale of the Bank as whole cannot be achieved. Within this context, it is assumed that the viability assessment to be performed by the European Commission following a successful change of ownership will have a positive outcome, meaning that the Bank will comply with all of the agreements reached in the EU proceedings. As it is not possible to objectively predict the course and outcome of the privatisation process, the process involved in the sale of HSH Nordbank AG creates considerable uncertainty regarding the implementation of the corporate planning, the determination of the loan loss provisions and accounting and measurement. The owners are responsible for the sale of the shares, HSH Nordbank's Management Board supports the sale accordingly.

Estimates regarding the long-term trend in loan loss provisions as well as the planning for payment defaults and, consequently, the actual drawdown of the second loss guarantee are subject to significant uncertainty due to the very long planning horizon, which can influence the future development of the Bank to a greater degree than expected. The main uncertainty factors result, for example, from the movement in key market parameters such as freight and charter rates, ship values as well as the US dollar exchange rate. 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). Estimates concerning long-term loan loss provisions assume a recovery in the shipping markets, in particular in the container shipping industry, as well as the continuation of the current commitment strategies for the problem loan portfolio and therefore of the assumption that HSH Nordbank is willing to continue to provide financing in order to achieve the planned reversals of impairment losses in the future.

Developments over the past years have shown that the ability to make forecasts in a volatile environment is generally limited, which is illustrated by the fact that the difficult market conditions in the shipping industry are lasting longer than expected, although there are increasing signs of a gradual recovery in the shipping markets.

In this section, HSH Nordbank 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. 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. The risk types specific to the Bank are then separately explained in the "Risk Report" chapter.

Unless otherwise explicitly stated below, the following forecast relates solely to HSH Nordbank's operating company, which was established following the legal separation of the present HSH Nordbank into an operating company and holding company as agreed under the EU decision. This separation relieved the operating HSH Nordbank from the additional premium obligations, the obligation to pay base premiums on the drawn down portions of the guarantee and to pay a substantial proportion of the base premium (reduction by 1.8% from the previous 4%) on indrawn portions of the guarantee from 2016 onwards. Corresponding obligations were assumed by the holding company.

ANTICIPATED UNDERLYING CONDITIONS

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

Second half of 2017: Good economic outlook with continuing uncertainty regarding US trade policy

Based on the developments in the first half of the year and decrease in political uncertainty in the eurozone we also expect robust growth in the second half of 2017. GDP of the global economy is likely to increase at a rate of 3.5% for the whole year compared to 3.1% in the previous year. The broad-based acceleration is driven by the USA, the eurozone and most of the emerging countries. Yields are likely to increase slightly on the financial markets, whilst the stock markets should tend to move sideways at the high level already reached. In HSH Nordbank's view, the key risks are changes in the US trade policy and the course of the Brexit negotiations.

Broad-based recovery in the global economy

The good second quarter in particular indicates an upswing in the USA in the months between July and December 2017. However, the growth potential of the USA has declined due to structural reasons, such that economic growth in the current year is expected to be not higher than 2.5% (previous year: 1.6%). In view of the continuing decrease in the unemployment rate inflation pressure should gradually increase and, excluding energy and food prices, reach the 2% level at the end of the year.

China's economic growth is likely to weaken slightly in the second half of the year, so that a GDP change of 6.6% can be expected for the entire year. This may also be in the interests of the government, as the risks in the financial sector have increased as a result of the higher level of indebtedness, the very sharp increase in house prices and unsustainable investment growth. In the case of Brazil and Russia, the Bank expects a cyclical rebound from the deep recession of the past two years.

The robust growth in the eurozone is likely to continue at a slightly lower level, which is indicated by the more stable political situation and the surprisingly positive sentiment scores. At the same time, the political uncertainty surrounding the Brexit negotiations and US trade policy as well as the Catalonia independence referendum scheduled for the beginning of October may dampen the recovery. We do not expect the Bundestag election in September to have any significant impact on economic growth in the eurozone. The Bank expects economic growth of around 1.9% for 2017 as a whole (2016: 1.8%).

The German economy is already producing above its capacity, which is reflected in an increasing shortage of skilled workers and capacity utilisation of 86% in the manufacturing industry, the highest level since 2008. It will probably not be possible to maintain the rapid pace of expansion and we are accordingly assuming somewhat weaker economic growth of 1.8% (previous year: 1.9%, data not adjusted for working days).

Further tightening of monetary policy in the USA, announcement expected of a reduction in the purchases of securities by the ECB

Following the raising of the key interest rate by the US Federal Reserve five times since the end of 2015 a further interest rate step can also be expected in the second half of the year. Furthermore, the official date for the start of the reduction in total assets is still likely to be announced this year. The ECB will also probably disclose this year their plans for reducing its purchases of securities. Whether and how the American government will adopt its tax reduction plans and the infrastructure programme announced in the election campaign will again be important for the financial markets – however, the euphoria regarding a rapid implementation of these plans by the Trump administration has already clearly cooled down in the first half of the year. The good economic situation and weakening support provided to the bond markets by the central banks should ensure that yields on government bonds in the eurozone and USA increase slightly. Protectionist measures – restrictions on steel imports are currently being discussed – could prove to be the biggest disruptive factor for the global financial markets.

The euro is likely to remain above the psychologically important level of US dollar 1.10 in the second half of the year, as the relatively robust economy and increased political uncertainty have significantly reduced the vulnerability of the common currency. The oil price will probably move sideways from the currently low level, because the US oil supply is likely to react quickly with production increases, should the price increase.

Outlook for relevant markets

The signs of a moderate recovery in the shipping markets – apart from the tanker segment – should continue. The reasons for the recovery in the charter rates are currently an increase in demand, the scrapping of ship capacity and the consolidation of shipping lines. The incipient recovery in charter rates was also reflected in an increase in ship values, although to a lesser extent. However, a recovery failed to materialise in the tanker segment, even though the tanker market is also benefiting from the more favourable underlying global economic conditions.

A weak recovery trend for container ships is likely to emerge in the current year. It is expected that charter rates will exceed operating costs in all sub-segments by the year end. Ship values should bottom out and climb slightly above the all-time lows. Demand growth should accelerate noticeably compared to the previous year. On the supply side growth in the fleet will also pick up, as scrapping activities should slow in the second of the year and an increase in deliveries can be expected. However, fleet utilisation is expected to be higher on balance. This market recovery should also carry over into 2018. However, geopolitical risks together with threatened trade restrictions could have a dampening effect on container traffic.

Demand growth for bulkers is expected to slow down slightly over the remainder of the year. However, the long-term outlook is shaped by the heavy reliance on the import demand for coal and iron ore from the Asia region, particularly from China, and the uncertainty regarding the development of environmental goals as well as steel production. Despite a decrease in scrapping activities the fleet growth, and therefore the supply of tonnage, remains relatively low due to few orders. Utilisation of the existing fleet will increase further as a result of the positive developments in the first half of the year and increase in transport volume. It can therefore be expected that charter rates and ship values will remain stable over the remainder of the year.

The oil tanker market will remain under pressure for the rest of the year. Growth in demand will be dampened for the time being by the OPEC production limit and may not compensate for the expected increase in supply due to the upcoming deliveries of ordered ships. Both charter rates and second-hand prices are therefore likely to fall slightly by the year end, especially in the case of crude oil tankers. We expect a trend reversal in the coming year in view of the slower growth in tonnage. However, the subsequent recovery is likely to be slowed down somewhat by the current new order activity.

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

The German real estate markets should continue to benefit in the second half of 2017 from the favourable underlying conditions and develop very positively. However, demand is falling slightly in the housing markets of most large cities despite the continuing increase in the level of immigration. More and more homes are coming onto the market while building activity is increasing at the same time with the effect that the reduction in the vacancy rate is likely to slow down gradually. The retail sector currently benefits from the positive consumer sentiment and increasing household income. However, demand for space is growing at a noticeably slower pace, not least because consumers are increasingly purchasing on-line. In the office real estate markets, declining vacancy rates can be expected due to only a slight increase in completions together with a demand for space that is hardly flagging and is still buoyant. Office rents are therefore likely to increase further, not least in central but also secondary locations, whereas a considerably more moderate rate of growth is expected for retail real estate and it is likely to mostly stagnate in secondary locations. Residential rents should increase more slowly on an increase in completions. The statutory limits placed on rent increases on the reletting of homes should only start to take effect after the introduction of supplementary measures. Whether this will happen continues to depend on the outcome of the Bundestag elections. Following the very strong growth in the first half of the year and gradual increase in interest rates housing prices and market values of commercial properties are likely to increase only moderately in 2017. Market values of retail properties should increase only slightly in 2017.

Prospects for the expansion of renewable energies also remain mixed in 2017: Whilst the capacity added is likely to stagnate at an overall good level in Europe, there are certainly growth opportunities globally. However, a distinction must be made between wind and solar energy: The substantial increase in capacity added over recent years should slow somewhat in the German wind energy segment. Demand should increase temporarily particularly as a result of the conversion to bidding procedures for the 2017 and 2018 transitional years passed in the amendment to the Renewable Energies Act (EEG). 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 – should stabilise at a moderate level over the coming years. The more moderate outlook is due mainly to the implemented and intended restrictions on state subsidies. It is therefore likely that the target set by the Federal Government of an annual added capacity of 2.5 gigawatts in Germany will also not be met again in 2017.

The increase in transport demand as a result of slightly stronger 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. Revenues of companies in the logistics sector should increase in the 2017 financial year at a faster rate than in 2016. 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. It is not expected that Brexit will have any tangible macroeconomic effect on the logistics economy in 2017. The business climate indicator in the German logistics sector is also likely to hover over the long-term average and maintain the expansive underlying trend in the second half of the year.

Incoming orders, the further improvement in the sentiment indicators and the employment trend in the manufacturing industry point to a continuing upwards moving industrial economy. However, it is not only the economic slowdown in China that is worrying over the medium-term for the heavily export-oriented sectors of the manufacturing industry such as automotive, engineering, electronics and chemicals. The long-term consequences of the Brexit vote cannot yet be predicted, but should become increasingly clearer in 2017 as the exit negotiations progress. The current discussions regarding diesel cars are likely to have an adverse impact on the export prospects of the German automotive industry. Furthermore, it remains to be seen to what extent the new US administration will actually implement the protectionist measures announced in the 2016 election campaign. This still represents in total – in addition to geopolitical risks – a significant downside risk for the global economy and especially of course for the German export industry. Positive aspects are the strengthening economy in the USA as a result of the planned expensive fiscal measures (including infrastructure spending, tax reductions), the implementation of which has been delayed so far, and the brighter economic expectations in the eurozone. The upward growth rates will therefore be sustainable for the time being. The food industry will probably continue to grow due to the still satisfactory level of consumer confidence of private households, but is likely to lose momentum.

The outlook is positive for the international business of companies in the wholesale and foreign trade sector due to the increasing growth dynamics in German industry. The cyclical business-to-business sector in particular will probably continue to benefit from this.

The positive underlying conditions caused by the good employment situation are also continuing to also have a beneficial effect on the retail sector. However, momentum is likely to slow slightly, as increases in real wages of private households will probably be lower as a result of increasing inflation. E-commerce will also remain a growth driver of trade over the remainder of 2017.

Investment budgets of companies should increase sector-wide in the second half of the year due to strong domestic demand. The reluctance to invest prevailing in the previous year is likely to gradually disappear, which will have a further positive impact on loan demand. Loan volume transacted with companies and the self-employed had already reached in the first quarter its best level in a quarter since 2007.

Ongoing challenging environment for banks

Against the backdrop of increasing geopolitical and economic uncertainties in conjunction with the economic policy of the new US administration, the implementation of the vote of the British electorate to leave the EU (Brexit) and possibly continued high volatility on the financial markets the macroeconomic environment is also likely to remain challenging for banks in the second half of the year – even though the market environment, particularly in Europe but also the overall global economic situation, appears overall to be a lot more friendlier now than was expected at the beginning of the year.

Signs are also gradually emerging of a prospective turnaround in monetary policy in Europe as well. Although the ECB is likely to initially maintain its expansive monetary policy with the effect that the growing pressure on net interest income resulting from the low interest rate environment will continue to increase, the European banks should also be able to benefit over the medium term from a yield curve that is becoming steeper – with positive effects on the income side. Nevertheless, institutions must keep trying to offset the negative effect on profitability caused by the low interest rate environment by expanding income sources not dependent on interest rates (for example, commission income) and by further reducing costs.

On a European comparison, the need to adapt in this regard is the greatest in the German banking market, as German institutions generate below-average non-interest income due to the highly competitive environment and low loan margins together with very high cost/income ratios. Although, against this backdrop, the German banks are likely to benefit disproportionately from a steeper yield curve, they still see themselves exposed to great pressure on profitability. The gradual increase in the pace of consolidation is probably due, on the one hand, to intense cost pressure and also indicates on the other hand the potential that can be leveraged in the German banking market.

The regulators and market participants are continuing to increasingly focus on the 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 future 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) to be defined by the national banking supervisory authorities and resolution authorities.

Other fundamental adjustments can already be identified alongside to these capital requirements that are being increasingly defined. The changes discussed 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 to improve transparency vis-à-vis the markets. The change projects include in particular 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 the capital backing of securitisations. Even though an agreement on the application of the Basel IV rules had not been reached in the middle of 2017, and there is still uncertainty regarding this, an increasing trend of higher capital requirements can be expected.

Attention is likely to be increasingly concentrated on the EBA stress test planned for the beginning of 2018 as part of the supervisory review and evaluation process (SREP) in addition to the focus on the reduction in non-performing loans and review of internal models (TRIM). As was the case in previous years, the EBA will publish in December comprehensive data on the large European banks in order to increase market transparency and market discipline. In addition to the inclusion of IFRS 9 elements, the stress test itself will also primarily model the impact of the current low interest rate environment and the implications of an interest rate shock. It is intended to publish the results for the 59 large participating banks in the middle of 2018. As was the case in 2016, HSH will also participate in the ECB stress test as part of the SREP process.

New accounting rules and reporting requirements – preparations for IFRS 9 and BCBS 239

In addition to the various new requirements regarding future capital adequacy, focus is being increasingly placed on preparations for the new accounting rules for financial instruments under IFRS 9 that come into effect from 2018, which will entail changes in the classification of financial assets and determination of loan loss provisions. The final version of the IFRS 9 Standard published in July 2014 replaces the existing provisions set out in IAS 39 and must be applied compulsory for the first time from 1 January 2018.

Reference is made to Note 1 in the Group explanatory notes regarding the material changes in accounting policies expected as a result of the introduction of IFRS 9.

Since the end of 2014 HSH Nordbank has been making intensive preparations as part of several projects for the first-time application of IFRS 9. The objective of these projects is the timely implementation of the new classification and measurement requirements, especially impairment and hedge accounting, in the IT systems and processes concerned as at 1 January 2018.

The projects have gone through the functional specification phase for the most part and their mapping in the EDP systems is well advanced. The Bank is currently conducting an integration test, in which the interaction between the various programs and systems is tested.

It is currently not possible to quantify the effects of IFRS 9 for HSH Nordbank in a manner that satisfies the disclosure requirements for external reporting. The impact will be estimated in test calculations, which will be gradually refined on the basis of the further development of models, systems and data. Based on the current, but not final status of the project and analysis this will entail changes to the measurement categories with regard to the new classification model for certain portfolios or individual financial asset transactions held in HSH Nordbank's portfolio. This results in an increase in the portfolio of instruments to be measured at fair value.

With respect to the new loan loss provision model a significant increase in loan loss provisions for the non-defaulted business (levels 1 and 2 in the new loan loss provision model) and a corresponding reduction in equity can be expected at initial application.

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 regarding borrowing entities 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 currently under discussion, would result in a significant reduction in income from the capital markets business. However, an agreement of the draft currently under discussions has not yet been reached. 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.

The Bank is preparing itself for the regulatory and accounting rules listed above in a targeted manner. The necessary management measures were also put in place at an early stage with regard to the challenges posed by the low interest rate environment. Additional requirements should arise from the further development of the Basel III Framework (Basel IV), for example for securitisations such as HSH Nordbank's second loss guarantee and capital backing under the credit risk standard approach.

In this context, the focus is placed on the detailed definition of the requirements for HSH Nordbank and on ensuring that the new standards are applied on a timely basis. In general, quantitative effects, if known, arising, for example, from the expected IFRS 9 requirements have been included in HSH Nordbank's bank planning.

EXPECTED BUSINESS PERFORMANCE OF HSH NORDBANK

2017 – the year of the preparation for the privatisation

The EU structural measures already implemented, particularly the sale of non-performing shipping loans of € 5 billion to hsh portfoliomanagement AöR in the past financial year and the further winding down in 2017 of at least € 5.5 billion of legacy assets, parts of which are attributable to sales of the market portfolio transaction concluded as well as the progress made to date as planned in the privatisation process, are a good basis for vigorously driving forward the intended change in ownership. Nevertheless, the total amount of NPE relief agreed as part of the EU decision has been low which is why significant legacy portfolios continue to adversely impact the Bank's balance sheet and could make the privatisation process more difficult.

Based on the restructuring progress made in the first half of 2017 and the continuing satisfactory overall key financial figures and ratios the Bank expects that the performance in the second half of 2017 will also in principle be in line with the plan. The Bank remains cautious in its forecast, particularly because of the inherent uncertainties regarding the future progress of the privatisation process. The Bank specifically expects that

- new business for the whole of 2017 will be at least at the level of the previous year (€ 8.9 billion), which would slightly exceed prior expectations
- the winding down of the high risk portfolios as well as the reduction in the NPE ratio will be continued in line with the current plan (decrease in legacy assets of at least € 5.5 billion) as far as possible
- the ongoing cost reduction programme, which so far has been implemented according to plan, will be systematically continued to further build on the noticeable progress already made at the cost and process level and thereby enhance the Bank's performance over the long term
- the CET1 ratio will be above the ambition level of around 13 % but significantly below the high figure as at 30 June 2017. The Bank also expects with regard to the Pro-Forma CET 1 ratio determined on the basis of hypothetical assumptions excluding the regulatory of the relief provided under the second loss guarantee (see "Capital and funding" section for explanatory comments) to be able to disclose a Pro-Forma CET1 ratio above the ambition level of 13 % as at the year end.

It can be generally assumed that additional earnings and cost potential can be leveraged on a successful change in ownership. It can also be assumed that the elimination of existing uncertainties will have a positive effect on the Bank's important key management indicators on the one hand and on the perception of investors and rating agencies on the other. Against this backdrop the Bank expects that – following a successful transformation process – a sustainable business model can be established and the Bank's continued existence can thereby be secured.

Earnings forecast

HSH Nordbank is basing the second half of 2017 on the overall good performance in the first half of the year and the current market environment with regard to new business and achievable margins. Against this backdrop the Bank assumes that the new business trend will be slightly better in the second half of 2017 and that new business volume for the whole of 2017 will be at least at the level of the previous year (€ 8.9 billion), thereby exceeding prior expectations. Furthermore, HSH Nordbank expects that new business margins will continue to be risk-commensurate but at moderately lower levels than in the 2016 financial year due to the continuing challenging competitive environment. At the same time, sales of the range of services offered over and above loan financing will continue to be driven forward to optimally exploit the business and earnings potential.

The earnings base will continue to be strengthened by the focussed new business development and product sales, whereby the restrictions (regional and functional) imposed by the EU are still to be observed until the change in ownership. This will be offset by the elimination of income as a result of the ongoing winding down of non-strategic portfolios and impaired shipping loans. In total, HSH Nordbank still expects a marked increase in total income at the Group level for 2017 as a whole, which according to the plan assumptions also includes effects from the recognition of unrealised gains on the sales of securities, which have already been realised for the most part in the first half of 2017.

Overall satisfactory operating earnings driven by all segments are expected for the Core Bank. Furthermore, the positive effects from the release of unrealised gains are mainly included in the Treasury & Markets segment, which were realised – on the full utilisation of the second loss guarantee – to offset the loan loss provisions recognised. A significant reduction in the balance sheet is planned for the Non-Core Bank in the whole of 2017, through which risk positions should be reduced and the NPE ratio significantly decreased. The focus will be on winding-down measures, particularly as part of the ongoing commitment strategies in different asset classes. Total income for the Non-Core Bank will also stagnate at an overall low level in the future in view of the continuing reduction in the portfolio. The active winding down of the portfolio can only be realised to a limited extent due to the complex settlement conditions under the guarantee agreement.

The commitments undertaken in accordance with the list of conditions and commitments were reflected in the Bank's planning. Under these the Bank is required to limit annual new shipping business to € 1.2 billion. Furthermore, total assets may not exceed € 98 billion at the end of 2017 (on an average EUR/USD exchange rate of 1.10). Asset-based aircraft financing business, which had already been discontinued, will not be resumed. The existing restriction on external growth by prohibiting the acquisition of control in other companies and extension of the ban on proprietary trading will continue to apply. Furthermore, the list of conditions and commitments contains conditions in respect of corporate client business (limited to German clients and their domestic and foreign investments as well as foreign clients, provided they are seeking to execute transactions in Germany).

Opportunities and risks in the earnings forecast

Opportunities

A successful conclusion to the privatisation process will provide numerous opportunities to sharply increase new business and expand the client base taking account of the business potential in the Core Bank that could be realised, especially when the list of conditions and commitments no longer apply. This could result in the leveraging of additional earnings potential.

Following the elimination of the existing uncertainties relating to the privatisation process the Bank could resume a more active role as a stable banking partner, also with regard to the existing business in particular, and thereby expand its objective of being the Bank for Entrepreneurs. The Bank's refinancing costs could also decrease on a successful conclusion to the privatisation process, whereby competitiveness would be strengthened.

The business opportunities in the corporate sector included in the list of conditions and commitments, 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.

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 other possible strategic alignments such as, for example, the planned expansion of asset management activities for institutional clients 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.

Risks

Any deterioration in the macroeconomic environment and conditions in relevant markets would probably result in a lower than assumed demand for loan financing. The competitive situation could also put more pressure on margins than expected. Total income could also be lower than expected due to a more marked rise in the amount of impaired loans.

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

Despite the significant reduction in the amount of high risk securities held higher measurement losses on debt instruments and derivatives 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 already decreased markedly after the planned portfolio transactions have been executed and will further decrease.

Delayed settlement under the guarantee of losses arising on the realised as well as possible further sales of loan portfolios may have a negative impact on HSH Nordbank's earnings situation (for example, as a result of the reduction in the relief from premium payments for the guarantee).

A privatisation process that does not progress according to plan could also have a negative effect on new business performance. An unsuccessful conclusion to the sale process would result in the cessation of new business under the list of conditions and commitments. In such an event HSH Nordbank would have to administer its assets with the objective of orderly private resolution. This would then have a significant adverse impact on earnings and the long-term existence of HSH Nordbank in its present form would not be assured.

Should uncertainties arise relating to the risks described in the "Capital and RWA", "Formal decision in the EU proceedings" and "Funding forecast" subsections, these might subsequently adversely effect the new business and cross-selling performance, which would subsequently have a negative impact on future earnings.

Should more extensive sales of asset positions be executed than planned or the expansion of new business be consciously reduced, this might also have a negative impact on earnings.

There are further closing conditions with respect to the contractually agreed sale of aircraft financing transactions, including technical inspections of the aircraft, which may have further consequences (for example, adjustments to the sales price or withdrawal from the contracts) with a negative impact on the earnings situation.

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.

Furthermore, potential adjustments to the business model and the planned expansion of asset management activities may not be reflected in earnings as expected.

Forecast for administrative expenses

HSH Nordbank's plan provides for the continuing gradual significant reduction in administrative expenses in order to achieve an appropriate cost/income ratio for the Bank on a sustained basis of in principle less than 50 % by 2019.

Within the scope of the planning process, HSH Nordbank has planned a noticeable decrease in administrative expenses and the cost/income ratio for the Group and Core Bank for the whole of 2017 compared to 2016. Thereby, the guidelines of the Management Board were fully incorporated in the cost reduction programme (2018PLUS), which was intensified in May 2016. The plan includes, for example, an accelerated reduction in staff and further decreases in operating expenses. The basis for this is that the implementation of the personnel measures could be more rapidly implemented based on the reconciliation of interests and social plan agreed with the Works Council. The relevant business measures were reviewed in parallel and their implementation was also accelerated. Additional operating expense measures have been specified during the course of business in 2016 and will probably be implemented in 2017 virtually in line with the plan. In general, according to the list of conditions and commitments, which forms the basis for the formal decision of the EU Commission, the Bank is obligated to gradually reduce administrative expenses during the divestiture period to € 540 million (excluding any potential IFRS 10 effects) in 2017. This requirement will be clearly exceeded in 2017 from today's perspective.

The cost reduction programme, which has existed since 2014 and was last adjusted on a needs basis in May 2016, is generally aimed at a further streamlining of the organisational structure, simplification of key processes, optimisation of the product portfolio and realignment of the Bank's IT and had an impact in the 2017 financial year. Thus, the controllable administrative expenses for operating activities decreased noticeably compared to the previous year. Expenses incurred by HSH Nordbank in servicing hsh portfoliomanagement AöR are remunerated in line with market conditions; the remuneration is disclosed under other operating income.

The number of employees will be significantly reduced by 2019 at a gradual pace as part of the extended cost reduction measures. An additional moderate reduction is planned for the year 2017 as a whole. 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 of administrative expenses

Opportunities

Should the privatisation process come to a successful conclusion, this would give rise to opportunities under a new owner for making further adjustments to the current cost structures and realise additional cost-saving potential that would arise from possible synergies and, if applicable, 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 area, will be continuously reviewed as part of the measures controlling process to ensure the successful implementation of the cost plan.

The Bank assumes that measures initiated to reduce costs will also continue to be implemented successfully with regard to the expected reduction in the number of employees. 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 reductions in total assets, and therefore refinancing requirements, there may result savings in terms of the Bank's planned expenses for the bank levy and deposit guarantee fund, while other calculation parameters (for example the institution risk factor) remain the same.

Risks

If the cost-saving measures are not implemented as planned, particularly because of unforeseeable risks in the business operations, it cannot be ruled out that some costs cannot 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 extent is difficult to estimate, but unavoidable consequences for administrative expenses are possible.

It cannot be excluded that 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 implementation risk, 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 required in connection with the initiated and continuing cost reduction programme to achieve cost savings 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.

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

The signs of a moderate recovery in the shipping markets important for HSH Nordbank – apart from the tanker segment – should continue in the second half of 2017. Second-hand prices are nevertheless only recovering slowly, such that HSH Nordbank assumes that further significant additions to loan loss provisions will be required by the 2017 year end. The Bank estimates that net additions in the Group and Non-Core Bank will continue to be significant and in line with the plan. At the same time, the Bank continues to assume that total net additions to be recognised in the 2017 financial year will be appreciably below the significantly high level in the 2016 financial year. The focal point of loan loss provisions will continue to be the non-performing shipping loans in the legacy portfolio, especially in the container ship segment. Due to the continuing reduction in non-performing loans in the Non-Core Bank the Bank also assumes that there will be a further marked reduction in the NPE ratio at the Group level in the second half of 2017. Contrary to the previous plan, the Non-Core Bank's NPE ratio will only decrease slightly on a purely arithmetical basis. The NPE ratio for the Core Bank will remain at a low level.

The Bank assumed a reduction of € 5.5 billion (EaD) in the Non-Core Bank's legacy asset portfolios, which contains the major portion of the Bank's NPE volume, for the whole of 2017. € 4.2 billion of this had already been implemented in the first half of the year, of which portfolio sales in the market account for € 2.3 billion. The Non-Core Bank's EaD is to amount to a maximum of € 15.9 billion as at the 2017 year end. The Bank assumes that legacy assets will continue to be wound down in line with the plan in the second half of 2017. Opportunities are to be exploited where possible to reduce historical concentration risks, which could result in the planned EaD reduction of € 5.5 billion being exceeded. Against the backdrop of a high utilisation of loan loss provisions with a corresponding reduction in volume the coverage ratio in the Group and Non-Core Bank will decrease significantly in the second half of 2017 compared to the high level achieved as at 30 June 2017. It will probably be at the previous year's level in the Group and Non-Core Bank as at the 2017 year end and will not moderately increase again as assumed in the previous plan.

The Bank also expects full balance sheet utilisation of the guarantee in the second half of 2017 as well, with the effect that further planned additions to loan loss provisions in the guaranteed portfolio will no longer be compensated for by the guarantee and will therefore be recognised directly through profit or loss.

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). Estimates concerning long-term loan loss provisions are based on the assumption of a recovery in the shipping markets respectively in the container shipping industry as well as the continuation of the current commitment strategy for the problem loan portfolio and therefore on the assumption that HSH Nordbank is willing to continue to provide financing in order to achieve the planned reversals of impairment losses in the future.

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. It is conceivable that the global economy might grow more strongly in the second half of the 2017 financial year than forecast, which in turn could support a gradual recovery of the shipping markets and therefore entail a lower need for loan loss provisions.

A greater level of restructuring successes than expected and a rapid winding down of the non-performing loans could reduce loan loss provisions in the future more sharply than expected.

An appreciation of the EUR/USD exchange rate would accordingly reduce total loan loss provisions for the guaranteed US dollar portfolio as a result of the currency effect and would tend to reduce the amount of expected payment defaults in future.

Risks

Estimates regarding the long-term trend in loan loss provisions as well as loss planning and, consequently, the final drawdown of the second loss guarantee are subject to considerable uncertainty due to the long planning horizon. This applies in particular to the movement in the US dollar exchange rate and key market parameters in the shipping industry such as cargo and charter rates as well as ship values, which are key input parameters for determining the loan loss provisions. In view of the continuing existing overcapacity in the shipping markets, it cannot be ruled out that the extent and timing of the market recovery and recoverability of individual commitments may not be achieved in the planning period as assumed in the loan loss provision plan. Due to this, and particularly in the case of new or further falls in charter rates or ship values, loan loss provisions required may continue to increase significantly. This could have a significant long-term impact on the total expected payment defaults. This would adversely impact HSH Nordbank mainly as a result of higher than planned loan loss provisions, which could no longer be compensated for due to the expected full balance sheet utilisation of the guarantee. Reference is made to the explanations set out in the "Opportunities and risks in the capital and RWA forecast" section regarding the impact of the non-occurrence of the recovery in the shipping markets assumed as part of the planning.

Developments regarding the situation in other sectors may also be worse than expected and require higher loan loss provisions as a result. Furthermore, it can also not be ruled out that, following the Brexit vote in Great Britain, the cohesion of the EU will be weakened, which could lead to a weakening in the relevant markets. This in turn could result in additional impairment losses having to be recognised. Market turbulence in emerging countries and geopolitical risks could also have negative effects.

Furthermore, unplanned losses could also be incurred, if additional assets were to be sold in an unfavourable environment as part of a further acceleration in the reduction in risk or the restructuring strategy, particularly the Bank's willingness to continue to finance non-performing loans, were to be changed. A change in the restructuring strategy and, as a result, the recognition of loan loss provisions based on the assumption of the workout of loan commitments could restrict the recognition of planned future reversals of loan loss provisions due to the recovery in the shipping markets assumed in the plan.

Individual restructuring measures for large commitments or restructuring solutions, which require a change to commitment strategies (for example, extensive waivers of debt), may result in a significant increase in the need for loan loss provisions.

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.

With respect to the planned reduction in NPE, which is also supported as part of the restructuring solutions for non-performing commitments, and based on this the assumed improvement of the NPE ratio , implementation of the winding-down strategy may not be feasible as to the amount, loan valuations and/or timing assumed by the Bank. This could give rise to the need to recognise additional loan loss provisions and, on the other hand, the NPE ratio may not be reduced as assumed. Additional loan loss provisions may also be needed in the event of unplanned asset sales. The main reason for this is that, according to the requirements of the guarantee agreement, only the loan value based on the credit rating and not the current market price is applied in the settlement under the guarantee.

Inspections of the aircraft included in the market portfolio transaction signed in January 2017 could result in subsequent unfavourable adjustments to the sales price and thus to an additional need for loan loss provisions.

The amount of losses settled on the drawdown of the second loss guarantee may be lower than the assumptions made by the Bank regarding the hedging effect of the guarantee (for example, if certain losses are not recognised by the guarantor) and result in a charge to profit and loss from the corresponding reversal of the compensation previously recognised under the second loss guarantee.

New accounting rules (such as IFRS 9 from 2018) may also have a significant adverse impact on loan loss provisions over and above the conversion effects incorporated in the current plan. For example, potentially higher than planned required general loan loss provisions as a result of a deterioration in the risk parameters or a much more extensive application of fair value accounting under IFRS 9 than previously assumed, may adversely impact loan loss provisions in the lending business or capital on the adoption date. This applies in particular to a currently unanticipated situation, in which further portfolios of HSH Nordbank – contrary to the current plan – are assigned to a business model as defined in IFRS 9 that requires the portfolio to be measured at fair value.

Reference is made to the "Opportunities and risks of the formal decision in the EU state aid proceedings" regarding risks in the privatisation process, which also affect loan loss provisions.

Capital and RWA forecast

HSH Nordbank assumes that the capital ratios will continue to be significantly above the SREP requirements for 2017 and as at the 2017 year end. HSH Nordbank expects to be able to continue to disclose a regulatory CET1 ratio above the ambition level of 13.0 %, which, however, will be significantly below the level as at 30 June 2017. The Bank expects with regard to the Pro Forma CET1 ratio determined on the basis of hypothetical assumptions excluding the regulatory effect of the relief provided under the second loss guarantee (see "Capital and funding" subsection for explanatory comments) that the Bank will also be able to disclose a pro forma CET1 ratio above the ambition level of 13.0 %. Through this the Bank anticipates in its reporting any future developments in the privatisation process and possible regulatory requirements.

HSH Nordbank assumes a slight increase in RWA as at the 2017 year end compared to the reporting date based on a stronger US dollar and expected new business. The market transactions signed at end of the first half of the year are not expected to provide any significant relief in the second half of the year.

HSH Nordbank expects with regard to the CET1 ratio forecast to incur significant regulatory charges over the remainder of 2017, particularly as a result of the further reduction in NPE as part of the restructuring solutions for non-performing commitments in the Non-Core bank's shipping portfolio. In this connection, the guarantee volume not yet settled is reduced by the settlement of losses vis-à-vis the guarantor and the regulatory equity deduction item ("sub-senior tranche of the federal state guarantee") in turn increases and aversely impacts the capital ratios.

The transfer of the majority of the shares in HSH Nordbank AG from the previous shareholders to the holding company has 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 (CET1 4.5%) as well as additional capital buffer requirements, are to be complied with. According to the plan the Pillar 1 minimum capital requirements pursuant to CRR (CET1 4.5%) 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 completed. HSH Nordbank expects a CET1 capital ratio significantly below the level of 30 June 2017 for the financial holding group as at the year end.

Opportunities and risks in the capital and RWA forecast

Opportunities

Opportunities for the capital ratios and RWA result from more favourable trends in the relevant market and risk parameters and a sustained recovery in the shipping markets, which mitigate the negative effects from the restructuring solutions required for the legacy assets.

If the EUR/USD exchange rate remains at its high level of 30 June 2017 or the EUR/USD exchange rate appreciates further, the capital ratio may be significantly above the expectations.

A continuing satisfactory earnings performance, or which exceeds expectations, in the second half of 2017 would also have a positive effect on the capital ratio.

With respect to the Pro-Forma capital ratio determined under hypothetical assumptions that excludes the regulatory effect of the relief provided under the second loss guarantee (see "Capital and funding" subsection for explanatory comments), an increase in the reduction in the NPE could improve the capital ratio within the context of the loan loss provisions recognised.

Risks

Material risks for the capital ratios and RWA result from a potential deterioration in market and risk parameters in the Bank's core markets including a stronger US dollar, a lower than planned reduction in the portfolios and the regulatory environment, for instance from interpretation decisions or audits. There is the risk 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 or appropriate restructuring measures, will result in a marked increase in losses and put considerable pressure on the capital ratios. Developments that result in an increase in risk-weighted assets (RWA) in the guaranteed portfolio have a direct, adverse impact on the Bank's CET1 ratio due to the guarantee buffer of the federal state guarantee having been exhausted from a regulatory perspective.

It is also possible that additional individual and increased capital requirements or additional requirements will arise from the regular SREP process carried out in the Banking Union. Further discretionary decisions on the part of the regulator, e.g. regarding model risks and validations and sector-wide capital requirements (capital buffer for systemic and cyclical risks) may therefore result in higher capital requirements.

Discretionary decisions made by the regulator regarding compliance with the significant risk transfer requirement as defined in Article 244 CRR that the second loss guarantee is to be recognised for regulatory purposes as a securitised position using the Supervisory Formula Approach (SFA) may also, against the backdrop of an increase in the economic utilisation of the guarantee, result in its recognition as a securitised position being no longer permitted under the SFA, which will have an adverse impact on the capital ratios.

It is expected with respect to the regulatory effectiveness of the second loss guarantee that the supervisory authorities will perform a follow-up review of the second loss guarantee mechanism including compliance with the transfer of significant risk in the context of the privatisation with regard to the treatment of the second loss guarantee. The public owners and potential investors involved in the privatisation process were notified of this.

If the recovery in the shipping industry assumed in the plan does not materialise, measures would be required to strengthen the capital ratios (for example, reduction in new business, sales of loan portfolios, sales of securities portfolios) in order to comply with the regulatory minimum requirements (Pillar 2 Guidance) at the sub-group level. In such a scenario (marketing recovery in the shipping industry fails to materialise) or a further downside scenario (weaker macroeconomic environment, reduction in new business, adverse impact of additional loan loss provisions) the owners and/or third parties would be required to take measures to strengthen the capital ratios in order to be able to comply with the regulatory minimum capital requirements, insofar as its recognition of the second loss guarantee as a securitisation position using the SFA is no longer permitted by the regulator (see Pro-Forma capital ratio in the "Capital and funding" subsection).

Reference is made to the "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" subsection regarding risks in the privatisation process, which also affect capital.

Specific 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, however, required to comply with the regulatory requirements at the financial holding level. 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 specific risks for HSH Nordbank AG resulting from the financial holding group are described below:

There is a risk with regard to the financial holding group subject to banking supervision that not all capital buffer requirements, which exceed the Pillar 1 minimum requirements pursuant to CRR (CET1 4.5 %), can be fully complied with at the financial holding group level due to the high premiums payable 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.

There is also the risk that even the Pillar 1 minimum requirements pursuant to CRR (CET1 4.5 %) could not be complied with in the planning period (e.g. on a significant deterioration in market and risk parameters, non-occurrence of the recovery in the shipping industry assumed in the plan) without implementing additional capital strengthening measures involving the owners and/or third parties. Non-compliance with the minimum capital requirements could have serious repercussions for the operating business. Capital-strengthening measures would have to be taken by the owners and/or third parties to comply with the Pillar 1 minimum capital requirements according to CRR (CET1 of 4.5 %) to prevent such a scenario.

Also in the event of a downside scenario (weaker macroeconomic environment, reduction in new business, adverse impact of additional loan loss provisions) the Pillar 1 minimum requirements according to the CRR (CET1 of 4.5 %) may only be complied with after implementation of capital-strengthening measures taken by the Bank itself (for example, reduction in new business, sales of loan portfolios, sales of securities) or under the assumption of the deferral (supervisory phasing-in) of the capital charge arising on the first-time adoption of IFRS 9 over 5 years or by measures taken by the owners and/or third parties to strengthen the capital ratios. Non-compliance with the minimum capital requirements could have serious repercussions on the operating company.

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 full settlement under the guarantee by 2022. 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 holding company level.

At the financial holding group level there are risks particularly relating to unresolved interpretation questions concerning the first-time adoption of IFRS 9 (e.g. in connection with the assignment of assets to a business model as defined in IFRS 9) that may have a significantly adverse impact on the capital ratios of the financial holding group.

With the formation of HSH Beteiligungs Management GmbH HSH Nordbank as the “parent institution” is required under Article 11 (2) CRR to also comply with the large exposure regulations (Part 4 of the CRR) at the financial holding group level. The large exposure limit, which is also to be adhered to, is therefore based on the regulatory capital at the Group level of the financial holding group. However, as this is significantly lower than in the sub-group 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 taken over the lower regulatory capital at the Group level of HSH Beteiligungs Management GmbH as a reference value for large exposure management as well and, as a result, has partially set limits according to its trading and credit lines as a precautionary measure to reduce the risk of exceeding the large exposure limit.

The large exposure limit at the financial holding group level is € 1,008 million as at 30 June 2017, whilst that of the HSH Nordbank Group (sub-Group) is € 853 million higher at € 1,861 million. A reduction in the large exposure limit may lead to restrictions if restructuring tools are chosen to restructure loans or result in the large exposure limit being exceeded by individual large exposure cases.

Risks resulting from the general regulatory and accounting regulations

The forecast of the medium-term CET1 ratio is based on the assumption that the operation of the guarantee structure remains unchanged under the regulations currently applicable to securitisations. A tightening of the supervisory set or rules regarding securitisations due to the further development of the Basel III framework (CRR II), which could come into force as from 2020 for HSH Nordbank through its implementation in the EU, could result in the waiving of the recognition of the second loss guarantee under the SFA and could adversely impact the capital ratios.

A large number of potential changes in the area of market, operational and counterparty risk will be consolidated in this regard under CRR II from 2020. The capital ratios may continue to be significantly impacted in future by the intended changes to the regulatory requirements (partly referred to as “Basel IV“), probably gradually from 2021 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). It is planned under Basel IV 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).

As expected, new accounting rules (for example, IFRS 9 from 2018) will adversely impact capital adequacy over and above the regulatory requirements. These risks are addressed in detail in the “Forecast of loan loss provisions” section.

The transposition of the Bank Recovery and Resolution Directive (BRRD) into national law (Recovery and Resolution Act, Sanierungs- und Abwicklungsgesetz, SAG) will result in new capital requirements 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 institutions directly supervised by the ECB and therefore for HSH Nordbank (Minimum Requirements on Eligible Liabilities, MREL).

There are risks for German institutions regarding compliance with the MREL ratio in the discussions still in progress at the European Commission (trialogue) about the qualitative requirements for eligible liabilities for non-global systemically important institutions and the recognition of sub-senior liabilities existing since 1 January 2017 under Section 46f KWG (grandfathering).

If several of the risks described for the capital ratios or the risks in the privation process affecting capital described in the “Opportunities and risks resulting from the formal decision in the EU state aid proceedings” subsection were to materialise together, the owners and/or third parties may be required to take additional measures to strengthen capital at all regulatory levels. If additional measures to strengthen capital are required in the event that one of the risks described in this “Capital and funding forecast” subsection materialises, which cannot be implemented by the Bank itself or without state aid, this could result in the workout 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.

Funding forecast

The Bank expects to continue to successfully implement its diversified funding strategy in the second half of 2017. The Bank’s asset business will continue to be refinanced primarily by providing bond products for the client business of the savings banks and other financial institutions and placing secured and unsecured bonds with institutional investors and the deposit business transacted with the Bank’s corporate clients.

The funding plan is based on access to the relevant markets including the German Savings Banks Association and other financial institutions. 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. Additional forms of potential funding are asset-based transactions, to which HSH Nordbank attaches great importance especially for the refinancing of the US dollar asset business.

The Bank expects the regulatory liquidity ratio as defined in the Liquidity Regulation (LiqV) to be at the high level prevailing at the 2016 year end for the remainder of 2017. HSH Nordbank also expects that the trend of the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) will be stable compared to the 2016 year end and consequently that the corridor of 80% to 120% provided for in the list of conditions and commitments will be complied with. 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 and the key ratios will remain more or less at the currently high 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 transactions contractually agreed at the beginning of 2017 have contributed to the improvement in the Bank's liquidity situation. A significant portion of the purchase price payments has already been received in March and April 2017. Further purchase price payments expected in September and October 2017 relating to executed and planned portfolio sales and any returns from winding down measures will also lead to a further improvement in the liquidity situation in the second half of 2017 In this regard, the Bank assumed in its liquidity planning that the sales prices will be paid on the respective transaction dates and associated inflows relating to the settlement of losses for the market portfolio will occur six to nine months after the respective transaction date.

Stable access, also in unfavourable market conditions, to refinancing sources that are not dependent for the most part on events in the capital markets such as the German Savings Banks Association and other financial networks as well as to collateralised refinancing sources such as Pfandbriefe and asset-based funding, which is also important for refinancing US dollar business, is paramount.

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 USD business in the Core Bank refinanced by primary USD funding (and not by derivatives) is to be at least 55% as at the 2017 and 2018 year ends.

The two rating agencies, Moody's and Fitch, regarded the conclusion of the EU proceedings as important milestones and assessed the structural measures, which lead to an improvement in the financial and risk profile, as positive in principle. This applies in particular to the portfolio transfer which relieves the Bank of non-performing loans. Nevertheless, the agencies especially consider the uncertainty during the divestiture period and ambitious time frame for a change in ownership to be a burden. The Bank's future rating position will be determined by the planned further implementation of the structural measures against the backdrop of a challenging market environment as well as the progress made in selling the Bank.

Opportunities and risks in the funding forecast

Opportunities

The fulfilment of the funding objectives is mainly influenced by external factors. A favourable capital market environment would support the implementation of the issuing strategy in the remainder of 2017. A sustained expansive monetary policy on the part of the ECB and the associated ample liquidity base is likely to tend to continue 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. This is also of key importance for assessments made by the rating agencies. Like this, ratings that are continued to be confirmed as investment grade would significantly underpin the implementation of the funding targets.

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.

The current funding plan was also positively impacted by sales of loan portfolios over and those described in the plan and revenues from restructuring activities.

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 in the first half of the year. 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 area which could have a significant adverse impact on the Bank's funding.

Should there be delays in the settlement of losses or sales prices relating to the sub-portfolios sold in the market since January 2017 or to be sold in the future, this may negatively affect the Bank's planned liquidity position at each settlement date. Furthermore, the planned liquidity relief could be delayed if the speed at which losses are settled is lower than that assumed in the plan, particularly in the case of the settlement of losses arising on the sale of market portfolios.

Potential rating downgrades, which cannot be excluded despite the recently confirmed investment grade rating during the privatisation process, 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 both Moody's as well as by Fitch would result in a rating outside investment grade. Adverse developments, particularly during the privatisation period (for example a decrease in capitalisation, non-compliance with the minimum capital requirements, liquidity problems, unplanned deterioration in earnings or setbacks in the privatisation process) may 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 54: residual maturity breakdown of financial instruments in the Group financial statements as at 31 December 2016 for details on the maturity structure of liabilities) and existing depositor concentration on institutional investors. At the financial holding group level there are risks particularly relating to unresolved interpretation questions concerning the first-time adoption of IFRS 9 (e.g. in connection with the assignment of assets to a business model as defined in IFRS 9) that may have a significantly adverse impact on the capital ratios of the financial holding group.

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. Even 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 other refinancing sources such as the German Savings Bank's Association and other financial institutions significantly be hampered, this would also severely limit the funding options and would adversely impact the rating of the Bank.

A significant portion of assets denominated in foreign currency is 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.

Because of the influence of the EUR/USD exchange rate on the Bank's liquidity position due to the need to provide collateral for EUR/USD basis swaps the focus continues to be placed on the reduction of US dollar assets in different asset classes in the course of the winding down of portfolios in the Non-Core Bank. Furthermore, the restrictions on US dollar business will be maintained.

The regulatory liquidity ratio of the German Liquidity Regulation (LiqV) as well as other 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, the 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.

Reference is made to the "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" subsection regarding risks in the privatisation process that also affect liquidity and funding.

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 finally 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. These measures are generally in line with the informal agreement already announced in the 2015 financial year. These include in particular the reduction in guarantee fees, formation of a holding structure and sale of non-performing loans in an initial amount of € 5 billion to the federal state owners and in the amount of up to € 3.2 billion in the market as well as a one-off payment of € 210 million from HSH Nordbank to the holding company in connection with the premium obligations taken over by the holding and the provision of liquidity in the amount of € 50 million to the holding company to ensure its operations.

Furthermore, it is intended to sell HSH Nordbank by 28 February 2018. In this regard, the list of conditions and commitments provide for the option of selling business divisions or parts thereof with the consent of the federal state owners. Consequently, a sale of HSH Nordbank as a whole or in part is possible. The divestment deadline is met upon the signing of a purchase agreement and may be extended by up to six months with the consent of the EU Commission where there are delays in the technical implementation of the model for reasons outside the control of the federal states.

The planned structural measures and resulting expected effect on the net assets, financial position and earnings are taken into account in the Bank's new plan for the coming years. Key structural measures were implemented in line with the plan in the previous year and first half of 2017, such as the formation of the holding structure to relieve the operating HSH Nordbank from guarantee obligations, sale of non-performing loans of € 5 billion as at 30 June 2016 to hsh portfoliomanagement AöR (federal state owners), sale of a portion of the market portfolio in January 2017 and further sales in the market over the remainder of the year.

Following the relief recognised in the 2015 annual and Group financial statements a large proportion of the long-term structural improvements for the Bank's financial and risk situation, primarily due to the significant reduction in the base premium and noticeable improvement in the NPE ratio, has been achieved. This will improve the conditions for a sustainable long-term business model for the Bank. It is expected that the reduction in the significant legacy assets covered as the reference portfolio under the guarantee facility provided by the federal states will be accelerated. Nevertheless, the targeted improvements are restricted given the complex settlement conditions, particularly with regard to the options for winding down legacy assets based on purely economic criteria as part of an active portfolio management and thereby counteract the build-up of a high NPE volume.

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 is to be restructured in such a way that facilitates the successful sale of this company as a whole or of divisions or parts thereof (with the consent of the public owners) by 28 February 2018. This divestiture period is met with the signing of a sales agreement and may be extended by six months with the consent of the EU Commission, if the technical implementation of the model is delayed due to circumstances over which the federal states have no direct influence. The transfer in rem of the shares to a buyer (closing) may be made at a later date. The sale will be executed as part of an open, non-discriminatory, competitive and transparent process. The participating bidders must have the necessary financial resources and proven sector expertise to manage the operating company as a profitable and active competitor.

Shares representing 94.9 % held directly by HSH Beteiligungs Management GmbH ("HoldCo") are to be sold as part of the intended sale of the Overall Bank. The federal states of Hamburg and Schleswig-Holstein and (to a much lesser extent) other (indirect) shareholders of HSH Nordbank AG stand behind the HoldCo. The acquisition of the remaining shares of 5.1 % held by the fund managed by J.C. Flowers & Co. LLC is also possible under certain conditions. Under the EU decision the federal states are entitled to retain their investment in the holding company up to 25 % of the shares in the operating company for a period of up to four years following completion of the sale.

The owners are responsible for the sale of the shares, HSH Nordbank's Management Board supports the sale accordingly.

From the shareholders' standpoint, the sale of HSH Nordbank as a whole, i.e. the sale of all shares held by the seller in a share deal, is the objective of the sale process. Preference is to be given in assessing the bids to those bidders whose bid is based on the acquisition of the Bank as a whole at a positive price. In order to ensure the maximum degree of flexibility, the federal state owners have also provided as a precaution the possibility in the sales announcement of transaction structures that differ from the preferred sale of the Bank as a whole Accordingly, the list of conditions and commitment also provides for the possibility of the sale of divisions or parts thereof with the consent of the federal state owners. In this way, the maximum interest of potential investors is sounded out and it is ensured that all available solution options are considered. Against this backdrop alternative privatisation options are also being discussed in addition to the preferred sale of the Bank as a whole. The sale of a bank structurally relieved of legacy assets is therefore being discussed in addition to the preferred sale of the Bank as a whole to one or several investors (bidder consortium). In this case, the scope of the risk transfer offered by potential investors would be a key assessment criterion for the sellers. A potential reduction of legacy assets as part of the sale of the bank as a whole does not represent an isolated portfolio transaction of the Bank, but could be a part of the bidding process and therefore of the sale process. The Management Board will only agree to an alternative transaction structure if it is ensured that the Bank's continued existence is guaranteed by the sale. This means in the event of such a scenario that a sale of individual portfolios before or during the privatisation would only be executed if it is ensured that the remaining bank is regarded as being in a economically better after such sale.

The federal state owners stated in its announcement of 2 July 2017 with respect to the submission of expanded indicative bids that bids expected by the federal states had been submitted on time and, after an initial review, form a good basis for successfully continuing the sale process.

Based on the available information the Bank continues to expect in its plans that the Bank will be sold as a whole.

Following the successful completion of the sales process resulting in an offer that does not require state aid and an offer price that is positive (while retaining the guarantee) the intended acquisition will be subject to a viability assessment of the new corporate structure by the EU Commission prior to implementation and has to be approved by the EU Commission. Should the divestment procedure not lead to offers not requiring state aid (while maintaining the guarantee) with a positive price being offered before the expiry of the deadline or should the Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business according to the list of conditions and commitments and manage its assets as far as legally permissible with the aim of a privately managed orderly wind-down. Under the list of conditions and commitments the restructuring of existing loans in recovery, certain transactions entered into for liquidity management purposes, prolongations at the same terms or to avoid losses as well as derivative transactions entered into to manage the Bank's overall market risk positions, are still permitted in this connection.

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.

Based on the information available as at the reporting date, the Bank assumes that, on the successful conclusion of the privatisation process, it will again be able to pay dividends and make distributions on hybrid capital for the 2019 financial year at the earliest in 2020.

According to the list of conditions and commitments provisions regarding the reduction in total assets and the business model are also to be complied with during the restructuring phase, which ends with the sale of the operating company, and the restriction on external growth through the acquisition of control in other companies is also to be observed (see also the Earnings forecast report including opportunities and risks in this section).

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

Opportunities

The successful implementation of the measures undertaken and still outstanding would create a further improved basis for establishing a sustainable business model for the Bank and enabling a successful privatisation process.

The successful implementation of the structural measures provided for in the list of conditions and commitments in the EU decision, particularly privatisation and a positive viability review of a new corporate structure required in this regard, and approval by the EU Commission would significantly improve the Bank's business activities and funding situation and end the uncertainty for clients and employees as well as capital market participants.

Acquisition of an ownership position by another strong partner as part of the planned privatisation of HSH Nordbank would increase business and refinancing opportunities of the Bank and thereby contribute to the further strengthening of the business model.

Risks

If the implementation of the formal decision and list of conditions and commitments, particularly the privatisation to be completed by 28 February 2018 and the viability review of the new corporate structure required in this connection as well as approval of the acquisition by the EU Commission, is not, not fully or not successful within the specified time frame, this would represent a significant threat to the further implementation of the business model and therefore the outlook for the Bank.

Should the scope of the higher relief proposed and agreed by the Bank for the NPE portfolio on the basis of the EU decision prove to be too low on a sustained basis, this would significantly jeopardise the further implementation of the business model and thus the Bank's prospects.

In the event that the privatisation is not successful or not completed on time, and the required final viability review of the new corporate structure or approval of the acquisition by the EU Commission is not, not fully carried out nor given nor within the currently specified time frame, HSH Nordbank would have to cease new business activities and administer its assets with the objective of a privately managed orderly wind-down. The long-term survival of HSH Nordbank in its present form would not be ensured in this case. Such a situation – also in view of the fact that cessation of new business would also include the deposit business – 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 applies if the Bank is subject to a privately managed orderly wind-down as a result of this or due to other reasons.

In this regard, the Bank analyses different scenarios as a precaution in coordination with the supervisory authorities 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 privately managed orderly wind-down or in other situations the resolution conditions laid down in Regulation (EU) no. 806/2014 (SRM-VO) 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.

If it should transpire during the Bank's privatisation process that the preferred sale of HSH Nordbank as a whole, i.e. the sale of all shares held in the Bank by the seller including all assets and liabilities as the key assumption of the Bank's corporate planning, cannot be implemented, this could result in structured sub-bank solutions. It cannot be ruled out in this case that extensive sales of loan portfolios, particularly in the Non-Core Bank, will become necessary, which could result in significant additional loan loss provision expense and also have a significant adverse impact on the capital ratios. Significant write-downs of deferred tax assets may also be required. In this case and especially in combination with other risks described the owners or third parties may also be required to take measures to strengthen the capital ratios in order to be able to comply with the necessary capital requirements. However, the Management Board will approve such portfolio sales, if it is ensured that the continued existence of the Bank is still guaranteed by the sale, i.e. this does not result particular in a shortfall in particular under the minimum capitalisation and/or liquidity requirements to be complied with.

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.

Furthermore, tax risks could arise in connection with the transfer of assets, particularly to foreign jurisdictions, as part of the implementation of the portfolio transaction. This may lead on the one hand to higher loan loss provision expense or other expense that is not included in the plan.

Under the list of conditions and commitments, the Bank is required to limit annual new shipping business to € 1.2 billion. Furthermore, total assets may not exceed € 98 billion at the end of 2017 (on an average EUR/USD exchange rate of 1.10). In addition, the list 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 trans-actions in Germany), a waiver on the part of the Bank not to resume the already discontinued asset-based aircraft financing business, a restriction on external growth by prohibiting the acquisition of control in other companies and an extension of the ban on proprietary trading. 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 Bank Finance Group (Section 39 (1) of the Framework Statute). Under the voluntary institutional protection there is no legally binding entitlement to support funds 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 at a date not currently known, its membership in the guarantee fund of the 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 event of a change in ownership as the result of a sale to private investors HSH Nordbank would cease to be a member of the DSGV, and therefore of the protection scheme of the Savings Banks Finance Group as well, after the expiry of a two year transition period. This could increase HSH Nordbank AG’s refinancing costs, make access to funding channels more difficult and have a substantial negative impact on the external rating issued by the rating agencies.

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 and significant group companies is based in particular on the following assumptions:

(i) the agreements required for the implementation of the decision taken by the EU Commission in the EU state aid proceedings on the replenishment of the second loss guarantee are entered into comprehensively and on a timely basis and that the decision will be implemented by HSH Nordbank AG and its shareholders in full and on a timely basis.

(ii) the operating company, HSH Nordbank AG, is sold at a positive sales price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline, or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company 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 during the privatisation period, it 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.

(iii) as part of the ongoing privatisation process of HSH Nordbank AG, HSH Nordbank AG will be sold in full as a whole bank, i.e. the shares in the Bank held by the seller will be disposed of, including all assets and liabilities, without any material early disposals of assets or subsegments at prices below the carrying amount in the case of offers for the entire business having been received. If extensive sales of loan portfolios, particularly in the Non-Core Bank, are required, it could result in significant additional loan loss provision expenses that are not compensated for by the guarantee, and could require material depreciation of deferred taxes.

(iv) the minimum capital requirements at all regulatory levels can be adhered to in accordance with the corresponding SREP resolutions passed by the European Central Bank and the statutory provisions during the forecast period. If there is a need for significant additional loan loss provision expenses and material depreciations of deferred taxes (e.g. in the scenario described above) or if the recovery of the shipping market that has been assumed in the Bank's corporate planning does not materialise as planned, or if the regulatory treatment of the second loss guarantee as a securitisation position is no longer approved by the banking supervisory authority, this could put considerable pressure on the capital ratios and additional measures may need to be taken by the owners and/or third parties to strengthen the capital ratios in order to be able to adhere to the minimum capital requirements, particularly at the level of the financial holding group. If such measures are not taken, it could result in the winding down of HSH Nordbank.

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

Overall appraisal and net income forecast

The ongoing privatisation process will also shape the second half of 2017. Following the submission of the expanded indicative bids the challenging due diligence phase will be continued rigorously. Based on the progress made so far in the privatisation process the Bank together with its federal state owners remains confident that it will be able to overcome the future challenges of an inherently very complex sales process.

Privatisation is taking place in a delicate balance between the forward-looking Core Bank, the high charges incurred as a result of the legacy loans held in the Non-Core Bank and the complex guarantee structure in term of its settlement procedures and regulatory effect. It should be borne in mind that the guarantee issued in 2009 as an important component of the Bank's recapitalisation required at that time is committed for the most part to the present Non-Core Bank and is therefore an essential element of the Non-Core Bank's capital base. A solution is therefore required in the context of the privatisation that ensures a sustainable business model with a resilient profitability, capital, risk and liquidity profile. In addition to the preferred sale of the Bank as a whole, alternative viable privatisation solutions are also not excluded in this regard, which will then have to be determined between the owners and potential investors.

Simultaneously with the privatisation process the Bank will progress the strict implementation of its restructuring in the second half of 2017 and systematically drive forward its hitherto encouraging client business based on the operating successes achieved. Furthermore, the Bank will implement the ongoing strategic and operational optimisation measures in a targeted manner. In addition, the ongoing winding-down of non-performing loans will be continued in order to further reduce the high amount of legacy loans covered by the guarantee, which were entered into as part of the strong business expansion in the years prior to 2009 and not decisively reduced by the EU decision in 2016, within the narrow limits set by the guarantee. These various measures will further strengthen the progress already made in realigning the Bank. This will gradually create a business model for HSH Nordbank which, at a minimum, should convince clients, employees and investors as well as potential bidders and facilitate a successful change in ownership.

In summary, substantial challenges and risks regarding the future development of HSH Nordbank may arise particularly as a result of a deviation from the planned privatisation process, the difficult market conditions in the shipping industry, the low level of interest rates and highly competitive environment, volatility in the financial and currency markets (particularly the US dollar), changing assessments from the rating agencies and not least the increasing requirements of the European bank regulators. The future trend of charter rates and ship values as well as estimates of the long-term trend of loan loss provisions are subject to significant uncertainty. The Bank still assumes that there will be a further significant need for loan loss provisions in 2017, primarily in the legacy portfolio. Moreover the privatisation process, during which intense political discussions cannot be excluded, should be structured in such a way that the Bank's forward-looking perspective as a recognised partner for the interests of the economy is not adversely affected.

It is also extremely important that, despite a multitude of influencing factors (including discretionary decisions on the part of the banking regulator, uncertainty regarding the impact of the IFRS 9 conversion, assumed long-term recovery of the shipping markets, potential losses on further sales of loan portfolios), the minimum capital ratios are complied with at both the HSH Nordbank sub-group level and the financial holding company level (HSH Beteiligungs Management GmbH) and 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.

It is expected with respect to the regulatory effectiveness of the second loss guarantee that the supervisory authorities will perform a follow-up review of the second loss guarantee mechanism including compliance with the transfer of significant risk in the context of the privatisation with regard to the treatment of the second loss guarantee. The public owners and potential investors involved in the privatisation process were notified of this. In this respect, the Bank expects to be able to disclose a Pro-Forma CET1 ratio as at the 2017 year end, which was determined on the basis of hypothetical assumptions excluding the regulatory effect of the relief provided under the second loss guarantee (see "Capital and funding" subsection for explanatory comments), above the ambition level of 13.0%.

Over the coming years, the future results of HSH Nordbank are likely to benefit noticeably from the implementation of the structural measures and further implementation of the strategy. Taking account of the planned realisation of unrealised gains and those already realised in the first half of 2017, the Bank expects to generate net income before taxes at the Group level for the whole of 2017 that is at the previous year's level and a return on equity slightly above that of the previous year. A moderate increase in net income before taxes and a further noticeable improvement in the return on equity are expected for the Core Bank in 2017. The expected net income before taxes of the Non-Core Bank will continue to fall significantly. This is mainly due to the planned loan loss provisions on the full balance sheet utilisation of the guarantee, which is partially compensated for by the realisation of unrealised gains. On the one hand, divergent estimates will arise with regard to expected new business developments. Based on the new business volume transacted in the first half of 2017 and the amount of new business in the pipeline the Bank now assumes that new business performance will be better. It is assumed that new business transacted will be at least at the previous year's level or could slightly exceed the previous year. On the other hand, the Bank assumes that due to the high utilisation of loan loss provisions in line with the planned winding down of legacy assets the coverage ratio in the Group and Non-Core Bank will not increase further as at the 2017 year end but will be at the satisfactory level of the previous year.

In principle, the Bank remains cautious in its earnings forecast for the whole of 2017 given the continuing challenging environment for banks in general and HSH Nordbank in particular.

In light of the EU decision, the Bank expects not to make any coupon payments on the hybrid capital instruments during the divestiture period as part of the implementation of the structural measures. Against this backdrop the Bank assumes that, on the successful conclusion of the change in ownership, it will again be able to pay dividends and make distributions on hybrid capital for the 2019 financial year at the earliest in 2020.

In order to fulfil the net income forecast for the financial year 2017, HSH Nordbank's planning needs to be implemented as intended and the risks described in this management report do not materialise.

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

RISK REPORT

The main risks to which the Bank is exposed include default risks, market risks, liquidity risks, operational risks, business strategy risks and reputation risks. The methods, instruments and processes used to manage these risks are explained in detail in the Risk Report contained in the Group management report for the 2016 financial year. In addition, the “Forecast, Opportunities and Risks Report” contained in this Interim Report provides information on the anticipated business situation, including a current assessment of the main opportunities and risks for HSH Nordbank for the remainder of the year.

SETTING RISK APPETITE AND RISK GUIDELINES

The Strategic Risk Framework (SRF), which forms the basis of the Bank’s risk culture, describes the focus of the Bank’s risk management activities and defines the risk management objectives based on the planned development of key business activities and the measures to be 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 portfolio.

The SRF contains risk strategy principles that serve as guiding principles for risk-conscious action and form the cornerstones of a sustainable risk culture. These principles provide the framework for the preparation of the Risk Appetite Statement (RAS) and the risk strategy. The RAS aims to provide a summary of selected risk tolerance areas in order to achieve the overall Bank objectives. It consists of a catalogue of key figures and qualitative requirements for the risk culture. Operationalisation is ensured via the risk strategy and the limit system. The risk strategy describes the management of risks on the basis of the risk inventory in accordance with the business strategy and RAS. It provides the framework for the sub-risk strategies (counterparty default, market, liquidity, reputation and operational risks) and forms a key basis for planning within the Bank. An effective limit system requires the stringent formulation of the Bank’s risk appetite. It is derived from the risk capacity separately for the three scarce resources: economic and regulatory capital and liquidity. Based on the risk appetite, the Bank has put in place a system of risk limits and risk guidelines for all three resources which serves to avert any risks that could threaten the Bank’s existence and to allow the Bank to meet its risk strategy objectives.

The SRF is the subject of a resolution passed by the Management Board (“tone from the top”) and is reviewed at least once a year. Adjustments are made where necessary. It is also fully integrated into the Bank’s processes, for example by being incorporated into the Bank’s objectives and the definition of requirements for the strategy process.

RISK-BEARING CAPACITY

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 it to the supervisory authority of the Bank. The comprehensive analysis of risk-bearing capacity, internal reporting and the development of any measures based on the results are part of a quarterly process at HSH Nordbank and also form part of the annual planning process.

The primary management process for our calculation of risk-bearing capacity is a liquidation approach which focuses on the 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, corresponding hedging transactions (line items) and liabilities.

As at 30 June 2017, the risk coverage potential amounted to € 8.1 billion (31 December 2016: € 8.5 billion). The main reason for the decline is the drop in unrealised gains from loans in the first half of 2017 due to changes in interest rates and a slight reduction in the portfolio.

The overall risk takes into account default risk, market risk, liquidity maturity transformation risk as an element of liquidity risk and the operational risk 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. In doing so, no risk-reducing correlations are utilised.

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 risks. The economic capital required for default risk as at the reporting date, taking account of the easing effect of the second loss guarantee, amounted to € 1.3 billion (31 December 2016: € 1.9 billion). The drop in the economic capital required for default risk is largely attributable to the ongoing winding-down of the loan portfolio and to currency effects.

In line with the risk-bearing capacity concept, market risk (value-at-risk, VaR) is scaled up on the basis of the confidence level chosen by the Bank and a one-day holding period to show the economic capital required for market risk positions for the purpose of managing risk-bearing capacity with a risk horizon of one year. The economic capital required for market risk was unchanged at € 0.6 billion as at 30 June 2017 (31 December 2016: € 0.6 billion).

HSH Nordbank also uses a VaR approach to quantify the liquidity maturity transformation risk. This long-term/structural liquidity risk is an expression of the danger of increased refinancing costs for the subsequent closure of open liquidity positions. As at 30 June 2017, the liquidity value-at-risk (LVaR), as a measure of the economic capital required for liquidity risk, was unchanged at € 0.1 billion (31 December 2016: € 0.1 billion). Insolvency risk, on the other hand, which is more significant for the purposes of managing the liquidity risk in principle, is backed by a buffer of liquid funds. Information on managing the insolvency risk, among other things, is included in the section entitled "Liquidity risk".

Operational risks are determined in accordance with the regulatory standard approach. The corresponding economic capital required was unchanged at € 0.2 billion as at 30 June 2017 (31 December 2016: € 0.2 billion).

Overall economic risk amounted to € 2.2 billion as at the reporting date. The utilisation of the risk coverage potential amounted to 27 % (31 December 2016: 34 %). The Bank's 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 remaining risk coverage potential buffer and the utilisation of risk coverage potential.

RISK-BEARING CAPACITY OF THE GROUP

(€ bn)	30.06.2017	31.12.2016
Economic risk coverage potential[1)]	**8.1**	**8.5**
Economic capital required	**2.2**	**2.9**
of which for default risks[2)]	1.3	1.9
for market risks	0.6	0.6
for liquidity risks	0.1	0.1
for operational risks	0.2	0.2
Risk coverage potential buffer	**5.9**	**5.6**
Utilisation of risk coverage potential (in %)	**27**	**34**

[1)] After deduction of the amount retained under 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, stress tests are regularly conducted 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. The scenario management group (SMG) develops macroeconomic and segment-specific forecasts on a regular basis on the basis of observed market developments. These expected and stress forecasts are included in various simulation scenarios and are presented to the Bank Steering Committee and the Overall Management Board on a quarterly basis. This involves calculating the impact of the macroeconomic scenarios, such as a severe economic slump or a scenario in which the expected recovery on the shipping markets fails to materialise, as well as the impact of a historical scenario on the Pillar I and II capital ratios and on the leverage ratio. The results are incorporated in HSH Nordbank's internal reporting system and are analysed on a regular basis by the Management Board in the interests 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 serves to discuss the need for options to strengthen the financial stability of HSH Nordbank.

HSH Nordbank's recovery plan under 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 predefined options. The effectiveness of the options identified, the selected recovery plan indicators and related processes are reviewed and substantiated 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 to identify scenarios which could endanger HSH Nordbank's ability to survive. Also this information is used by HSH Nordbank's Management Board as guidance for explaining and deciding upon the action required in the event of developments that threaten the Bank's existence.

DEFAULT RISK

Default risk exposure

The exposure at default (EaD) corresponds to the volume at risk 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). The total EaD amount outstanding was € 81,152 million as at 30 June 2017.

The EaD broken down by internal rating categories is presented in the following table. The EaD with an investment grade rating (rating category 1 to 5) accounts for 62 % of the overall exposure at Group level (31 December 2016: 59 %). The EaD for the investment grade exposures comes to 72 % for the Core Bank (31 December 2016: 69 %) and 17 % for the Non-Core Bank (31 December 2016: 16 %). 28 % of the Overall Bank portfolio is covered by the second loss guarantee (31 December 2016: 34 %). For the Core Bank a share of 15 % is covered by the guarantee (31 December 2016: 20 %) and 85 % for the Non-Core Bank (31 December 2016: 85 %). At 86 % (31 December 2016: 87 %), the share of the guaranteed portfolio is particularly high in the default categories 16 to 18.

DEFAULT RISK STRUCTURE BY RATING CATEGORY[1)]

(€ m)	30.06.2017				
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**	Thereof covered by the guarantee (in %)
1(AAAA) to 1 (AA+)	16,839	412	5,362	22,613	9
1(AA) to 1 (A–)	7,617	706	2,245	10,568	15
2 to 5	15,264	1,716	540	17,520	18
6 to 9	11,453	1,176	69	12,698	23
10 to 12	1,426	485	–	1,911	52
13 to 15	1,682	1,625	20	3,327	59
16 to 18 (default category)	884	10,973	–	11,857	86
Other[2)]	353	86	219	658	0
Total	**55,518**	**17,179**	**8,455**	**81,152**	**28**

[1)] Mean default probabilities (as %): 1 (AAAA) to 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)	31.12.2016				
	Core Bank	Non-Core Bank	Other and Consolidation	Total	Thereof covered by the guarantee (in %)
1(AAAA) to 1 (AA+)	13,684	700	6,726	21,110	17
1(AA) to 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 category)	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 (as %): 1 (AAAA) to 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.

The EaD broken down by sectors important for HSH Nordbank is presented in the following table:

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	30.06.2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Industry	7,809	1,343	1	9,153
Shipping	5,775	7,923	49	13,747
Trade and transportation	3,492	525	–	4,017
Credit institutions	5,122	571	4,334	10,027
Other financial institutions	1,853	1,734	60	3,647
Land and buildings	9,996	2,727	–	12,723
Other services	5,553	983	430	6,966
Public sector	15,684	922	3,567	20,173
Private households	234	451	14	699
Other	–	–	–	–
Total	**55,518**	**17,179**	**8,455**	**81,152**

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	31.12.2016			
	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 the EaD broken down by residual maturities:

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	30.06.2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Up to 3 months	12,144	3,698	199	16,041
> 3 months to 6 months	1,754	561	70	2,385
> 6 months to 1 year	2,878	898	982	4,758
> 1 year to 5 years	22,444	6,408	4,915	33,767
> 5 years to 10 years	10,313	2,670	1,961	14,944
> 10 years	5,985	2,944	328	9,257
Other	–	–	–	–
Total	**55,518**	**17,179**	**8,455**	**81,152**

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	31.12.2016			
	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
Other	–	–	–	–
Total	**51,703**	**21,406**	**10,517**	**83,626**

The following table provides an overview of the foreign exposure by region, which reached € 29,419 million as at 30 June 2017 (31 December 2016: € 33,617 million).

FOREIGN EXPOSURE BY REGION

(€ m)	30.06.2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Western Europe	11,569	6,694	2,514	20,777
of which eurozone countries	7,967	4,383	1,270	13,620
Central and Eastern Europe	554	527	–	1,081
of which eurozone countries	55	1	–	56
Africa	508	213	–	721
North America	625	1,438	5	2,068
Latin America	245	259	–	504
Middle East	43	497	–	540
Asia-Pacific region	1,242	1,713	–	2,955
International organisations	129	–	644	773
Total	**14,915**	**11,341**	**3,163**	**29,419**

FOREIGN EXPOSURE BY REGION

(€ m)	31.12.2016			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Western Europe	10,808	8,907	3,146	22,861
of which eurozone countries	8,280	5,441	1,214	14,935
Central and Eastern Europe	550	582	–	1,132
of which eurozone countries	51	2	–	53
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.

Due to their weak fiscal and economic data, a number of European countries are subject to increased monitoring. These include Croatia, Cyprus, Greece, Italy, Portugal and Spain. The exposure to Russia is also being monitored more closely as a result of the crisis concerning Ukraine as is the exposure to Turkey due to Turkey's interior and geopolitical development.

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 13% compared to the end of the previous year and amounted to € 5,178 million in total as at 30 June 2017 (31 December 2016: € 5,925 million).

The direct country exposure continues to be manageable. The commitments in the Corporates/Other sector for Greece, Turkey and Cyprus relate primarily to ship financings, which do not entail transfer risk due to the existing collateral.

EXPOSURE AT DEFAULT IN SELECTED EUROPEAN COUNTRIES

(€ m)	Country		Banks		Corporates/Other		Total	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
Greece	–	0	–	–	1,144	1,478	1,144	1,478
Italy	411	425	–	0	587	602	998	1,027
Croatia	–	–	–	0	97	101	97	101
Portugal	224	219	–	–	24	26	248	245
Russia	–	–	2	3	61	74	63	77
Spain	146	151	39	46	971	1,215	1,156	1,412
Turkey	–	–	84	31	295	379	379	410
Cyprus	–	–	–	–	1,093	1,175	1,093	1,175
Total	**781**	**795**	**125**	**80**	**4,272**	**5,050**	**5,178**	**5,925**

Note 45 includes more information on the selected European countries.

The non-performing exposure ratio (NPE ratio = the ratio of the total of all risk positions of borrowers in default to total risk positions) serves as an important management indicator that has also been defined as a risk guideline in the SRF. The NPE ratio fell considerably in the first half of 2017 and amounts to 14.6% (31 December 2016: 17.5%). This development is due to the above-average winding-down of the non-performing exposure (–19%) compared with the reduction in the total EaD (–3%). The NPE portfolio has been reduced, in particular, as a result of the portfolios sold by the Bank on the market in the first half of 2017 and also due to EUR/USD-related currency effects. Outstanding market portfolio sales and further winding-down measures in the Non-Core Bank will further reduce the NPE portfolio and, as a result, the NPE ratio, which is still too high overall, in the second half of 2017.

Another management indicator, the coverage ratio (ratio of total loan loss provisions on the non-performing exposure to the total risk positions in the non-performing exposure as a whole) has increased temporarily to 55.6% as a result of the additional loan loss provisions recognised in the first half of 2017 (31 December 2016: 48.4%). The coverage ratio is expected to fall slightly again as a result of the NPE winding-down measures that are scheduled to be taken in the second half of 2017.

Loan loss provisions

In the first six months of 2017, loan loss provisions were still characterised by considerable amounts allocated for legacy loan exposures which, as the reference portfolio, fall under the second loss guarantee. By the end of the year, loan loss provisions are not, however, expected to exceed the level projected to date.

Additional loan loss expense was recognised for legacy transactions in the shipping portfolio to continue to reflect the ongoing difficult market developments, which are characterised, on the whole, by charter rates and ship values that are still low. In addition, impairment losses were recognised in the energy portfolio of the Non-Core Bank. In contrast, the risk trend in other business sectors remained largely insignificant. The real estate client portfolio was characterised by the reversal of loan loss provisions due to loan repayments and improved risk assessments.

In total, loan loss provisions amounted to € – 379 million as at 30 June 2017 before taking account of the compensation effect of the guarantee (same period in the previous year: € – 520 million). This means that while the additions to loan loss provisions are down considerably year-on-year, they are still at a high level and in line with expectations.

The loan loss provisions recognised, once again, for legacy portfolios in particular were no longer compensated for in full as at 31 March 2017 due to the balance sheet utilisation of the second loss guarantee since the first quarter of 2017. Taking account of the hedging effect of the credit derivative of € – 89 million (same period in the previous year: € – 408 million), adding foreign exchange rate effects and after the compensation effect provided by the second loss guarantee, the loan loss provisions amounted to € – 241 million in total (same period in the previous year: € + 151 million).

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 € 3.4 billion.

An overview by segment is provided in the following table:

CHANGES IN LOAN LOSS PROVISIONS IN THE LENDING BUSINESS

(€ m)	January – June 2017							
	Specific loan loss provisions/ provisions	General loan loss provisions	**Loan loss provisions before currency translation and compensation**	Net income from foreign currency from loan loss provisions	Compensation item	**Total**	Hedging effect of credit derivative second loss guarantee	**Loan loss provisions incl. hedging effect credit derivative**
Corporates	11	3	14	–	– 10	4	–	4
Shipping	– 21	6	– 15	5	14	4	–	4
Real Estate Clients	2	– 1	1	–	– 1	–	–	–
Treasury & Markets	–	1	1	–	–	1	–	1
Total Core Bank	**– 8**	**9**	**1**	**5**	**3**	**9**	**–**	**9**
Non-Core Bank	**– 400**	**19**	**– 381**	**44**	**175**	**– 162**	**– 89**	**– 251**
Other and Consolidation	**2**	**– 1**	**1**	**–**	**–**	**1**	**–**	**1**
Group	**– 406**	**27**	**– 379**	**49**	**178**	**– 152**	**– 89**	**– 241**

CHANGES IN LOAN LOSS PROVISIONS IN THE LENDING BUSINESS[1]

(€ m)	January – June 2016							
	Specific loan loss provisions/ provisions	General loan loss provisions	**Loan loss provisions before currency translation and compensation**	Net income from foreign currency from loan loss provisions	Compensation item	**Total**	Hedging effect of credit derivative second loss guarantee	**Loan loss provisions incl. hedging effect credit derivative**
Corporates	6	1	7	–	–7	–	–	–
Shipping	–20	–19	–39	4	22	–13	–	–13
Real Estate Clients	1	–2	–1	–	2	1	–	1
Treasury & Markets	–	–	–	–	–	–	–	–
Total Core Bank	**–13**	**–20**	**–33**	**4**	**17**	**–12**	**–**	**–12**
Non-Core Bank	**–478**	**–10**	**–488**	**139**	**914**	**565**	**–408**	**157**
Other and Consolidation	**1**	**–**	**1**	**5**	**–**	**6**	**–**	**6**
Group	**–490**	**–30**	**–520**	**148**	**931**	**559**	**–408**	**151**

[1] The way in which loan loss provisions are presented has changed compared to the previous year. The previous year figures have been adjusted for purposes of comparability.

Detailed information on the development of loan loss provisions in the individual divisions is set out in the section entitled "Segment reporting". Details regarding the total loan loss provisions in the lending business are presented in Notes 11 and 21.

Market risk

For the purposes of measuring and managing market risk, HSH Nordbank employs a VaR approach (99.0 % confidence level, holding period of one day and historical observation period of 250 days), the results of which cannot be directly compared with the development in economic capital required for market risk positions within the risk-bearing capacity approach for methodological reasons. As at 30 June 2017, the market risk associated with the trading book positions amounted to € 0.4 million and that associated with the banking book positions amounted to € 14.2 million. The aggregated market risk – which cannot be derived from the total VaR of the trading and banking book positions due to risk-mitigating correlation effects – amounted to € 14.3 million. € 11.8 million of this amount was attributable to the Core Bank and € 9.9 million to the Non-Core Bank. Due to risk-mitigating correlation effects, the VaR for the Core Bank and the Non-Core Bank cannot be added up to produce the aggregated market risk either.

Developments with respect to the individual risk types during the first six months of 2017 are presented in the table set out below.

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]	
	Jan. – June 2017	Jan. – Dec. 2016	**Jan. – June 2017**	Jan. – Dec. 2016	**Jan. – June 2017**	Jan. – Dec. 2016	**Jan. – June 2017**	Jan. – Dec. 2016	**Jan. – June 2017**	Jan. – Dec. 2016	**Jan. – June 2017**	Jan. – Dec. 2016
Average	6.6	9.7	20.4	25.1	11.7	18.1	1.3	2.0	–	–	25.0	41.8
Maximum	9.7	19.9	26.7	27.1	20.8	25.8	1.6	4.1	–	–	33.7	49.9
Minimum	4.2	4.6	11.5	21.6	0.8	9.1	0.9	0.9	–	–	13.4	30.2
Period end amount	4.3	12.3	11.5	22.9	7.5	18.3	0.9	1.4	–	–	14.3	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.

Overall VaR fell from € 34.5 million at the end of 2016 to € 14.3 million. This is due to the winding-down of risk positions (the credit spread risk sensitivity fell from € –11.6 million to € –9.5 million and the USD sensitivity dropped from € –8.1 million to € –6.1 million) and to methodological improvements (use of more liquid credit spread curves), as well as, first and foremost, to the drop in market volatility observed for the relevant 250-day history. By way of example, volatile market data scenarios relating to the Brexit vote dating back to June 2016 no longer appeared in the 250-day history for the market risk calculation.

LIQUIDITY RISK

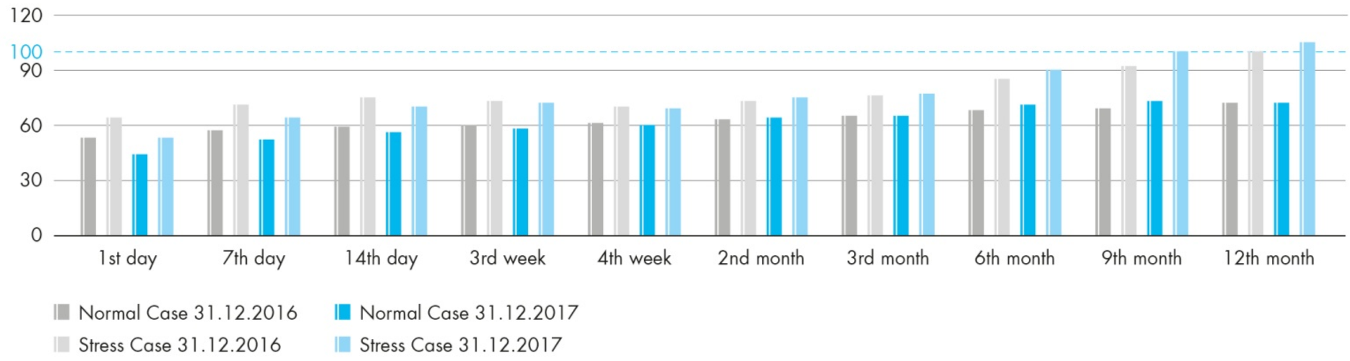
HSH Nordbank divides its liquidity risk into risk of insolvency and liquidity maturity transformation risk. Liquidity maturity transformation risk is also a component of the risk-bearing capacity concept and is explained in the section entitled “Risk-bearing capacity”. The risk of insolvency refers to the risk that present or future payment obligations cannot be met in part or in full.

The transactions in the Group impacting liquidity are presented as cash flows and the resultant inflows and outflows allocated to time buckets (liquidity development report) for the purposes of measuring the risk of insolvency or funding requirements. The difference between inflows and outflows represents a liquidity surplus or deficit (gap) in the relevant time buckets. The gaps are presented accumulated 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 time buckets and consequently represents the respective limit for insolvency risk. Utilisation of the limits is monitored on a daily basis.

The following illustration shows the relative utilisation levels of the liquidity potential for individual cumulative liquidity gaps in the normal case and stress case as at 30 June 2017 as well as 31 December 2016. Utilisation represents the share of the cumulative gap in total liquidity potential, which also includes the liquidity buffer required under supervisory law.

LIMIT ON CUMULATIVE LIQUIDITY GAPS

(Utilisation of liquidity potential in %)



Risk tolerance of the Bank 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% can be ensured under the normal and stress cases for insolvency risk.

In the normal case assessment that is based on the assumption of business development in an ordinary market environment, the liquidity potential had a peak utilisation of 74% in the eighth month as at the reporting date. All limits within the survival period of twelve months defined by the Bank were thereby adhered to. The stress case liquidity development report shows that the liquidity potential was also not exceeded within the minimum survival period of one month established taking Minimum Requirements for Risk Management (MaRisk) into account. In fact, the limits as at the reporting date are even maintained for a period of nine months. Compared to the 2016 year end, utilisation levels have changed slightly in the normal case and stress case. Utilisation is slightly reduced up until the fourth week and then slightly increased thereafter. There were no critical limit utilisation levels either in the normal case or in the stress case liquidity development report in the course of the period under review.

The regulatory management parameter for liquidity risks is the liquidity ratio defined by the German Liquidity Regulation (LiqV). With values between 1.69 and 1.92, it remained well above the regulatory minimum value at all times throughout the reporting period. The average value for the first six months of 2017 was 1.82 (2016: 1.78), and 1.87 as at the reporting date (31 December 2016: 1.92).

Under Basel III/ CRR, the Liquidity Coverage Ratio (LCR) was specified as an additional 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 compliance rate has had to be complied with since the Delegated Regulation (EU) 2015/61 entered into force in October 2015, whereby it increases from an initial 60% to 100% in 2018. As at the reporting date, the provisional LCR was 208% within the framework of the provisional data capture sheet of the Delegated Regulation (EU) 2015/61 (31 December 2016: 229%), meaning that it exceeded the current minimum threshold of 80%.

The Net Stable Funding Ratio (NSFR), which must be adhered to from 2018 at the earliest, is calculated as the ratio of available funding resources across all maturities to the funding required and also must be at least 100% after full implementation. As at 30 June 2017, the NSFR under the QIS amounted to 109% (31 December 2016: 111%).

Pursuant to Article 100 CRR in conjunction with Implementing Regulation (EU) 2015/79 of the European Commission, HSH Nordbank is also required to report asset encumbrance. An asset is deemed encumbered if it has been pledged or if it is subject to any form of arrangement to secure, collateralise or credit enhance any transaction from which it cannot be freely withdrawn. The ratio of encumbered assets to the total amount of encumbered and unencumbered assets at HSH Nordbank came to 33% as at the reporting date (31 December 2016: 33%).

HSH Nordbank successfully forged ahead with its funding strategy in the first half of 2017 and thereby strengthened its liquidity profile. Besides the issuing activities, a stable level of deposits contributed to the refinancing of the business. The regulatory requirements for the liquidity ratios were met at all times during the reporting period. However, there is still no unrestricted access to the capital markets. In addition, deposits have a comparatively low average duration, and there is a significant level of counterparty concentration. Future funding and HSH Nordbank's rating continue to be key challenges despite this positive development.

Further information on HSH Nordbank's refinancing situation is set out in the chapter entitled "Earnings, net assets and financial position". Details on the funding forecast can be found in the chapter entitled "Forecast, opportunities and risks report".

OTHER MATERIAL RISKS

Legal risks form part of operational risks. HSH Nordbank recognised provisions of € 31 million (31 December 2016: € 34 million) for litigation risks and costs as at the reporting date. In addition, contingent liabilities of € 30 million (31 December 2016: € 32 million) arising from legal disputes are disclosed. Contingent liabilities relating to legal disputes result from several individual cases involving claims of up to € 7 million. A major portion of the provisions for litigation risks relates to the legal proceedings mentioned below.

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 dollars in the year 2013 due to decisions of Turkish courts. The plaintiffs have filed new claims under which damages are asserted based on the same facts. Appropriate provisions have been recognised for this.

In addition, HSH Nordbank AG has been sued by a borrower for damages currently totalling up to € 238 million. The plaintiff is asserting claims to damages and cites unjustified enrichment. The underlying facts of the case had already been the subject of several court proceedings between the Bank and the borrower, in which the Bank has always succeeded before different courts apart from relatively small amounts. In the Bank's view, claims newly asserted by the borrower regarding the known facts of the case are unfounded. They do not contain any legally significant changes regarding the known facts and therefore do not provide any grounds for the previous legal assessment of this case to be revised. As the probability of success for the current legal action is assessed as small, no provision or contingent liability has been recognised.

Other provisions relating to legal risks in the amount of € 6.1 million on the basis of current German case law of the Federal Court of Justice (BGH) regarding liability for advice provided on swap transactions could be reversed in part (€ 2.73 million).

In addition, the Bank could be hit by legal uncertainty in connection with existing loan agreements.

Tax risks, a component of legal 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 of still outstanding tax audits. The tax audits have not yet been finalised for the years starting from 2003.

Further information on tax risks, as well as on other operational risks, reputational risks and the business strategy risk can be found in the Group management report for the 2016 financial year. Regarding the other risks set out in detail in the Group management report for the 2016 financial year, no material changes have arisen in the course of this year to date.

Hamburg/Kiel, 22 August 2017

Stefan Ermisch	Oliver Gatzke
Ulrik Lackschewitz	Torsten Temp

INTERIM GROUP FINANCIAL STATEMENT

GROUP STATEMENT OF INCOME
FOR THE PERIOD 1 JANUARY TO 30 JUNE 2017

(€ m)	Note	**January – June 2017**	January – June 2016	Change in %
Interest income		1,786	1,846	– 3
Negative interest on investments and derivatives		– 147	– 79	86
Interest expense		– 1,175	– 1,399	– 16
Positive interest on borrowings and derivatives		149	69	> 100
Net income from hybrid financial instruments		– 56	– 63	11
Net interest income	(5)	**557**	**374**	**49**
Net commission income	(6)	32	50	– 36
Result from hedging	(7)	– 9	2	> – 100
Net trading income	(8)	151	40	> 100
Net income from financial investments	(9)	26	74	– 65
Net income from financial investments accounted for under the equity method	(10)	2	1	100
Total income		**759**	**541**	**40**
Loan loss provisions in the lending business	(11)	– 152	559	> 100
Hedging effect of credit derivative under the second loss guarantee	(3)	– 89	– 408	78
Administrative expenses	(12)	– 246	– 277	– 11
Other operating income	(13)	47	43	9
Expenses for bank levy and deposit guarantee fund	(14)	– 41	– 63	– 35
Net income before restructuring and privatisation		**278**	**395**	**– 30**
Net income from restructuring and privatisation	(15)	– 25	– 98	74
Expenses for government guarantees	(16)	– 80	– 126	– 37
Net income before taxes		**173**	**171**	**1**
Income taxes		– 15	– 11	36
Group net result		**158**	**160**	**– 1**
Group net result attributable to non-controlling interests		–	–	–
Group net result attributable to HSH Nordbank shareholders		158	160	– 1

EARNINGS PER SHARE

(€)	Note	**January – June 2017**	January – June 2016
Undiluted	(17)	0.52	0.53
Diluted	(17)	0.52	0.53
Number of shares (millions)		**302**	**302**

GROUP STATEMENT OF COMPREHENSIVE INCOME
FOR THE PERIOD 1 JANUARY TO 30 JUNE 2017

RECONCILIATION WITH TOTAL COMPREHENSIVE INCOME/LOSS

(€ m)	**January – June 2017**	January – June 2016
Group net result	**158**	**160**
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)	– 9	48
Gains and losses (before taxes) reclassified to the statement of income	10	– 41
of which from exchange rate effects	– 10	– 4
Income taxes recognised	– 2	– 2
of which from exchange rate effects	–	–
	– 1	**5**
Differences resulting from currency translation	– 36	– 8
	– 36	**– 8**
Subtotal	**– 37**	**– 3**
Income and expense 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 FV (before taxes)	3	–
Income taxes recognised	– 1	–
	2	**–**
Changes resulting from the revaluation of net defined benefit liabilities (before taxes)	55	– 156
Income taxes recognised	– 17	49
	38	**– 107**
Subtotal	**40**	**– 107**
Other comprehensive income for the period	**3**	**– 110**
Total comprehensive income	**161**	**50**
Total comprehensive income attributable to non-controlling interests	1	–
Total comprehensive income attributable to HSH Nordbank shareholders	160	50

GROUP STATEMENT OF FINANCIAL POSITION
AS AT 30 JUNE 2017

ASSETS

(€ m)	Note	**30.06.2017**	31.12.2016	Change in %
Cash reserve	(18)	6,544	3,491	87
Loans and advances to banks	(19)	3,404	4,192	– 19
Loans and advances to customers	(20)	46,001	50,910	– 10
Loan loss provisions	(21)	710	1,142	– 38
Credit derivative under the second loss guarantee	(3)	113	199	– 43
Positive fair value of hedging derivatives	(22)	442	508	– 13
Positive adjustment item from portfolio fair value hedges		291	403	– 28
Trading assets	(23)	4,331	5,433	– 20
Financial investments	(24)	15,323	15,493	– 1
Financial investments accounted for under the equity method	(25)	12	13	– 8
Intangible assets	(26)	12	14	– 14
Property, plant and equipment	(27)	234	236	– 1
Investment property	(27)	10	12	– 17
Non-current assets held for sale and disposal groups	(28)	1,021	1,382	– 26
Current tax assets		47	65	– 28
Deferred tax assets	(29)	716	767	– 7
Other assets	(30)	99	105	– 6
Total assets		**79,310**	**84,365**	**– 6**

LIABILITIES

(€ m)	Note	**30.06.2017**	31.12.2016	Change in %
Liabilities to banks	(31)	9,515	9,501	–
Liabilities to customers	(32)	39,928	40,172	– 1
Securitised liabilities	(33)	14,306	16,624	– 14
Negative fair values of hedging derivatives	(34)	258	290	– 11
Negative adjustment item from portfolio fair value hedge		607	786	– 23
Trading liabilities	(35)	4,705	5,981	– 21
Provisions	(36)	1,395	1,521	– 8
Liabilities relating to disposal groups	(37)	45	65	– 31
Current tax liabilities		40	87	– 54
Deferred tax liabilities		7	7	–
Other liabilities	(38)	824	845	– 2
Subordinated capital	(39)	2,569	3,536	– 27
Equity	(40)	5,111	4,950	3
Share capital		3,018	3,018	–
Capital reserve		75	75	–
Retained earnings		1,712	1,617	6
Revaluation reserve		138	127	9
Currency conversion reserve		23	60	– 62
Group net result		158	67	>100
Total before non-controlling interests		5,124	4,964	3
Non-controlling interests		– 13	– 14	–7
Total equity and liabilities		**79,310**	**84,365**	**–6**

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 30 June 2016		**–**	**–**
Compensation for the Group net loss for the previous year		–	–
Changes in the scope of consolidation		–	–
As at 30 June 2016		**3,018**	**175**
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 value 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 FV		–	–
Exchange rate changes			
thereof resulting from currency translation		–	–
thereof resulting from changes in scope of consolidation		–	–
Other comprehensive income		–	–
Comprehensive income as at 30 June 2017		**–**	**–**
Compensation for the Group net profit for the previous year		–	–
As at 30 June 2017	(40)	**3,018**	**75**

Retained earnings	Currency conversion reserve	Revaluation reserve	Group net result	Total before non-controlling interests	Non-controlling interests	Total
1,464	**42**	**103**	**99**	**4,901**	**- 16**	**4,885**
–	–	–	160	160	–	160
– 107	–	–	–	– 107	–	– 107
–	–	9	–	9	–	9
–	– 8	– 4	–	– 12	–	– 12
–	–	–	–	–	–	–
– 107	– 8	5	–	– 110	–	– 110
- 107	**- 8**	**5**	**160**	**50**	**-**	**50**
99	–	–	– 99	–	–	–
– 2	–	–	–	– 2	–	– 2
1,454	**34**	**108**	**160**	**4,949**	**- 16**	**4,933**
1,617	**60**	**127**	**67**	**4,964**	**- 14**	**4,950**
– 9	–	9	–	–	–	–
1,608	**60**	**136**	**67**	**4,964**	**- 14**	**4,950**
–	–	–	158	158	–	158
8	–	–	–	38	–	38
–	–	– 1	–	– 1	–	– 1
– 1	–	3	–	2	–	2
–	– 38	–	–	– 38	1	– 37
–	1	–	–	1	–	1
37	– 37	2	–	2	1	3
37	**- 37**	**2**	**158**	**160**	**1**	**161**
67	–	–	– 67	–	–	–
1,712	**23**	**138**	**158**	**5,124**	**- 13**	**5,111**

GROUP CASH FLOW STATEMENT

CONDENSED CASH FLOW STATEMENT

(€ m)	**January – June 2017**	January – June 2016
Cash and cash equivalents as at 1 January	**3,491**	**3,394**
Cash flow from operating activities	4,116	– 1,521
Cash flow from investing activities	– 113	621
Cash flow from financing activities	– 950	–
Changes in cash and cash equivalents due to exchange rate fluctuations	–	–
Cash and cash equivalents as at 30 June	**6,544**	**2,494**

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 cash changes in assets and liabilities used in operating activities are taken into account.

In the reporting period, there were material new issues with a volume of € 672 million (previous year: € 2,672 million). The volume of repayments/repurchases during this period came to € 333 million (previous year: € 1,146 million) and the volume of due issues came to € 3,285 million (previous year: € 3,473 million).

Further information on the liquidity position of HSH Nordbank is provided in the Group Management Report in the sections on net assets and financial position and in the Risk Report.

The following standards, among others, have to be applied for the first time in financial years which start on or after 1 January 2018.

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, impairment and general hedge accounting.

IFRS 9 is 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 does, however, permit 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 in other comprehensive income (OCI), i.e. not through profit or loss. Application shall be 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, the effect (before taxes) 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 (in cumulative terms from the previous years in retained earnings) will be reclassified from retained earnings to the revaluation reserve (thereof credit risk-induced changes in the value of liabilities designated at fair value). This means that, as of 1 January 2017, future 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 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 reporting period, other comprehensive income of € 4 million (before taxes) was recognised in the revaluation reserve (thereof credit risk-induced changes in the value of liabilities designated at fair value) due to the early application of the change in disclosure.

HSH Nordbank has been making intensive preparations as part of several projects since the end of 2014 for the initial application of IFRS 9. The purpose of the projects is to fully implement the new requirements related to classification, hedge accounting and the determination of loan loss provisions (impairment) into the IT systems and processes concerned. Besides adjustments to existing IT systems, new software will also be introduced. This applies in particular to the topic of the complex new rules for determining loan loss provisions. Another objective of the projects is to initially classify and measure all instruments within the scope of IFRS 9 and to prepare an opening balance sheet as at 1 January 2018 in accordance with IFRS 9 including a reconciliation with the closing balance sheet as at 31 December 2017. The first interim financial statements in 2018 will therefore be prepared in accordance with IFRS 9.

The projects have largely completed the functional specification phase. IT implementation is at an advanced stage. The Bank is currently undergoing an integration test.

The new regulations set out in IFRS 9 will result in valuation effects to be recognised in equity in the opening balance sheet at the time of initial application. A sufficiently reliable, precise quantification of the impact of IFRS 9 is currently not yet possible. The impact is being estimated in several test calculations that are gradually being refined on the basis of the further development of models, systems and data. Key issues that are still associated with uncertainty within the context of the introduction of IFRS 9 as at 30 June 2017 include the fact that the expert-based estimate of loan loss provisions for various level 3 scenarios has still not been implemented, possible adjustments to the parameters used to determine loan loss provisions, the finalisation of the legacy portfolio analysis regarding the cash flow criterion, which is currently ongoing, and the definitive classification of the business model, which will take place as part of the 2017 strategy process.

The following sections compare the main changes resulting from the application of IFRS 9 compared with IAS 39. They also address the likely material, specific effects for the Bank and the use of options based on the current status of the implementation projects at HSH Nordbank. The statements are based on the current specification/decision-making status of the implementation projects. Amendments and supplements may be made as the projects progress up until the time of initial application. This also includes the potential for changes in the interpretation of certain IFRS 9 requirements.

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), 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.

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 likely expand the scope of instruments to be valued at FVPL/FVOCI.

As a result of the business model condition and based on the current analysis status of the implementation project, HSH Nordbank expects the following effects at the time of initial application of IFRS 9, insofar as these effects can be predicted at present (the assessment is based on the business model/circumstances at the time of initial application):

Within the securities portfolio (capital markets business), 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) is expected to be reclassified to the FVOCI category under IFRS 9.

In the loan portfolio (lending business), the business model is expected, as things stand at present, to be a “hold” business model at the time of initial application meaning that – provided that the cash flow condition at the level of the individual instrument does not stand in the way of this – measurement will be at AC, as under IAS 39. There is, however, uncertainty in this regard due to the ongoing bank privatisation process. This uncertainty is explained in the Forecast report in the section “Opportunities and risks resulting from the formal decision in the EU state aid proceedings” of the Group interim management report. By way of derogation from this principle, syndication shares from new business syndication are to be allocated to a separate portfolio that is to be measured at FVPL.

Due to the cash flow condition and based on the current analysis status of the implementation project, HSH Nordbank expects the following effects at the time of initial application of IFRS 9:

The vast majority of the securities portfolio (capital market business) is likely to meet the criterion relating to the cash flow condition. There are also structured holdings that will breach the cash flow condition. Material reclassifications from the IAS 39 LaR category (AC valuation category) to the IFRS 9 FVPL category will be made for securitisation items in the credit investment business (contractually linked instruments, e.g. asset backed securities). This is because certain categories do not satisfy the cash flow criterion due to specific contractual features or due to the credit risk test at tranche level provided for in IFRS 9.

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. There will also be loans that breach the cash flow condition, meaning that, at the time of initial application, they will be reclassified from the IAS 39 LaR category (AC valuation category) to the IFRS 9 FVPL category. The reason for the breach of the cash flow condition lies in certain detrimental side agreements or non-recourse financing where there was a substantial property/project risk on the commitment date, meaning that the payments depend, in economic terms, to a considerable degree on the property being financed.

Based on the current decision-making status – which is not yet final – HSH Nordbank does not plan to make use of the FVOCI categorisation option for equity instruments within the scope of IFRS 9.

The provisions governing the classification and measurement of financial liabilities remain largely unchanged compared with IAS 39. There will, however, be 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/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 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 and/or whether the financial instrument has an impaired credit rating, i.e. is credit-impaired. The minimum loan loss provisions correspond to the 12-month expected loss (level 1). 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).

GROUP EXPLANATORY NOTES
(SELECTED 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 (5) 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 315a (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 half-year financial report is composed of condensed interim group financial statements and an interim group management report taking account of the requirements of IAS 34. The condensed interim group financial statements consist of an income statement, a statement of comprehensive income, a statement of financial position, a statement of changes in equity, a condensed statement of cash flows and selected explanatory notes.

The interim Group financial statements as at 30 June 2017 were prepared in accordance with IFRS as published by the International Accounting Standards Board (IASB) and adopted as European law by the European Union (EU). In doing so, particular attention was paid to IAS 34 (Interim Financial Reporting).

In the interim Group financial statements, the same accounting policies have basically been applied as in the consolidated financial statements of HSH Nordbank AG as at 31 December 2016.

In accordance with IAS 34.C4, HSH Nordbank does not prepare any pension obligation reviews in the course of the current financial year and bases its figures on the data from the last expert opinion as at 31 December 2016. Each quarter, an assessment is performed to establish whether essential parameters related to pension provisions have changed. If this is the case, these are adjusted accordingly and are taken into account in accounting (in particular changes in the discount rate).

During the current financial year, the following accounting standards, whose adoption into EU law is still outstanding, need to be applied for the first time as a matter of principle.

Amendments to IAS 7 – Disclosure Initiative
The amendments aim to improve the information on changes to the company's debt. In line with the amendments, companies have to provide information on the changes in financial liabilities whose inflows and outflows are shown under cash flow from financing activities in the cash flow statement. Corresponding financial assets are also to be included in the disclosures (e.g. assets from hedging transactions).

Information is to be 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.

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 IFRSs (2014 – 2016) amended three IFRSs. 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. 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 amendments relating to IFRS 1 and IAS 28 need to be applied for the first time in the first reporting period in a financial year starting on or after 1 January 2018. Early application is permitted.

The provisions mentioned above will not have any material impact on the consolidated financial statements of HSH Nordbank.

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.

Any necessary adjustments/expansions of the existing models relate primarily to the implementation 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. 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 information relating to the future – if necessary.

The 12-month expected loss is calculated by multiplying the (one-year) credit risk parameters. The lifetime expected loss is calculated by multiplying 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.

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. Other characteristics (e.g. default days) are also used to allocate financial instruments to specific levels.

The extent giving rise to a significant deterioration in credit quality (significance threshold) is to be 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. If a change in rating that is defined as significant is exceeded, then the financial instrument in question is allocated to level 2. Otherwise, it remains in level 1.

A financial instrument is transferred from level 2 to level 1 if the loan default risk is no longer significantly increased based on the rating-based classification described above.

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 essentially include 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.

Loans and securities with objective evidence of impairment are 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 loss in the amount of the difference. The specific loan loss provision is set up in the amount of the 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. For those transactions that are to be allocated to levels 1 and 2 of the new loan loss provisioning model, loan loss provisions are expected to increase considerably compared with IAS 39 at the time of initial application.

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 the 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 the 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.

Based on the current findings of the implementation project, the overwhelming majority of modified assets will have to be allocated to level 3. At this level, the adjustment of the carrying amount generally results in an offsetting adjustment to the loan loss provisions in the same amount.

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 as well as amendments to IFRS 15: Date of initial application of 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 being applied for the first time in financial years beginning on or after 1 January 2018. While early application is permitted, the Bank does not currently intend to apply the standard early.

Based on the analysis of the impact of IFRS 15, HSH Nordbank does not expect the application of IFRS 15 to have any material impact on the Group financial statements compared with the current practice under IAS 18.

In addition to the IFRS, HSH Nordbank has also observed the German Accounting Standard GAS 16 Interim Financial Reporting for its interim management report.

These interim consolidated financial statements were reviewed by an auditor.

All facts up to 22 August 2017 were taken into account.

Going concern assumption

Regarding the going concern assumption, we refer to the discussion in the interim Group management report in the section “Opportunities and risks resulting from the formal decision in the EU state aid proceedings”. It is stated there that the going concern assumption for accounting and measurement purposes and the assumption of the continued going concern of HSH Nordbank and significant group companies is based in particular on the following assumptions:

(i) the agreements required for the implementation of the decision taken by the EU Commission in the EU state aid proceedings on the replenishment of the second loss guarantee are entered into comprehensively and on a timely basis and that the decision will be implemented by HSH Nordbank AG and its shareholders in full and on a timely basis,

(ii) the operating company, HSH Nordbank AG, is sold at a positive sale price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline, or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company 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 during the privatisation period, 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.

(iii) as part of the ongoing privatisation process of HSH Nordbank AG, HSH Nordbank AG will be sold in full as a whole bank, i. e. the shares in the Bank held by the seller will be disposed of, including all assets and liabilities, without any material early disposals of assets or sub-segments at prices below the carrying amount in the case of offers for the entire business having been received. If extensive sales of loan portfolios, particularly in the Non-Core Bank, are required, then this could result in significant additional loan loss provision expenses that are not compensated for by the guarantee, and could require the material depreciation of deferred taxes.

(iv) the minimum capital requirements at all regulatory levels can be adhered to in accordance with the corresponding SREP resolutions passed by the European Central Bank and the statutory provisions during the forecast period. If there is a need for significant additional loan loss provision expenses and the material depreciation of deferred taxes (e.g. in the scenario described above) or if the recovery of the shipping market that has been assumed in the Bank's corporate planning does not materialise as planned, or if the regulatory treatment of the second loss guarantee as a securitisation position is no longer approved by the banking supervisory authority, this could put considerable pressure on the capital ratios and additional measures may need to be taken by the owners and/or third parties to strengthen the capital ratios in order to be able to adhere to the minimum capital requirements, particularly at the level of the financial holding group. If such measures are not taken, this could result in the winding-down of HSH Nordbank.

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

2. EVENTS AFTER THE REPORTING DATE

Sale of another tranche of the market portfolio

As part of the decision made by the European Commission in the EU state aid proceedings on the replenishment of the second loss guarantee on 2 May 2016, the sale of non-performing loans totalling € 3.2 billion on the market was approved. Within this context, the Bank concluded transactions relating to five non-strategic portfolios (Aviation, Continental European Commercial Real Estate (Scandinavia, Netherlands, Germany), Energy and International Real Estate) in the first half of the year, among other measures. Most of these transactions have already been closed.

The signing process for another aviation portfolio was completed on 2 August 2017. The volume of the transaction amounts to around € 0.2 billion EaD. Corresponding effects on the valuation of the portfolio in question were recognised in these interim financial statements. The transaction is scheduled for closing in the course of the third or fourth quarter of 2017.

3. PROVISION OF A GUARANTEE FACILITY

I. Second loss guarantee of HSH Finanzfonds AöR

The basic hedging effect of the guarantee is described in the Annual Report as at 31 December 2016.

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.

In exchange for the guarantee HSH Nordbank AG has been paying a contractually agreed base premium of 2.2 % p.a. on the guarantee volume that has not yet been drawn down since 1 January 2016. 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) are assumed by the newly established holding company.

As at 30 June 2017 a compensation item disclosed on the balance sheet of € 7,024 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 amount of € 178 million (previous year: € 931 million) has been taken into account, with a positive effect, under loan loss provisions in the statement of income.

The compensation item on the balance sheet includes compensation claims of HSH Nordbank AG vis-à-vis the guarantor in the total amount of € 535 million, as the settled payment defaults under the guarantee exceeded the first loss piece to be borne by the Bank of € 3.2 billion in the previous year. 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 by the guarantor amount to € 2.9 billion in total as at 30 June 2017, with € 1.0 billion of these payments having been made in 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 at fair value are disclosed under the Hedging effect of credit derivative under the second loss guarantee line item in the statement of income. The fair value of the partial guarantee Two was € 113 million as at 30 June 2017 (31 December 2016: € 199 million). Expense of € 89 million (previous year: expense of € 408 million) has been recognised under the Hedging effect of credit derivative under the public second loss guarantee line item in the statement of income. This also includes the share of the premium of € 2 million (previous year: € 7 million) that is attributable to the credit derivative.

HEDGING EFFECT OF THE GUARANTEE

(€ m)	**30.06.2017**		31.12.2016		**January – June 2017**		January – June 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	7,024	–	7,854	–	–830	–	931	–
Compensation under the second loss guarantee	**7,024**	**–**	**7,854**	**–**	**–830**	**–**	**931**	**–**
Payments of HSH Finanzfonds AöR					1,008			
Fair value credit derivative	–	113	–	199	–	–89	–	–408
Hedging effect of the guarantee	**7,024**	**113**	**7,854**	**199**	**178**	**–89**	**931**	**–408**

Taking into account the compensation payments of HSH Finanzfonds AöR already received for credit losses in the hedged portfolio of € 2,861 million (previous year: € 1,852 million) and the hedging effect resulting from the credit derivative measured on the reporting date (protection leg) in the amount of € 115 million, the utilisation of the guarantee as at 30 June 2017 comes to € 10.0 billion (31 December 2016: € 9.9 billion). Since the 2009 reporting year the Bank has recorded premium expense totalling € 3,788 million for the provision of the second loss guarantee. € 3,748 million has been paid to date, of which € 2,713 million is attributable to the current base premium and € 1,035 million to one-off payments (thereof € 260 million to HSH Beteiligungs Management GmbH).

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. The premium expense for the first half of 2017 came to € 12.8 million. In 2017, the Bank expects to incur premium expense totalling a maximum of around € 26 million. The contractual term of the guarantee comes to 9 years (as of the conclusion of the guarantee agreement 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 amount of € 30 million (the aforementioned first loss piece comprises a first loss tranche of € 22.5 million and an initial and current 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. As at 30 June 2017, no compensation item was recognised because the specific and general loan loss provisions did not exceed the first loss piece of € 30 million in total. 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. SCOPE OF CONSOLIDATION

In addition to the parent company, HSH Nordbank AG, Hamburg/Kiel, the scope of consolidation includes 55 fully consolidated subsidiaries (31 December 2016: 57).

One associate consolidated under the equity method was included in the Group financial statements (also as at 31 December 2016). No joint ventures (31 December 2016: one) are included under the equity method at present.

The following subsidiaries and associates are included in the Group financial statements of HSH Nordbank AG:

CONSOLIDATED COMPANIES

Subsidiaries in which HSH Nordbank AG directly or indirectly holds 100 % of the equity interests	Registered office	**Share of equity capital in % as at 30.06.2017**	Share of equity capital in % as at 31.12.2016
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. Chasms Navigation Ltd.[11)]	Douglas	100.0	–
9. Cregneash Navigation Ltd.[11)]	Douglas	100.0	–
10. Curragh Navigation Ltd.[11)]	Douglas	100.0	–
11. FSL Asset Management Pte. Ltd.[6)]	Singapore	100.0	100.0
12. FSL Holdings Pte. Ltd.[7)]	Singapore	100.0	100.0
13. FSL Trust Management Pte. Ltd.[5)]	Singapore	100.0	100.0
14. GODAN GmbH	Hamburg	100.0	100.0
15. HSH Auffang- und Holdinggesellschaft mbH & Co. KG	Hamburg	100.0	100.0
16. HSH Facility Management GmbH	Hamburg	100.0	100.0
17. HSH Gastro+Event GmbH[8)]	Hamburg	100.0	100.0
18. HSH N Finance (Guernsey) Limited	St. Peter Port	100.0	100.0
19. HSH N Residual Value Ltd.	Hamilton	100.0	100.0
20. HSH Nordbank Securities S.A.	Luxembourg	100.0	100.0
21. HSH Private Equity GmbH	Hamburg	100.0	100.0
22. Ilex Integra GmbH[1)]	Hamburg	100.0	100.0
23. ISM Agency LLC[10)]	New York	100.0	100.0
24. Mooragh Navigation Ltd.[11)]	Douglas	100.0	–
25. Neptune Finance Partner S.à.r.l.	Luxembourg	100.0	100.0
26. Neptune Finance Partner II S.à.r.l.	Luxembourg	100.0	100.0
27. Soderick Navigation Ltd.[11)]	Douglas	100.0	–
28. Unterstützungs-Gesellschaft der Hamburgischen Landesbank mit beschränkter Haftung i.L.	Hamburg	100.0	100.0
29. 2200 Victory LLC	Dover	100.0	100.0

CONSOLIDATED COMPANIES

Subsidiaries with non-controlling interests	Registered office	**Share of equity capital in % as at 30.06.2017**	Share of equity capital in % as at 31.12.2016
30. Adessa Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs KG[11]	Mainz	–	–
31. Amentum Aircraft Leasing No. Five Limited[11]	Dublin	49.0	49.0
32. Amentum Aircraft Leasing No. Seven Limited[11]	Dublin	49.0	49.0
33. Amentum Aircraft Leasing No. Six Limited[11]	Dublin	49.0	49.0
34. Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG[2]	Hamburg	83.3	83.3
35. Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG[2]	Hamburg	83.3	83.3
36. CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG[2]	Hamburg	83.3	83.3
37. CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG[2]	Hamburg	83.3	83.3
38. CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG[2]	Hamburg	83.3	83.3
39. CAPCELLENCE Vintage Year 17 Beteiligungen GmbH & Co. KG[2]	Hamburg	83.3	–
40. Castellum ABF S.A.[11]	Luxembourg	–	–
41. GmbH Altstadt Grundstücksgesellschaft[11]	Mainz	50.0	50.0
42. HSH Care+Clean GmbH[8]	Hamburg	51.0	51.0
43. HSH Move+More GmbH[8]	Kiel	51.0	51.0
44. HSH N Funding II[11]	George Town	56.3	56.3
45. Life Insurance Fund Elite LLC[11]	New York	–	–
46. Life Insurance Fund Elite LLC Trust[11]	Minneapolis	–	–
47. Next Generation Aircraft Finance 2 S.à.r.l.[11]	Findel	49.0	49.0
48. Next Generation Aircraft Finance 3 S.à.r.l.[11]	Findel	49.0	49.0
49. OCEAN Funding 2013 GmbH[11]	Frankfurt a.M.	–	–
50. RDM Limited[11]	George Town	–	–
51. RESPARCS Funding Limited Partnership I[11]	Hong Kong	0.0	0.0
52. RESPARCS Funding II Limited Partnership[11]	St. Helier	0.0	0.0
53. Senior Assured Investment S.A.[11]	Luxembourg	–	–
54. Senior Preferred Investments S.A.[11]	Luxembourg	–	–
55. Stratus ABF S.A.[11]	Luxembourg	–	–

COMPANIES CONSOLIDATED AT EQUITY

	Registered office	**Share of equity capital in % as at 30.06.2017**	Share of equity capital in % as at 31.12.2016
Associates consolidated under the equity method			
1. First Ship Lease Trust	Singapore	24.8	25.2

[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
- Chasms Navigation Limited, Douglas
- Cregneash Navigation Limited, Douglas
- Curragh Navigation Limited, Douglas
- Mooragh Navigation Limited, Douglas
- Soderick Navigation Limited, Douglas

The company CAPCELLENCE Vintage Year 17 Beteiligungen GmbH & Co. KG, which was set up on 5 April 2017 and in which HSH Nordbank holds the majority of voting rights, is included for the first time in the scope of consolidation on a fully consolidated basis.

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 each hold one container vessel which is leased to generate charter income until 2020/2021 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 have concluded swaps with HSH Nordbank AG.

HSH Nordbank 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 five single-ship companies that had been pledged to it to another party which holds the shares for HSH Nordbank on a fiduciary basis. This fiduciary relationship allows HSH Nordbank to exercise control over the single-ship companies.

The business combinations mean that existing business relationships between HSH Nordbank AG 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 loan receivables and the interest rate swaps totalling € 426 million were 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.

The material assets of the Navigation Group are the above-mentioned container vessels. As they were already intended for sale at the time of purchase, the intention being to sell them in the third quarter of 2017, these tangible assets are reported under Non-current assets held for sale (IFRS 5). 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 has a fair value of € 28 million. The other assets and liabilities of the Navigation Group that have been taken over are insignificant.

The results of the Navigation Group included in the Group financial statements as at 30 June 2017 amount to € 6 million. The revenue of the Navigation Group from the time of initial consolidation until 30 June 2017 amounts to € 8 million and largely relates to income from ship chartering. It is reported under Other operating result. The revenue of the Navigation Group in the period of 1 January to 30 June 2017 amounts to € 50 million.

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 Holding S.à.r.l., Luxembourg

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 connection to these companies in the future. A profit of € 1 million resulted from the deconsolidation of the Mitco Group and is recognised under the item Other operating result.

With effect from 23 June 2017, HSH Nordbank AG sold its shares in Solar Holding 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 Holding S.à.r.l., has 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.

C) Modification of holdings in subsidiaries

There were no changes in the ownership interests held by HSH Nordbank in a subsidiary in the period under review that did not lead to a loss of control.

II. Information on shares held in associates and joint ventures accounted for under the equity method

A) General information

The following company included in the scope of consolidation as at 31 December 2016 is no longer consolidated under the equity method:

- Kontora Family Office GmbH, Hamburg

All shares in Kontora Family Office GmbH were sold as at 22 March 2017. The associated deconsolidation did not have any material effect on income.

As at the reporting date, HSH Nordbank did not hold any shares in associates and joint ventures accounted for using the equity method that are material to the Group's earnings, net assets and financial position.

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)	**30.06.2017**	31.12.2016
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**	**12**

OTHER SHARES HELD IN JOINT VENTURES ACCOUNTED FOR UNDER THE EQUITY METHOD

(€ m)	**30.06.2017**	31.12.2016
Share of the following attributable to HSH Nordbank:		
Net income/loss for the year	–	–
Other comprehensive income	–	–
Total comprehensive income	–	–
Cumulative carrying amount	**–**	**1**

III. 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. Concerning three of these companies, the majority of the voting rights is also held.

NOTES ON THE GROUP STATEMENT OF INCOME

5. NET INTEREST INCOME

NET INTEREST INCOME

(€ m)	**January – June 2017**	January – June 2016
Interest income from		
Lending and money market transactions	545	632
Fixed-interest securities	115	135
Trading transactions	2	3
Derivative financial instruments	755	814
Unwinding	56	98
Disposal of receivables	298	142
Current income from		
Equities and other non-fixed-interest securities	4	4
Equity holdings in non-affiliated companies	10	15
Other holdings	1	3
Interest income	**1,786**	**1,846**
of which attributable to financial instruments not classified as HfT or DFV	907	880
Negative interest resulting from		
Lending and money market transactions	–9	–5
Derivative financial instruments	–138	–74
Negative interest	**–147**	**–79**
Interest expenses for		
Liabilities to banks	61	75
Liabilities to customers	211	241
Securitised liabilities	126	157
Subordinated capital	10	13
Other liabilities	9	11
Disposal of receivables	–	9
Derivative financial instruments	758	893
Interest expense	**1,175**	**1,399**
of which attributable to financial instruments not classified as HfT or DFV	245	294
Positive interest for		
Liabilities to banks	–4	–1
Liabilities to customers	–6	–1
Derivative financial instruments	–139	–67
Positive interest	**–149**	**–69**
Net income from discounting and compounding	–56	–63
Net income from hybrid financial instruments	**–56**	**–63**
of which attributable to financial instruments not classified as HfT or DFV	–56	–63
Total	**557**	**374**

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.

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 these instruments.

The cumulative net income from hybrid financial instruments amounts to € 287 million (previous year: € 398 million). € 1,644 million are attributable to the result from re-estimating interest and principal repayment flows (previous year: € 1,644 million) and € –1,357 million are attributable to the income/loss from discounting and compounding (previous year: € –1,246 million).

The difference between the valuation for tax purposes and measurement under IAS 39.A8 results in deferred tax assets of € 6 million (previous year: € 9 million deferred tax assets).

6. NET COMMISSION INCOME

NET COMMISSION INCOME

(€ m)	**January – June 2017**	January – June 2016
Commission income from		
Lending business	24	28
Securities business	4	5
Guarantee business	5	8
Payments and account transactions as well as documentary business	13	12
Other commission income	7	10
Commission income	**53**	**63**
Commission expense from		
Lending business	1	2
Securities business	2	3
Guarantee business	14	3
Payments and account transactions as well as documentary business	3	2
Other commission expenses	1	3
Commission expenses	**21**	**13**
Total	**32**	**50**

Financial instruments not classified as HfT or DFV accounted for € 33 million (previous year: € 49 million) of Net commission income.

The premium expense resulting from the synthetic securitisation transaction (see Note 3.II) is reported under Net commission income and amounted to € 13 million in the reporting period (previous year: € 0 million).

7. 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 hedge relationships. Micro fair value hedges have no longer been used since 1 July 2016. Hedge accounting is used solely for interest rate risks.

RESULT FROM HEDGING

(€ m)	**January – June 2017**	January – June 2016
Fair value changes from hedging transactions	– 56	11
Micro fair value hedge	–	– 16
Portfolio fair value hedge	– 56	27
Fair value changes from underlyings	47	– 9
Micro fair value hedge	–	16
Portfolio fair value hedge	47	– 25
Total	**– 9**	**2**

8. 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 not hedged against foreign exchange risk are disclosed in the loan loss provisions.

Other products comprises the income from foreign exchange transactions, credit derivatives and commodities.

NET TRADING INCOME

(€ m)	**January – June 2017**	January – June 2016
Bonds and interest rate derivatives		
HfT	124	– 146
DFV	– 17	188
Subtotal	**107**	**42**
Equities and equity derivatives		
HfT	–	– 4
DFV	– 2	– 1
Subtotal	**– 2**	**– 5**
Other products		
HfT	46	3
Subtotal	**46**	**3**
Total	**151**	**40**

Net trading income includes net income from foreign currency of € 45 million (previous year: € 8 million).

During the reporting period € 45 million (previous year: € 36 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 € 8 million (previous year: € 20 million) is attributable to changes in the credit spread.

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), i.e. not through profit or loss, since 1 January 2017. 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 prior-year reporting period, € 1 million (€ 3 million in cumulative terms) was reported under Net trading income.

9. 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)	**January – June 2017**	January – June 2016
Classified as AfS		
+ Realised gains/losses (–)	– 7	66
– Write-downs	3	39
Subtotal	**- 10**	**27**
Classified as LaR		
+ Realised gains/losses (–)	15	4
– Write-downs	–	9
+ Write-ups	21	49
Subtotal	**36**	**44**
+ Reversal of general loan loss provisions (LaR portfolios)	–	3
Subtotal	**–**	**3**
Total	**26**	**74**

10. NET INCOME FROM FINANCIAL INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

As at 30 June 2017, HSH Nordbank owns shares in one associate (31 December 2016: one associate and one joint venture) that are included in the Group financial statements under the equity method (see Note 4).

The pro rata net income assigned to the Group from financial investments accounted for under the equity method as at 30 June 2017 is summed up below.

NET INCOME FROM FINANCIAL INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

(€ m)	**January – June 2017**	January – June 2016
Pro rata net income for the period	2	1
Total	**2**	**1**

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 (First Ship Lease Trust).

11. LOAN LOSS PROVISIONS IN THE LENDING BUSINESS

LOAN LOSS PROVISIONS IN THE LENDING BUSINESS

(€ m)	January – June 2017	January – June 2016
– Expense from additions to loan loss provisions	693	771
+ Income from the reversal of loan loss provisions	218	407
Result from changes in loan loss provisions	**– 475**	**– 364**
Expenses from allocations to provisions in the lending business	13	38
+ Income from reversals of provisions in the lending business	30	16
Result from changes to provisions in the lending business	**17**	**– 22**
Direct write-downs	19	176
+ Payments received on loans and advances previously written down	98	42
Result from other changes to loan loss provisions in the lending business	**79**	**– 134**
Result from changes in loan loss provisions in the lending business before currency translation gains or losses and compensation	**– 379**	**– 520**
Currency translation gains or losses on loan loss provisions denominated in foreign currency	**49**	**148**
Compensation under the second loss guarantee	**178**	**931**
Total loan loss provisions in the lending business	**– 152**	**559**

With regard to the compensation item related to HSH Finanzfonds AöR please refer to Note 3.

Direct write-downs of € 19 million (previous year: € 176 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)	January – June 2017	January – June 2016
Specific loan loss provisions	– 498	– 333
General loan loss provisions	23	– 31
Net change in loan loss provisions in the lending business	**– 475**	**– 364**
Provisions for specific risks	13	– 23
Provisions for portfolio risks	4	1
Net change in provisions in the lending business	**17**	**– 22**

12. ADMINISTRATIVE EXPENSES

ADMINISTRATIVE EXPENSES

(€ m)	January – June 2017	January – June 2016
Personnel expenses	113	129
Operating expenses	124	132
Depreciation on property plant and equipment, leasing assets, investment property and amortisation on intangible assets	9	16
Total	**246**	**277**

In the reporting period, there was unscheduled depreciation on non-current assets held for sale and disposal groups in the amount of € 3 million (previous year: € 1 million on leasing assets) which was attributable to the Non-Core Bank.

13. OTHER OPERATING INCOME

OTHER OPERATING INCOME

(€ m)	January – June 2017	January – June 2016
Other operating income	90	76
Other operating expenses	43	33
Total	**47**	**43**

Other operating income includes, among other things, income from the leasing business of € 15 million (previous year: € 13 million) as well as income arising from the reversal of provisions in the amount of € 27 million (previous year: € 5 million). The other operating income includes € 15 million in income from five single-ship companies, € 7 million of which is attributable to effects from the initial consolidation of these companies (see Note 4).

The other operating expenses include, among other things, expenses for investment property of € 2 million (previous year: € 3 million) as well as expenses arising from additions to provisions in the amount of € 12 million (previous year: € 10 million). The newly consolidated single-ship companies have other operating expenses of € 2 million.

14. EXPENSES FOR BANK LEVY AND DEPOSIT GUARANTEE FUND

EXPENSES FOR BANK LEVY AND DEPOSIT GUARANTEE FUND

(€ m)	January – June 2017	January – June 2016
Expenses for European bank levy and deposit guarantee	41	63
Total	**41**	**63**

The event triggering the obligation to pay the bank levy pursuant to IFRIC 21 is established at the beginning of each year. As a result, the expense for the bank levy is recognised in full at the start of the year and not on a pro rata basis.

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).

15. NET INCOME FROM RESTRUCTURING AND PRIVATISATION

NET INCOME FROM RESTRUCTURING AND PRIVATISATION

(€ m)	January – June 2017	January – June 2016
Personnel expenses due to restructuring	–	63
Operating expenses due to restructuring	11	38
Income from reversals of provisions and liabilities from restructuring	7	3
Expenses from privatisation	21	–
Total	**-25**	**-98**

The programme for the reduction of operating and personnel expenses initiated in the fourth quarter of 2014 was continued during the reporting period. In particular, expenses were incurred in connection with IT, legal and strategic advice. These expenses are reflected in the operating expenses due to restructuring. The expenses associated with the privatisation of HSH Nordbank are also reported under Net income from restructuring and privatisation. The privatisation expenses consist primarily of one-off expenses for external consultancy and support with the sale process.

16. EXPENSES FOR GOVERNMENT GUARANTEES

EXPENSES FOR GOVERNMENT GUARANTEES

(€ m)	**January – June 2017**	January – June 2016
HSH Finanzfonds AöR	80	126
Total	**80**	**126**

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. Since 1 January 2016, the Bank has calculated the base premium as corresponding to 2.2% p.a. of the portion of the guarantee that is still undrawn. No settled drawdowns had been made as at 30 June 2016. € 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 prior-year period. The share of the premium relating to partial guarantee Two (CDS) is disclosed under the line item Hedging effect of credit derivative under the second loss guarantee in the amount of € 2 million (previous year: € 7 million).

17. EARNINGS PER SHARE

To calculate 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 diluted forms of capital as at 30 June 2017, i.e. the diluted and undiluted earnings are the same. The calculation was based on non-rounded values.

EARNINGS PER SHARE

	January – June 2017	January – June 2016
Attributable Group net result (€ m) – undiluted/diluted	158	160
Number of shares (millions)		
Average number of ordinary shares outstanding – undiluted/diluted	302	302
Earnings per share (€)		
Undiluted	0.52	0.53
Diluted	0.52	0.53

NOTES ON THE GROUP STATEMENT OF FINANCIAL POSITION

18. CASH RESERVE

CASH RESERVE

(€ m)	**30.06.2017**	31.12.2016
Cash on hand	10	5
Balances at central banks	6,487	3,368
of which at the Deutsche Bundesbank	6,469	3,342
Treasury bills, discounted treasury notes and similar debt instruments issued by public-sector institutions	47	118
Total	**6,544**	**3,491**

19. LOANS AND ADVANCES TO BANKS

LOANS AND ADVANCES TO BANKS

(€ m)	**30.06.2017**	31.12.2016
Payable on demand	2,119	2,951
Other loans and advances	1,285	1,241
Total	**3,404**	**4,192**

20. LOANS AND ADVANCES TO CUSTOMERS

LOANS AND ADVANCES TO CUSTOMERS

(€ m)	**30.06.2017**	31.12.2016
Retail customers	911	1,001
Corporate clients	40,987	44,905
Public authorities	4,103	5,004
Total	**46,001**	**50,910**

21. LOAN LOSS PROVISIONS

LOAN LOSS PROVISIONS

(€ m)	30.06.2017	31.12.2016
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	6,313	6,711
Loan loss provisions in the lending business	**6,314**	**6,712**
Compensation under the second loss guarantee	–7,024	–7,854
Loan loss provisions for items in the statement of financial position	**–710**	**–1,142**
Provisions in the lending business	88	110
Loan loss provisions for items in the statement of financial position and off-balance-sheet risk in the lending business	**–622**	**–1,032**

The specific and general loan loss provisions are determined at first without taking the hedging effect of the second loss guarantee 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). As at 30 June 2017, there were impairment losses of € 91 million attributable to the Non-current assets held for sale and disposal groups line item in the statement of financial position (as at 31 December 2016: € 233 million). The expected fair values or transfer values were taken into account in determining loan loss provisions of the assets held for sale.

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 30 June 2017.

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	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
As at 1 January	**–**	**14**	**1**	**1**	**1**	**15**
Additions	–	–	–	–	–	–
Reversals	–	–	–	–	–	–
Utilisation	–	14	–	–	–	14
As at 30 June 2017/31 December 2016	**–**	**–**	**1**	**1**	**1**	**1**

Loan loss provisions for customers during the period under review developed 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	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
As at 1 January	**6,336**	**7,601**	**375**	**611**	**6,711**	**8,212**
Additions	693	2,590	–	31	693	2,621
Reversals	195	908	23	270	218	1,178
Utilisation	430	2,864	–	–	430	2,864
Other changes	–	–7	–	–	–	–7
Unwinding	–56	–162	–	–	–56	–162
Changes in the scope of consolidation	–14	6	–	–	–14	6
Exchange rate changes	–367	80	–6	3	–373	83
As at 30 June 2017/31 December 2016	**5,967**	**6,336**	**346**	**375**	**6,313**	**6,711**

The loan loss provisions relate exclusively to items categorised as loans and receivables (LaR).

22. 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 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 the 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)	**30.06.2017**	31.12.2016
Positive fair value of derivatives used in portfolio fair value hedges	442	508
Total	**442**	**508**

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.

23. 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)	**30.06.2017**	31.12.2016
Debentures and other fixed-interest securities	335	458
Positive fair value of financial derivatives	3,982	4,943
Other, including promissory notes held for trading	14	23
Receivables from syndication transactions	–	9
Total	**4,331**	**5,433**

24. 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)	**30.06.2017**	31.12.2016
Debentures and other fixed-interest securities	15,079	15,203
Shares and other non-fixed-interest securities	153	170
Equity holdings in non-affiliated companies	90	119
Interests in affiliated companies	1	1
Total	**15,323**	**15,493**

25. 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 30 June 2017, HSH Nordbank owns shares in one associate that is included in the Group financial statements under the equity method (31 December 2016: one associate and one joint venture). The carrying amount was € 12 million as at 30 June 2017 (31 December 2016: € 13 million).

An overview of and detailed information on the associates and joint ventures included in the Group financial statements are set out in Note 4 . Net income from financial investments accounted for under the equity method is disclosed in Note 10 .

26. INTANGIBLE ASSETS

INTANGIBLE ASSETS

(€ m)	**30.06.2017**	31.12.2016
Software	10	12
developed in-house	4	5
acquired	6	7
Software in development	2	2
acquired	2	2
Total	**12**	**14**

27. PROPERTY, PLANT AND EQUIPMENT AND INVESTMENT PROPERTY

PROPERTY, PLANT AND EQUIPMENT

(€ m)	**30.06.2017**	31.12.2016
Land and buildings	221	222
Plant and equipment	12	13
Assets under construction	1	1
Total	**234**	**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. Real estate leased as lessor in the operating leasing business is also included in this item.

INVESTMENT PROPERTY

(€ m)	**30.06.2017**	31.12.2016
Investment property	10	12
Total	**10**	**12**

28. NON-CURRENT ASSETS HELD FOR SALE AND DISPOSAL GROUPS

NON-CURRENT ASSETS HELD FOR SALE AND DISPOSAL GROUPS

(€ m)	30.06.2017	31.12.2016
Loans and advances to banks	–	2
Loans and advances to customers	299	1,133
Financial investments	147	18
Property, plant and equipment	571	186
Investment property	1	34
Other assets	3	9
Total before loan loss provisions	**1,021**	**1,382**
Loan loss provisions	91	233
Total after loan loss provisions	**930**	**1,149**

As at 31 December 2016, this balance sheet item largely included assets that have been/are still to be sold on the market as part of the implementation of the EU decision of 2 May 2016 (market portfolio). The market portfolio consists of five disposal groups (the time of disposal in 2017 is shown in brackets):

- Continental European Commercial Real Estate (first quarter)
- Aviation I (second quarter)
- Energy (second quarter)
- Aviation II (third quarter; expected)
- International Real Estate (third quarter; expected)

The market portfolio consists of the non-strategic loan portfolio in the LaR category which is to be allocated in full to the Non-Core Bank segment in the amount of € 19 million (31 December 2016: € 1,133 million), for which loan loss provisions in the amount of € 9 million (31 December 2016: € 233 million) have been recognised. The market portfolio transaction also includes loan receivables in the amount of € 275 million (31 December 2016: € 419 million) from six fully consolidated subsidiaries (largely special purpose companies) (31 December 2016: 14 fully consolidated subsidiaries). The Group financial statements of HSH Nordbank recognise the assets and liabilities of these subsidiaries. The loan receivables to be sold are not reported in the Group financial statements as intra-Group obligations. In respect of one of the fully consolidated subsidiaries (31 December 2016: nine fully consolidated subsidiaries), the sale of the loan receivable will result in a loss of control by HSH Nordbank pursuant to IFRS 10. This means that all assets and liabilities of this fully consolidated subsidiary form part of disposal groups held for sale. With regard to five other subsidiaries, while the implementation of the transaction will not lead to a loss of control by HSH Nordbank, certain assets and liabilities of these five subsidiaries are also to be transferred to the buyer of the loan receivable in connection with the sale of the loan receivable. This means that tangible assets and other assets held by these subsidiaries, and provisions reported by these companies, are also held for sale. The losses from the subsequent measurement of assets belonging to the disposal groups in the market portfolio are shown in Note 12.

As at 30 June 2017, two other loan portfolios meet the criteria for classification as “held for sale” pursuant to IFRS 5. These also consist of non-strategic loan portfolios in the real estate and aviation asset classes (attributable to the Non-Core Bank) and are split, pursuant to IFRS 5, into the Aviation III and Real Estate disposal groups. Both disposal groups consist exclusively of loans and advances to customers in the LaR category with a total carrying amount of € 245 million for which loan loss provisions totalling € 65 million have been set up. The purchase agreement for the Aviation III disposal group was signed in August 2017 and the agreement for the Real Estate disposal group is expected to be signed in the third quarter of 2017. The transactions will be closed individually for the portfolio items included in the disposal group in each case. Most of them are expected to be closed in the second half of 2017.

This item also includes four loan receivables in the LaR category amounting to € 35 million (attributable to the Non-Core Bank) that are to be sold to another credit institution as part of a transaction in the third quarter of 2017. Loan loss provisions of € 17 million have been set up for these four loan receivables.

The financial investments reported under Non-current assets held for sale and disposal groups include a bond from the public cover pool (€ 129 million) that is attributable to the Core Bank segment and, as was the case as at 31 December 2016, an equity holding (€ 18 million) that is attributable to the Other and Consolidation segment. Both financial investments were sold in July 2017. 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 will be realised through profit or loss in the third quarter of 2017.

The tangible assets relate to vessels and aircraft held by fully consolidated borrower units. The vessels are the material assets of five single-ship companies (borrowers of HSH Nordbank AG) which were included in the Group financial statements by way of full consolidation for the first time as a result of restructuring measures taken on 1 June 2017. As they were already intended for sale at the time of purchase, the vessels are reported under this balance sheet item (Note 4). The vessels are expected to be sold in the third quarter of 2017.

The aircraft relate to tangible assets held by fully consolidated borrower units in connection with the Aviation II disposal group.

A property located in the US that is attributable to the Non-Core Bank segment is reported under investment property. The disposal is planned for the third quarter of 2017. The properties reported under this item as at 31 December 2016 were removed from the balance sheet in connection with the disposal of the continental European real estate.

The other assets relate to assets held by a fully consolidated borrower in connection with the Aviation II disposal group.

29. DEFERRED TAX ASSETS

Of the deferred tax assets in the amount of € 716 million (31 December 2016: € 767million), an amount of € 99 million (31 December 2016: € 100 million) was attributable to tax loss carryforwards.

As at 30 June 2017, these are attributable to the Singapore branch in the amount of € 5 million (31 December 2016: € 5 million), to the former New York branch in the amount of € 90 million (31 December 2016: € 90 million) and to consolidated subsidiaries in the amount of € 4 million (31 December 2016: € 5 million). For the Singapore branch, the recoverability of the deferred taxes on loss carryforwards results from planned future income. The deferred tax assets on loss carryforwards relating to the former New York branch and consolidated subsidiaries are offset by deferred tax liabilities recognised on temporary differences.

30. OTHER ASSETS

OTHER ASSETS

(€ m)	**30.06.2017**	31.12.2016
Receivables from insurance contracts	26	27
Other prepaid expenses	19	18
Receivables from fund transactions	8	7
Receivables from other taxes	5	7
Receivables from participations and affiliated companies	1	–
Other assets	40	46
Total	**99**	**105**

€ 46 million of the assets reported here relate to financial instruments (31 December 2016: € 50 million).

31. LIABILITIES TO BANKS

LIABILITIES TO BANKS

(€ m)	**30.06.2017**	31.12.2016
Payable on demand	1,135	1,543
Other term liabilities	8,380	7,958
Total	**9,515**	**9,501**

32. LIABILITIES TO CUSTOMERS

LIABILITIES TO CUSTOMERS

(€ m)	**30.06.2017**	31.12.2016
Savings deposits	17	18
Other liabilities		
Payable on demand	10,605	12,271
Term liabilities	29,306	27,883
Total	**39,928**	**40,172**

33. SECURITISED LIABILITIES

SECURITISED LIABILITIES

(€ m)	**30.06.2017**	31.12.2016
Debentures issued	14,266	16,555
Money market securities issued	40	69
Total	**14,306**	**16,624**

Debentures issued include € 666 million of hybrid financial instruments (31 December 2016: € 660 million) The carrying amount of these hybrid financial instruments was determined based on assumptions relating to future earnings of HSH Nordbank (IAS 39.A8 measurement).

In the item Securitised liabilities, repurchased own debentures in the amount of € 2,393 million (31 December 2016: € 2,643 million) were deducted.

34. NEGATIVE FAIR VALUES OF HEDGING DERIVATIVES

This item shows the negative fair value of derivatives used in hedge accounting. Only interest rate 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 the derivative's fair value. The remainder is stated under Trading liabilities. Hedge accounting is used solely for interest rate risks.

Changes in this item are directly related to changes in the item Positive fair value of the hedging derivatives (see Note 22). 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.

NEGATIVE FAIR VALUES OF HEDGING DERIVATIVES

(€ m)	**30.06.2017**	31.12.2016
Negative fair value of derivatives used in portfolio fair value hedges	258	290
Total	**258**	**290**

35. 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)	**30.06.2017**	31.12.2016
Negative fair value from derivative financial instruments		
Interest rate-related business	4,126	5,152
Currency-related business	68	191
Other business	511	638
Total	**4,705**	**5,981**

36. PROVISIONS

PROVISIONS

(€ m)	30.06.2017	31.12.2016
Provisions for pension obligations and similar obligations	1,097	1,152
Other provisions		
Provisions for personnel expenses	20	39
Provisions in the lending business	88	110
Provisions for restructuring	59	85
Provisions for litigation risks and costs	31	34
Other provisions	100	101
Total	**1,395**	**1,521**

The net change in pension obligations of € –55 million comprises the payments for pension obligations in the amount of € 24 million and net reversals of € 31 million. The drop in pension liabilities is largely due to the increase in the market interest rate level.

Provisions in the lending business are composed of the following items:

PROVISIONS IN THE LENDING BUSINESS

(€ m)	30.06.2017	31.12.2016
Specific loan loss provisions for		
Contingent liabilities	22	25
Irrevocable loan commitments	18	40
Other credit risks	10	2
Subtotal	**50**	**67**
Portfolio loan loss provisions for		
Contingent liabilities	32	33
Irrevocable loan commitments	6	10
Subtotal	**38**	**43**
Total	**88**	**110**

37. LIABILITIES RELATING TO DISPOSAL GROUPS

LIABILITIES RELATING TO DISPOSAL GROUPS

(€ m)	30.06.2017	31.12.2016
Provisions	44	63
Other liabilities	1	2
Total	**45**	**65**

All of the liabilities included in this item are attributable to the disposal groups in connection with the market portfolio transaction (see Note 28).

38. OTHER LIABILITIES

OTHER LIABILITIES

(€ m)	**30.06.2017**	31.12.2016
Collateral provided for liabilities assumed	655	657
Liabilities for invoices outstanding	48	52
Outstanding payments for the second loss guarantee	39	45
Liabilities for restructuring	18	28
Other tax liabilities	16	18
Deferred income	16	18
Personnel liabilities	11	9
Other	21	18
Total	**824**	**845**

The collateral provided for liabilities assumed serves to hedge leasing transactions of our customers with third parties.

€ 794 million of the liabilities reported here relate to financial instruments (31 December 2016: € 812 million).

39. SUBORDINATED CAPITAL

SUBORDINATED CAPITAL

(€ m)	**30.06.2017**	31.12.2016
Subordinated liabilities	1,154	2,110
Silent participations	1,415	1,412
Profit participation capital	–	14
Total	**2,569**	**3,536**

The carrying amounts of silent participations and profit participation capital were determined on the basis of assumptions of the future earnings situation of HSH Nordbank and assumptions with regard to making use of termination or extension options (IAS 39.A8).

40. EQUITY

EQUITY

(€ m)	**30.06.2017**	31.12.2016
Share capital	3,018	3,018
Capital reserve	75	75
Retained earnings	1,712	1,617
Cumulative gains and losses arising on the revaluation of net defined benefit liabilities recognised in OCI	– 186	– 242
Deferred taxes on cumulative gains and losses arising on the revaluation of net defined benefit liabilities recognised in OCI	59	76
Revaluation reserve	138	127
Thereof: from fair value measurement AfS	126	127
Thereof: credit risk-induced changes in the value of liabilities designated at FV	12	–
Currency conversion reserve	23	60
Group net profit/loss	158	67
Total before non-controlling interests	**5,124**	**4,964**
Non-controlling interests	– 13	– 14
Total	**5,111**	**4,950**

CHANGES IN ORDINARY SHARES

(Number of shares)	**30.06.2017**	31.12.2016
Number at the beginning of the year	301,822,453	301,822,453
Number at the end of the period	**301,822,453**	**301,822,453**

SEGMENT REPORTING

41. SEGMENT REPORT

(€ m/%)	Corporates		Real Estate		Shipping		Treasury & Markets		Core Bank	
	30.06. 2017	30.06. 2016	**30.06. 2017**	30.06. 2016	**30.06. 2017**	30.06. 2016	**30.06. 2017**	30.06. 2016	**30.06. 2017**	30.06. 2016
Net interest income	67	84	86	90	37	50	348	168	538	392
Net commission income	24	27	6	8	6	5	2	–1	38	39
Result from hedging	–	–	–	–	–	–	–	–	–	–
Net trading income	26	–2	19	2	4	10	44	67	93	77
Net income from financial investments[1]	–	–	–	–	–	2	15	61	15	63
Total income	**117**	**109**	**111**	**100**	**47**	**67**	**409**	**295**	**684**	**571**
Loan loss provisions in the lending business incl. credit derivative under the second loss guarantee[2]	4	–	–	1	4	–13	1	–	9	–12
Administrative expenses	–66	–69	–28	–25	–22	–28	–44	–50	–160	–172
Other operating income	4	3	2	–	1	1	1	–3	8	1
Expenses for bank levy and deposit guarantee fund	–6	–8	–7	–10	–4	–7	–8	–9	–25	–34
Net income before restructuring and privatisation	**53**	**35**	**78**	**66**	**26**	**20**	**359**	**233**	**516**	**354**
Net income from restructuring and privatisation	–	–	–	–	–	–	–	–	–	–
Expenses for government guarantees	–1	–2	–1	–2	–8	–8	–	–	–10	–12
Net income before taxes	**52**	**33**	**77**	**64**	**18**	**12**	**359**	**233**	**506**	**342**
Cost/income ratio (CIR)	55%	62%	25%	25%	46%	41%	11%	17%	23%	30%
Return on equity before tax	8%	7%	15%	19%	9%	7%	140%	41%	30%	22%
Average equity	1,369	1,009	1,043	672	405	338	512	1,149	3,329	3,168

(€ bn)	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016
Segment assets	**12**	**12**	**11**	**11**	**6**	**6**	**22**	**19**	**50**	**48**

[1] Including net income from financial investments accounted for under the equity method.
[2] Summary of the loan loss provisions in the lending business and hedging effect of credit derivative under the second loss guarantee line items.

(€ m/%)	Core Bank		Non-Core Bank		Other and Consolidation [3]		Group	
	30.06. 2017	30.06. 2016	**30.06. 2017**	30.06. 2016	**30.06. 2017**	30.06. 2016	**30.06. 2017**	30.06. 2016
Net interest income	538	392	–6	28	25	–46	557	374
Net commission income	38	39	11	14	–17	–3	32	50
Result from hedging	–	–	–	–	–9	2	–9	2
Net trading income	93	77	32	–43	26	6	151	40
Net income from financial investments[1]	15	63	12	15	1	–3	28	75
Total income	**684**	**571**	**49**	**14**	**26**	**–44**	**759**	**541**
Loan loss provisions in the lending business incl. credit derivative under the second loss guarantee[2]	9	–12	–251	157	1	6	–241	151
Administrative expenses	–160	–172	–95	–100	9	–5	–246	–277
Other operating income	8	1	28	21	11	21	47	43
Expenses for bank levy and deposit guarantee fund	–25	–34	–9	–20	–7	–9	–41	–63
Net income before restructuring and privatisation	**516**	**354**	**–278**	**72**	**40**	**–31**	**278**	**395**
Net income from restructuring and privatisation	–	–	–	–	–25	–98	–25	–98
Expenses for government guarantees	–10	–12	–70	–113	–	–1	–80	–126
Net income before taxes	**506**	**342**	**–348**	**–41**	**15**	**–130**	**173**	**171**
Cost/income ratio (CIR)	23%	30%	–	–	–	–	31%	47%
Return on equity before tax	30%	22%	–	–	–	–	7%	7%
Average equity	3,329	3,168	1,409	1,182	293	559	5,031	4,909

(€ bn)	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016
Segment assets	**50**	**48**	**18**	**22**	**11**	**14**	**79**	**84**

[1] Including net income from financial investments accounted for under the equity method.
[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] Consolidation includes the effect from different accounting.

(€ m/%)	30.06.2017			30.06.2016		
	Other	**Consoli-dation[3)]**	**Total Other and Consoli-dation**	Other	Consoli-dation[3)]	Total Other and Consoli-dation
Net interest income	– 8	33	25	– 6	– 40	– 46
Net commission income	– 14	– 3	– 17	–	– 3	– 3
Result from hedging	–	– 9	– 9	–	2	2
Net trading income	14	12	26	9	– 3	6
Net income from financial investments[1)]	4	– 3	1	– 2	– 1	– 3
Total income	**– 4**	**30**	**26**	**1**	**– 45**	**– 44**
Loan loss provisions in the lending business incl. credit derivative under the second loss guarantee[2)]	1	–	1	6	–	6
Administrative expenses	8	1	9	– 6	1	– 5
Other operating income	13	– 2	11	21	–	21
Expenses for bank levy and deposit guarantee fund	– 5	– 2	– 7	– 12	3	– 9
Net income before restructuring and privatisation	**13**	**27**	**40**	**10**	**– 41**	**– 31**
Net income from restructuring and privatisation	–	– 25	– 25	–	– 98	– 98
Expenses for government guarantees	–	–	–	–	– 1	– 1
Net income before taxes	**13**	**2**	**15**	**10**	**– 140**	**– 130**
Cost/income ratio (CIR)	–	–	–	–	–	–
Return on equity before tax	–	–	–	–	–	–
Average equity	294	– 1	293	560	– 1	559

(€ bn)	30.06.2017			31.12.2016		
Segment assets	**11**	**–**	**11**	**14**	**–**	**14**

1) Including net income from financial investments accounted for under the equity method.
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) 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.

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, trusts 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.

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 settlement and, as a result, also for the active winding-down of the portfolio of impaired loan commitments.

The segment structure was adjusted in the second half of 2016. Up until the time of the adjustment, the Core Bank consisted of the following segments: Shipping, Project and Real Estate Financing (SPI), Corporates & Markets (CM) and the Corporate Center (CC). As part of the change in internal reporting, the SPI segment was split into the Real Estate and Shipping segments. The CM segment was split into two segments: Corporate Clients and Treasury & Markets. The CC segment is now disclosed, together with reconciliation effects, as a segment not subject to a reporting requirement within "Other and Consolidation". The segment previously known as the Restructuring Unit was renamed the Non-Core Bank in the second half of 2016. The figures for the previous year have been adjusted accordingly.

In connection with the adjustment of the segment structure, shifts took place in the portfolio between the Core Bank and the Non-Core Bank in the third quarter of 2016. In this context, impaired loan portfolios in the amount of € 6.2 billion exposure at default (EaD), particularly from the Shipping recovery unit within the Core Bank, were transferred to the Non-Core Bank. These mainly relate to legacy burdens from the years before 2009, which are largely covered by the second loss guarantee of the federal state owners. In return, € 4.5 billion (EaD) relating mainly to cover pool portfolios was transferred from the Non-Core Bank to the Treasury & Markets segment of the Core Bank. This resulted in the consistent allocation of loan portfolios to continuing operations in the Core Bank and the reduction in risk in certain non-performing portfolios in the Non-Core Bank. The figures for the previous year have been adjusted accordingly.

Since the 2016 year end, the expenses for the bank levy and deposit guarantee fund have been allocated to the segments based on the adjusted balance sheet volume. The figures for the previous year have been adjusted accordingly.

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.

Unlike in the previous year, the guarantee fees are no longer allocated to the segments based on the compensation effect, but rather based on the regulatory equity capital requirements for the guaranteed portfolio. The figures for the previous year have been adjusted accordingly.

The effects from the results of the loss settlements reported in the compensation item are shown in full in the Non-Core Bank. The compensation effect from the unwinding is also allocated to the Non-Core Bank in full.

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.

Reconciliation effects relating to net interest income in the amount of € 33 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 continuously amortised within Net interest income.

The reconciliation effects relating to Net trading income in the amount of € 13 million (net) include differences resulting from the recognition of capital market transactions between the internal management system and IFRS accounting, among other things resulting from different posting methods for foreign currency transactions in the amount of € 43 million that were not taken into account in internal management. Net trading income of individual subsidiaries in the scope of consolidation in the amount of € 12 million is not taken into account in the internal management. Further differences result from the hedging of certain financial instruments in the amount of around € –45 million 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 addition, Net income from restructuring and privatisation is also shown in full under Consolidation as a reconciling item 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 10 for comments on companies consolidated under the equity method recognised as part of Net income from financial investments.

NOTES ON FINANCIAL INSTRUMENTS

42. CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS BY IAS 39 CATEGORY

CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS BY IAS 39 CATEGORY

(€ m) **30.06.2017**	LaR	AfS	DFV	HfT	LIA	No IAS 39 category	**Total**
Assets							
Cash reserve	6,497	47	–	–	–	–	6,544
Loans and advances to banks	3,325	79	–	–	–	–	3,404
Loans and advances to customers	44,604	52	1,263	–	–	–	45,919
Receivables under finance leases	–	–	–	–	–	82	82
Credit derivative under the second loss guarantee	–	–	–	113	–	–	113
Positive fair values of hedging derivatives	–	–	–	–	–	442	442
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	291	291
Trading assets	–	–	–	4,331	–	–	4,331
Financial investments	1,269	12,552	1,502	–	–	–	15,323
Non-current assets held for sale and disposal groups	432	17	–	–	–	–	449
Other assets	46	–	–	–	–	–	46
Total assets	**56,173**	**12,747**	**2,765**	**4,444**	**–**	**815**	**76,944**
Liabilities							
Liabilities to banks	–	–	119	–	9,396	–	9,515
Liabilities to customers	–	–	1,181	–	38,747	–	39,928
Securitised liabilities	–	–	1,865	–	12,441	–	14,306
Negative fair value of hedging derivatives	–	–	–	–	–	258	258
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	607	607
Trading liabilities	–	–	–	4,705	–	–	4,705
Liabilities relating to disposal groups	–	–	–	–	1	–	1
Subordinated capital	–	–	84	–	2,485	–	2,569
Other liabilities	–	–	–	–	794	–	794
Total liabilities	**–**	**–**	**3,249**	**4,705**	**63,864**	**865**	**72,683**

CARRYING AMOUNTS OF FINANCIAL INSTRUMENTS BY IAS 39 CATEGORY

(€ m) 31.12.2016	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 value 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**

43. RECLASSIFICATION UNDER IAS 39 (REVISED 2008)

HSH Nordbank Group 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 reclassifications of the assets still in the portfolio (from the second quarter of 2009) are shown in the table below:

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).

(€ m)		**30.06.2017**		31.12.2016	
	Carrying amount as at the time of reclassification	Carrying amount	Fair value	Carrying amount	Fair value
Reclassified from AfS to LaR	6,336	574	676	623	733
Total financial assets reclassified as LaR	**6,336**	**574**	**676**	**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 have fallen due since reclassification had a carrying amount of € 5,864 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 € 11 million (previous year: € 63 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 is as follows: In the reporting period, the statement of income includes Net interest income of € 7 million (previous year: € 9 million), Net interest income of € –6 million (previous year: € 23 million) and Net income from financial investments of € 15 million (previous year: € 38 million).

44. DISCLOSURE OF FAIR VALUE IN ACCORDANCE WITH IFRS 7 AND IFRS 13

I. 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 Section IV of this Note 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 mainly comprise interest-bearing 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 value is not calculated for unlisted equity instruments (holdings in affiliated companies and equity holdings treated under IAS 39 or IFRS 5) as there is no active market for them and the necessary estimates cannot be made within an acceptable range of variation and suitable probability of occurrence. Therefore these financial instruments are recognised at cost of acquisition.

d. Credit derivative under the second loss guarantee (HfT):

The fair value is calculated on the basis of the discounted expected cash flows and present value of the premium of 2.2% p.a. payable 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 structured registered and bearer instruments. 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).

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. Sector-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.

II. 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:

FAIR VALUES OF FINANCIAL INSTRUMENTS

ASSETS

(€ m)	**30.06.2017**			31.12.2016		
	Carrying amount	**Fair value**	**Difference**	Carrying amount	Fair value	Difference
Held for Trading (HfT)						
Trading assets	4,331	4,331	–	5,433	5,433	–
Credit derivative under the second loss guarantee	113	113	–	199	199	–
Designated at Fair Value (DFV)						
Loans and advances to customers	1,263	1,263	–	1,321	1,321	–
Financial investments	1,502	1,502	–	1,554	1,554	–
Available for Sale (AfS)						
Cash reserve	47	47	–	118	118	–
Loans and advances to banks	79	79	–	84	84	–
Loans and advances to customers	52	52	–	61	61	–
Financial investments[1)]	12,552	12,681	129	12,441	12,603	162
of which equity instruments measured at cost[2)]	148	–	– 148	203	–	– 203
Non-current assets held for sale and disposal groups	17	17	–	19	19	–
Loans and Receivables (LaR)						
Cash reserve	6,497	6,497	–	3,373	3,373	–
Loans and advances to banks	3,324	3,331	7	4,107	4,122	15
Loans and advances to customers	38,382	38,646	264	42,952	43,086	134
Financial investments	1,269	1,294	25	1,498	1,563	65
Non-current assets held for sale and disposal groups	341	382	41	907	910	3
Other assets	46	46	–	50	50	–
No IAS 39 category						
Positive fair value of hedging derivatives	442	442	–	508	508	–
Receivables under finance leases	82	82	–	98	98	–
Value adjustments from the portfolio fair value hedge	291	–	– 291	403	–	– 403
Total assets	**70,630**	**70,805**	**175**	**75,126**	**75,102**	**– 24**

[1)] Without taking into account the equity instruments measured at cost, the deviation between the carrying amount and the fair value of financial investments amounts to € 277 million. This amount is offset by the separately reported reconciling item from the portfolio fair value hedge (€ 291 million), € 277 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.

[2)] € 148 million of the difference between the carrying amount and the fair value is attributable to equity instruments measured at cost pursuant to IAS 39.46 (c) and for which no fair value can be calculated.

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 € 277 million is accounted for by financial investments classified as available for sale (AfS) (31 December 2016: € 365 million) and € 14 million (31 December 2016: € 38 million) by loans and advances to banks and customers classified as LaR.

FAIR VALUES OF FINANCIAL INSTRUMENTS
LIABILITIES

(€ m)	**30.06.2017**			31.12.2016		
	Carrying amount	**Fair value**	**Difference**	Carrying amount	Fair value	Difference
Held for Trading (HfT)						
Trading liabilities	4,705	4,705	–	5,981	5,981	–
Designated at Fair Value (DFV)						
Liabilities to banks	119	119	–	120	120	–
Liabilities to customers	1,181	1,181	–	1,331	1,331	–
Securitised liabilities	1,865	1,865	–	2,256	2,256	–
Subordinated capital	84	84	–	87	87	–
Other Liabilities (LIA)						
Liabilities to banks	9,396	9,329	– 67	9,381	9,387	6
Liabilities to customers	38,747	39,763	1,016	38,841	39,891	1,050
Securitised liabilities	12,441	12,144	– 297	14,368	14,138	– 230
Liabilities relating to disposal groups	1	1	–	2	2	–
Other liabilities	794	794	–	812	812	–
Subordinated capital	2,485	2,075	– 410	3,449	2,948	– 501
No IAS 39 category						
Negative fair value of hedging derivatives	258	258	–	290	290	–
Value adjustments from the portfolio fair value hedge	607	–	– 607	786	–	– 786
Total liabilities	**72,683**	**72,318**	**– 365**	**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.

III. 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			
30.06.2017	Level 1	Level 2	Level 3	**Total**
Balance sheet item/category/instrument type				
Cash reserve				
AfS	–	47	–	47
of which debt instruments	–	47	–	47
Loans and advances to banks				
AfS	–	36	43	79
of which debt instruments	–	36	43	79
Loans and advances to customers				
AfS	–	–	52	52
of which debt instruments	–	–	52	52
DFV	–	50	1,213	1,263
of which debt instruments	–	50	1,213	1,263
Credit derivative under the second loss guarantee	–	–	113	113
of which credit derivatives	–	–	113	113
Positive fair value of hedging derivatives	–	442	–	442
of which interest rate derivatives	–	442	–	442
Trading assets (HfT)	69	3,860	402	4,331
of which debt instruments	69	267	–	336
of which interest rate derivatives	–	3,092	85	3,177
of which cross-currency interest rate derivatives	–	339	–	339
of which currency derivatives	–	43	1	44
of which credit derivatives	–	28	–	28
of which other derivatives	–	13	45	58
of which structured derivatives	–	64	271	335
of which other trading portfolios	–	14	–	14
Financial investments (excluding equity instruments measured at cost)				
AfS[1]	5,957	6,420	27	12,404
of which debt instruments	5,894	6,415	–	12,309
of which equity and near-equity instruments	63	5	27	95
DFV	–	995	507	1,502
of which debt instruments	–	995	506	1,501
of which equity and near-equity instruments	–	–	1	1
Non-current assets held for sale and disposal groups				
AfS	–	17	–	17
of which equity and near-equity instruments	–	17	–	17
Total	**6,026**	**11,867**	**2,357**	**20,250**

[1] The difference between the total AfS financial investments in the asset hierarchy table and the fair value disclosures in Section II is attributable to effects in the item Value adjustments from the portfolio fair value hedge in the amount of € 277 million. These effects are not disclosed in the hierarchy table.

HIERARCHY LEVELS, ASSETS

(€ m)	Assets recognised at fair value			
31.12.2016	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 (excluding 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 II 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			
30.06.2017	Level 1	Level 2	Level 3	**Total**
Liabilities to banks				
DFV	–	11	108	119
of which debt instruments	–	11	108	119
Liabilities to customers				
DFV	–	294	887	1,181
of which debt instruments	–	294	887	1,181
Securitised liabilities				
DFV	–	1,400	465	1,865
of which debt instruments	–	1,400	465	1,865
Negative fair values of hedging derivatives	–	258	–	258
of which interest rate derivatives	–	258	–	258
Trading liabilities (HfT)	–	3,868	837	4,705
of which interest rate derivatives	–	3,310	517	3,827
of which cross-currency interest rate derivatives	–	297	–	297
of which currency derivatives	–	58	10	68
of which other derivatives	–	–	46	46
of which structured derivatives	–	203	264	467
Subordinated capital				
DFV	–	84	–	84
of which debt instruments	–	84	–	84
Total	**–**	**5,915**	**2,297**	**8,212**

HIERARCHY LEVELS, LIABILITIES

(€ m)	Liabilities recognised at fair value			
31.12.2016	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 liabilities (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, € 1,955 million of assets (31 December 2016: € 2,101 million) and € 1,839 million of liabilities (31 December 2016: € 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.

During 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) 30.06.2017	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)	–	–	–	–40	40	–
of which interest rate derivatives	–	–	–	–14	14	–
of which structured derivatives	–	–	–	–26	26	–
Financial investments (excl. equity instruments measured at cost)						
AfS	328	–4,003	4,003	–328	–	–
of which debt instruments	328	–4,003	4,003	–328	–	–
Total	**328**	**–4,003**	**4,003**	**–368**	**40**	**–**

TRANSFER, ASSETS

(€ m) 31.12.2016	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) **30.06.2017**	**Transfer to level 1**	**Transfer from level 1**	**Transfer to level 2**	**Transfer from level 2**	**Transfer to level 3**	**Transfer from level 3**
Liabilities to customers						
DFV	–	–	–	–6	6	–
of which debt instruments	–	–	–	–6	6	–
Trading liabilities (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 prior-year period.

IFRS 13 and IDW RS HFA 47 specify the principles to be applied in determining the fair value. These also include 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	
30.06.2017	1 January 2017	Net income recognised in profit or loss	Net income not recognised in profit or loss
Balance sheet item/category/instrument type			
Loans and advances to banks			
AfS	44	– 3	1
of which debt instruments	44	– 3	1
Loans and advances to customers			
AfS	61	–	– 4
of which debt instruments	61	–	– 4
DFV	1,273	– 48	–
of which debt instruments	1,273	– 48	–
Credit derivative under the second loss guarantee (HfT)	199	– 86	–
of which credit derivatives	199	– 86	–
Trading assets (HfT)	446	– 63	–
of which debt instruments	9	–	–
of which interest rate derivatives	96	– 25	–
of which currency derivatives	29	– 20	–
of which other derivatives	51	– 6	–
of which structured derivatives	261	– 12	–
Financial investments (excluding equity instruments measured at cost)			
AfS	29	–	–
of which equity and near-equity instruments	29	–	–
DFV	545	– 21	–
of which debt instruments	544	– 21	–
of which equity and near-equity instruments	1	–	–
Total	**2,597**	**– 221**	**– 3**

	Quantitative change in balance			Transfers					
	Purchases	Sales	Settlements	From level 3	To level 3	Reclassi-fication	Exchange rate changes	**30 June 2017**	Net income from assets held as at 30 June 2017
									–
	–	–	1	–	–	–	–	43	– 3
	–	–	1	–	–	–	–	43	– 3
	–	–	–	–	–	–	– 5	52	–
	–	–	–	–	–	–	– 5	52	–
	–	– 11	–	–	–	–	– 1	1,213	– 48
	–	– 11	–	–	–	–	– 1	1,213	– 48
	–	–	–	–	–	–	–	113	– 86
	–	–	–	–	–	–	–	113	– 86
	1	– 21	–	–	40	–	– 1	402	24
	–	– 9	–	–	–	–	–	–	–
	–	–	–	–	14	–	–	85	– 11
	1	– 9	–	–	–	–	–	1	–
	–	–	–	–	–	–	–	45	– 6
	–	– 3	–	–	26	–	– 1	271	41
	1	– 1	–	–	–	–	– 2	27	–
	1	– 1	–	–	–	–	– 2	27	–
	–	–	– 16	–	–	–	– 1	507	– 20
	–	–	– 16	–	–	–	– 1	506	– 20
	–	–	–	–	–	–	–	1	–
	2	**– 33**	**– 15**	**–**	**40**	**–**	**– 10**	**2,357**	**– 133**

RECONCILIATION, ASSETS

(€ m)		Change in balance affecting income	
31.12.2016	1 January 2016	Net income recognised in profit or loss	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 under the 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	
30.06.2017	1 January 2017	Net income recognised in profit or loss	Net income not recognised in profit or loss
Balance sheet item/category/instrument type			
Liabilities to banks			
DFV	109	– 1	–
of which debt instruments	109	– 1	–
Liabilities to customers			
DFV	1,018	– 17	1
of which debt instruments	1,018	– 17	1
Securitised liabilities			
DFV	494	– 13	7
of which debt instruments	494	– 13	7
Trading liabilities (HfT)	999	– 182	–
of which interest rate derivatives	583	–71	–
of which currency derivatives	40	– 22	–
of which other derivatives	51	– 5	–
of which structured derivatives	325	– 84	–
Total	**2,620**	**– 213**	**8**

Quantitative change in balance				Transfers					
Purchases	Sales	New business	Settlements	From level 3	To level 3	Reclassi-fication	Exchange rate changes	**30 June 2017**	Net income from assets held as at 30 June 2017
–	–	–	–	–	–	–	–	108	–
–	–	–	–	–	–	–	–	108	–
1	–10	–	–110	–	6	–	–2	887	12
1	–10	–	–110	–	6	–	–2	887	12
–18	–1	–	–	–	–	–	–4	465	12
–18	–1	–	–	–	–	–	–4	465	12
–	–8	–	–	–	31	–	–3	837	59
–	–	–	–	–	5	–	–	517	71
–	–8	–	–	–	–	–	–	10	1
–	–	–	–	–	–	–	–	46	6
–	–	–	–	–	26	–	–3	264	–19
–17	**–19**	**–**	**–110**	**–**	**37**	**–**	**–9**	**2,297**	**83**

RECONCILIATION, LIABILITIES

(€ m)		Change in balance affecting income		
31.12.2016	1 January 2016	Net income recognised in profit or loss	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 liabilities (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 2015
	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)				
30.06.2017	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	–3	–	–	–	–3
of which debt instruments	–3	–	–	–	–3
Loans and advances to customers					
AfS	–	–	–	–	–
of which debt instruments	–	–	–	–	–
DFV	6	–54	–	–	–48
of which debt instruments	6	–54	–	–	–48
Credit derivative under the second loss guarantee (HfT)	–	–86	–	–	–86
of which credit derivatives	–	–86	–	–	–86
Trading assets (HfT)	5	–68	–	–	–63
of which interest rate derivatives	–2	–23	–	–	–25
of which currency derivatives	–	–20	–	–	–20
of which other derivatives	–	–6	–	–	–6
of which structured derivatives	7	–19	–	–	–12
Financial investments (excluding equity instruments measured at cost)					
DFV	7	–28	–	–	–21
of which debt instruments	7	–28	–	–	–21
Total	**15**	**–236**	**–**	**–**	**–221**

	Other net income for the period	Net income from assets still held as at 30 June 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	–3	–	–	–	–3	1
	1	–3	–	–	–	–3	1
	–4	–	–	–	–	–	–4
	–4	–	–	–	–	–	–4
	–	6	–54	–	–	–48	–
	–	6	–54	–	–	–48	–
	–	–	–86	–	–	–86	–
	–	–	–86	–	–	–86	–
	–	14	10	–	–	24	–
	–	6	–17	–	–	–11	–
	–	–	–	–	–	–	–
	–	–	–6	–	–	–6	–
	–	8	33	–	–	41	–
	–	8	–28	–	–	–20	–
	–	8	–28	–	–	–20	–
	–3	**25**	**–158**	**–**	**–**	**–133**	**–3**

NET INCOME ITEMS FROM RECONCILIATION, ASSETS

(€ m)

30.06.2016	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	– 1	–	–	–	– 1
of which debt instruments	– 1	–	–	–	– 1
Loans and advances to customers					
AfS	–	–	– 29	–	– 29
of which debt instruments	–	–	– 29	–	– 29
DFV	6	150	–	–	156
of which debt instruments	6	150	–	–	156
Credit derivative under the second loss guarantee (HfT)	–	–	–	– 403	– 403
of which credit derivatives	–	–	–	– 403	– 403
Trading assets (HfT)	– 6	36	–	–	30
of which interest rate derivatives	– 9	– 13	–	–	– 22
of which other derivatives	–	66	–	–	66
of which structured derivatives	3	– 17	–	–	– 14
Financial investments (excluding equity instruments measured at cost)					
AfS	–	–	– 1	–	– 1
of which equity and near-equity instruments	–	–	– 1	–	– 1
DFV	8	50	–	–	58
of which debt instruments	8	50	–	–	58
Total	**7**	**236**	**– 30**	**– 403**	**– 190**

	Other net income for the period	Net income from assets still held as at 30 June 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
	–1	–1	–	–	–	–1	–1
	22	–	–	–29	–	–29	21
	22	–	–	–29	–	–29	21
	–	6	150	–	–	156	–
	–	6	150	–	–	156	–
	–	–	–	–	–403	–403	–
	–	–	–	–	–403	–403	–
	–	1	–74	–	–	–73	–
	–	–4	16	–	–	12	–
	–	–	–66	–	–	–66	–
	–	5	–24	–	–	–19	–
	2	–	–	–	–	–	–1
	2	–	–	–	–	–	–1
	–	8	50	–	–	58	–
	–	8	50	–	–	58	–
	23	**14**	**126**	**–29**	**–403**	**–292**	**19**

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 30 June 2017				
30.06.2017	Net interest income	Net trading income	Net income from financial invest-ments	**Total**	**Revalu-ation reserve**	Net interest income	Net trading income	Net income from financial invest-ments	**Total**	**Other net income for the period**
Balance sheet item/ category/ instrument type										
Liabilities to banks										
DFV	–	1	–	1	–	–	–	–	–	–
of which debt instruments	–	1	–	1	–	–	–	–	–	–
Liabilities to customers										
DFV	– 1	18	–	17	– 1	– 3	15	–	12	– 1
of which debt instruments	– 1	18	–	17	– 1	– 3	15	–	12	– 1
Securitised liabilities										
DFV	– 7	20	–	13	– 7	– 7	19	–	12	– 7
of which debt instruments	– 7	20	–	13	– 7	– 7	19	–	12	– 7
Trading liabilities (HfT)	– 10	192	–	182	–	– 14	73	–	59	–
of which interest rate derivatives	– 14	85	–	71	–	– 14	85	–	71	–
of which currency derivatives	–	22	–	22	–	–	1	–	1	–
of which other derivatives	–	5	–	5	–	–	6	–	6	–
of which structured derivatives	4	80	–	84	–	–	– 19	–	– 19	–
Total	**– 18**	**231**	**–**	**213**	**– 8**	**– 24**	**107**	**–**	**83**	**– 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 30 June 2016				
30.06.2016	Net interest income	Net trading income	Net income from financial invest-ments	**Total**	**Revaluation reserve**	Net interest income	Net trading income	Net income from financial invest-ments	**Total**	**Other net income for the period**
Balance sheet item/ category/ Instrument type										
Liabilities to banks										
DFV	–	2	–	2	–	–	3	–	3	–
of which debt instruments	–	2	–	2	–	–	3	–	3	–
Liabilities to customers										
DFV	2	14	–	16	–	–3	43	–	40	–
of which debt instruments	2	14	–	16	–	–3	43	–	40	–
Securitised liabilities										
DFV	–10	–5	–	–15	–	–10	–11	–	–21	–
of which debt instruments	–10	–5	–	–15	–	–10	–11	–	–21	–
Trading liabilities (HfT)	–6	–215	–	–221	–	–10	–258	–	–268	–
of which interest rate derivatives	–13	–149	–	–162	–	–14	–150	–	–164	–
of which other derivatives	–	–67	–	–67	–	–	–67	–	–67	–
of which structured derivatives	7	1	–	8	–	4	–41	–	–37	–
Total	**–14**	**–204**	**–**	**–218**	**–**	**–23**	**–223**	**–**	**–246**	**–**

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) **30.06.2017**			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	52	–	DCF method	Spread (bps)	700	700
	DFV	Debt instruments	1,213	–	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate FX correlation	– 28 % – 16 %	– 12 %
					Price	Price	39 – 78	6
Credit derivative under the second loss guarantee	HfT	Credit derivatives	113	–	DCF method	Expected cash flow	–	–
Trading assets/trading liabilities		Interest rate derivatives	85	517	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	15 % – 69 %	24 %
						Interest rate correlation	– 65 % – 100 %	18 %
						Interest rate FX correlation	– 28 % – 16 %	– 12 %
		Currency derivatives	1	10	Option pricing model	FX correlation	43 % – 69 %	54 %
		Other derivatives	45	46	Option pricing model	Securities FX correlation	– 35 % – 49 %	– 2 %
		Structured derivatives	271	264	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatilities	15 % – 69 %	24 %
						Interest rate correlation	– 51 % – 100 %	23 %
						Interest rate FX correlation	– 28 % – 16 %	– 12 %
						FX correlation	43 % – 69 %	54 %

FAIR VALUE

(€ m) **30.06.2017**			Assets	Liabilities	Measurement procedures	Significant unobservable inputs (level 3)	Margin	(Weighted) average margin
Financial investments		Equity and near-equity instruments	27	–	Price	Price	93 – 12,000	237
	DFV	Debt instruments	506	–	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatilities	15 % – 69 %	24 %
		Equity and near-equity instruments	1	–	Price	Price	5	5
Liabilities to banks	DFV	Debt instruments	–	108	Option pricing model	Interest rate volatilities	15 % – 69 %	24 %
						Interest rate FX correlation	– 32 % – 16 %	– 16 %
Liabilities to customers	DFV	Debt instruments	–	887	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	19 % – 77 %	31 %
						Interest rate correlation	– 65 % – 100 %	18 %
						Interest rate FX correlation	– 28 % – 16 %	– 12 %
					Price	Price	78	78
Securitised liabilities	DFV	Debt instruments	–	465	Option pricing model	Mean reversion	0 % – 10 %	2 %
						Interest rate volatility	15 % – 69 %	24 %
						FX correlation	43 % – 69 %	54 %
						Securities FX correlation	– 35 % – 49 %	2 %
					Price	Price	49	49
			2,357	**2,297**				

FAIR VALUE

(€ m)

31.12.2016			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	Securities 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) 31.12.2016			Assets	Liabilities	Measurement 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 volatilities	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 volatilities	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 volatilities	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 volatilities	19 % – 77 %	31 %
						FX correlation	35 % – 66 %	49 %
						Securities 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, the change of which 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 close 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 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 therefore not required. 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 table. 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 %) and mean reversion by +/− 0.5 %. Furthermore, price parameters and spreads were also changed by +/− 2 % and +/− 50 bps, respectively.

A) Financial instruments for which there are no economic hedging relationships in place (at the micro level)

FAIR VALUE CHANGES LEVEL 3

(€ m)			30.06.2017		31.12.2016	
			advantageous	**disadvantageous**	advantageous	disadvantageous
Loans and advances to customers	AfS	Debt instruments	2	2	3	3
Credit derivative under the second loss guarantee	HfT	Credit derivatives	2	2	9	10
Trading assets/trading liabilities	HfT	Interest rate derivatives	1	1	1	1
		Other derivatives	–	–	1	1
		Structured derivatives	5	5	2	2
Financial investments	AfS	Equity and near-equity instruments	1	1	1	1
			11	**11**	**17**	**18**
thereof measured in profit or loss			8	8	13	14
thereof not measured in profit of loss			3	3	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)			30.06.2017		31.12.2016	
			advan-tageous	disadvan-tageous	advan-tageous	disadvan-tageous
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)	30.06.2017	31.12.2016
Holdings as at 1 January	13	22
Additions not recognised in profit or loss	–	2
Reversals recognised in profit or loss	10	11
Reserve as at 30 June	**3**	**13**

The day one profit and loss reserve is solely attributable to financial instruments classified as HfT.

VI. Equity instruments measured at cost

For equity instruments which are not listed and whose fair value cannot be determined reliably by other methods, subsequent measurement takes place at cost in accordance with IAS 39.46 (c) in conjunction with IAS 39.A81. These are primarily equity instruments of unlisted companies for which no active market exists and reliable estimates of the parameters determining market value are not possible because future expectations are difficult to forecast.

The portfolio of shares and other non-interest bearing securities measured at cost amounts to € 108 million (31 December 2016: € 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 € 40 million (31 December 2016: € 78 million). There are currently no concrete intentions to dispose of these equity instruments.

Financial instruments accounted for at cost are disclosed as Financial investments under Assets measured at fair value (AfS).

In the period under review, no equity instruments classified as AfS not measured at fair value were disposed of (31 December 2016: € 26 million). This did not result in any profit, as was the case as at 31 December 2016:

45. FINANCIAL TRANSACTIONS ENTERED INTO WITH SELECTED STATES

The following tables contain overviews of HSH Nordbank's exposure in selected 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	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
Portugal	**195**	**193**	**6**	**7**	**203**	**190**
Public sector	174	171	–	–	189	176
Corporates/Other	21	22	6	7	14	14
Italy	**582**	**595**	**254**	**100**	**303**	**480**
Public sector	21	23	–	–	22	24
Corporates/Other	561	572	254	100	281	456
Greece	**1,131**	**1,442**	**233**	**268**	**796**	**1,100**
Corporates/Other	1,131	1,442	233	268	796	1,100
Russia	**37**	**44**	**–**	**–**	**37**	**44**
Corporates/Other	37	44	–	–	37	44
Spain	**1,069**	**1,244**	**68**	**108**	**1,012**	**1,152**
Public sector	146	151	–	–	153	159
Corporates/Other	923	1,093	68	108	859	993
Cyprus	**1,086**	**1,144**	**489**	**524**	**518**	**519**
Corporates/Other	1,086	1,144	489	524	518	519
Croatia	**96**	**99**	**–**	**–**	**100**	**101**
Corporates/Other	96	99	–	–	100	101
Turkey	**369**	**389**	**9**	**7**	**314**	**344**
Banks	75	10	–	–	74	10
Corporates/Other	294	379	9	7	240	334
Total	**4,565**	**5,150**	**1,059**	**1,014**	**3,283**	**3,930**

FINANCIAL TRANSACTIONS ALLOCATED TO THE HOLDING CATEGORY

(€ m)	HfT		Hedge		DFV		AfS	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
Portugal	**–**	**–**	**–**	**–**	**50**	**49**	**–**	**–**
Public sector	–	–	–	–	50	49	–	–
Italy	**6**	**6**	**–**	**–**	**389**	**402**	**–**	**–**
Public sector	–	–	–	–	389	402	–	–
Corporates/ Other	6	6	–	–	–	–	–	–
Greece	**6**	**9**	**–**	**–**	**–**	**–**	**–**	**–**
Corporates/ Other	6	9	–	–	–	–	–	–
Russia	**24**	**31**	**–**	**–**	**–**	**–**	**–**	**–**
Banks	1	2	–	–	–	–	–	–
Corporates/ Other	23	29	–	–	–	–	–	–
Spain	**64**	**75**	**9**	**10**	**–**	**–**	**–**	**–**
Banks	30	37	9	10	–	–	–	–
Corporates/ Other	34	38	–	–	–	–	–	–
Cyprus	**2**	**1**	**–**	**–**	**–**	**–**	**–**	**–**
Corporates/ Other	2	1	–	–	–	–	–	–
Croatia	**1**	**1**	**–**	**–**	**–**	**–**	**–**	**–**
Corporates/ Other	1	1	–	–	–	–	–	–
Total	**103**	**123**	**9**	**10**	**439**	**451**	**–**	**–**

The cumulative measurement result recognised directly in equity for financial instruments held in the AfS category amounted to € 0 million for the selected countries as in the previous year. A cumulative measurement result did not arise, as was the case as at 31 December 2016.

46. 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	
	30.06. 2017	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016
Held for Trading (HfT)								
Trading assets	656	778	1,156	870	1,798	2,818	310	418
Credit derivative under the second loss guarantee	113	199	–	–	–	–	–	–
Designated at Fair Value (DFV)								
Loans and advances to banks	–	–	–	–	–	–	–	–
Loans and advances to customers	1,188	1,234	–	–	–	–	–	–
Financial investments	111	127	532	603	858	822	–	–
Available for Sale (AfS)								
Cash reserve	47	118	–	–	–	–	–	–
Loans and advances to banks	–	43	–	–	79	41	–	–
Loans and advances to customers	–	–	–	–	–	–	–	–
Financial investments	8,998	9,194	2,726	2,211	596	779	31	33
Non-current assets held for sale and disposal groups	12	15	4	3	1	1	–	–
Loans and Receivables (LaR)								
Cash reserve	6,497	3,373	–	–	–	–	–	–
Loans and advances to banks	1,272	1,463	1,214	1,440	746	1,167	24	27
Loans and advances to customers	3,162	4,227	4,966	4,646	11,584	12,459	10,145	10,533
Financial investments	294	527	199	251	75	149	279	350
Non-current assets held for sale and disposal groups	95	–	–	7	37	9	51	1
Other assets	–	–	–	–	–	–	–	–
No IAS 39 category								
Positive fair value of hedging derivatives	136	202	100	148	188	151	18	7
Receivables under finance leases	7	11	12	12	29	33	25	27
Value adjustments from the portfolio fair value hedge	89	160	66	118	124	120	12	5
Total	**22,677**	**21,671**	**10,975**	**10,309**	**16,115**	**18,549**	**10,895**	**11,401**

CREDIT QUALITY

(€ m)	10 to 12		13 to 15		16 to 18	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
Held for Trading (HfT)						
Trading assets	33	27	187	250	191	272
Credit derivative under the second loss guarantee	–	–	–	–	–	–
Designated at Fair Value (DFV)						
Loans and advances to banks	–	–	–	–	–	–
Loans and advances to customers	–	49	59	16	16	22
Financial investments	–	–	1	1	–	1
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	7	5	110	127	3	–
Non-current assets held for sale and disposal groups	–	–	–	–	–	–
Loans and Receivables (LaR)						
Cash reserve	–	–	–	–	–	–
Loans and advances to banks	68	11	–	–	–	–
Loans and advances to customers	1,679	1,934	2,195	3,184	–	680
Financial investments	–	–	46	49	23	36
Non-current assets held for sale and disposal groups	6	7	12	6	80	254
Other assets	46	–	–	50	–	–
No IAS 39 category						
Positive fair value of hedging derivatives	–	–	–	–	–	–
Receivables under finance leases	4	5	5	8	–	2
Value adjustments from the portfolio fair value hedge	–	–	–	–	–	–
Total	**1,843**	**2,038**	**2,615**	**3,691**	**313**	**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	
	30.06. 2017	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016	**30.06. 2017**	31.12. 2016
Loans and Receivables (LaR)								
Loans and advances to banks	1	–	–	–	–	–	–	–
Loans and advances to customers	658	859	249	643	546	185	481	395
of which hedged by the second loss guarantee	167	631	211	498	480	99	412	338
Non-current assets held for sale and disposal groups	8	–	–	–	–	–	–	–
Total	**667**	**859**	**249**	**643**	**546**	**185**	**481**	**395**

Payments of € 128 million (31 December 2016: € 4 million) on transactions with a carrying amount volume of € 367 million (31 December 2016: € 96 million) were received up to ten days after the reporting date of 30 June 2017. Payments are regarded as being in arrears when they are one day overdue.

The overdue, unimpaired credit portfolio is offset by 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	
	30.06.2017	31.12.2016	**30.06.2017**	31.12.2016	**30.06.2017**	31.12.2016
Loans and Receivables (LaR)						
Loans and advances to banks	–	–	–	–	–	–
Loans and advances to customers	8,939	9,685	5,877	6,103	3,062	3,582
Financial investments[1]	480	302	127	166	353	136
Non-current assets held for sale and disposal groups (LaR)	143	856	91	233	52	623
Available for Sale (AfS)					–	–
Loans and advances to customers	83	90	31	29	52	61
Financial investments[1]	234	236	153	144	81	92
Total	**9,879**	**11,169**	**6,279**	**6,675**	**3,600**	**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.

€ 9,559 million (31 December 2016: € 9,634 million) of the total carrying amount of impaired financial assets of € 9,879 million (31 December 2016: € 11,169 million) is hedged by the second loss guarantee, of which € 8,019 million is attributable to Loans and advances to customers
(31 December 2016: € 8,637 million), € 150 million to Financial investments in the LaR and AfS holding categories (31 December 2016: € 163 million) as well as € 119 million to Non-current assets held for sale and disposal groups (31 December 2016: € 834 million).

Further details on the second loss guarantee 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 42 as well as off-balance sheet liabilities as presented in Note 48.

In the case of Loans and advances to banks and customers, the credit risk exposure corresponds to the carrying amount after value adjustments as presented in Note 21. 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		
30.06.2017	**Carrying amount**	**Real estate and registered liens**	**Sureties and guarantees**	**Other collateral**
HfT				
Trading assets	4,331	353	25	515
Credit derivative under the second loss guarantee	113	–	–	–
DFV		–		–
Loans and advances to customers	1,263	–	–	–
Financial investments	1,502	–	–	–
AfS				
Cash reserve	47	–	–	–
Loans and advances to banks	79	–	–	–
Loans and advances to customers	52	–	–	–
Financial investments	12,552	–	–	–
Non-current assets held for sale and disposal groups	17	–	–	–
LaR				
Cash reserve	6,497	–	–	–
Loans and advances to banks	3,325	11	24	56
Loans and advances to customers	44,604	14,716	658	1,609
Financial investments	1,269	–	–	–
Non-current assets held for sale and disposal groups	432	157	4	2
Other assets	46	–	–	2
No IAS 39 category				
Positive fair value of hedging derivatives	442	–	–	–
Value adjustments from the portfolio fair value hedge	291	–	–	–
Receivables under finance leases	82	–	–	–
Contingent liabilities	1,932	131	10	123
Irrevocable loan commitments	6,327	756	60	195
Total assets	**85,203**	**16,124**	**781**	**2,502**

FINANCIAL ASSETS AND ASSOCIATED COLLATERAL

(€ m)		Value of collateral received		
31.12.2016	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

The HSH Nordbank Group received collateral from counterparties with a total fair value of € 518 million (31 December 2016: € 415 million). The collateral received is split up as follows: € 465 million (31 December 2016: € 353 million) relate to OTC derivatives and structured transactions. The Group received collateral in the amount of € 53 million (31 December 2016: € 62 million) within the framework of genuine repo transactions where it acted as the lender. This includes cash collateral in the amount of € 465 million (31 December 2016: € 320 million). Of the collateral received, an amount of € 30 million (31 December 2016: € 34 million) was resold or pledged. There are no restrictions on disposal or realisation, HSH Nordbank is 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

As in the previous year, no assets from the realisation of collateral were recognised in the reporting period.

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.

47. RESTRUCTURED OR MODIFIED LOANS

The following table shows the gross carrying amounts of loans and loan commitments that have been restructured or the contractual terms and conditions of which 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		
30.06.2017	Rating class 1–15	Rating class 16–18	Rating class 1–15	Rating class 16–18	**Total**
Loans and Receivables (LaR)	1,375	767	465	8,837	11,444
Loans and advances to customers	1,375	767	449	8,693	11,284
Non-current assets held for sale and disposal groups	–	–	16	144	160
Irrevocable and revocable loan commitments	73	–	16	122	211
Total	**1,448**	**767**	**481**	**8,959**	**11,655**

FORBEARANCE EXPOSURE

(€ m)	Core Bank		Non-Core Bank		
31.12.2016	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	10,239	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	74	23	33	421	551
Total	**1,878**	**700**	**834**	**10,660**	**14,072**

Loan loss provisions in the amount of € 5,342 million (previous year: € 5,098 million) have already been created for the volume of receivables stated here to which forbearance measures have been applied. The cover for the forbearance exposure by the Sunrise guarantee is about 82 % (previous year: about 83 %).

48. CONTINGENT LIABILITIES AND IRREVOCABLE LOAN COMMITMENTS

CONTINGENT LIABILITIES

(€ m)	**30.06.2017**	31.12.2016
Contingent liabilities	1,932	2,189
Irrevocable loan commitments	6,327	6,654
Total	**8,259**	**8,843**

The fair value of irrevocable loan commitments with a nominal volume of € 6,327 million (31 December 2016: € 6,654 million) comes to € 15 million as at the balance sheet date (31 December 2016: € 12 million).

There were no material changes in the litigation risks included in the contingent liabilities as against the amount reported at the end of the year.

With regard to future premium expense for the synthetic securitisation transaction, we refer to our statements in Note 3.II.

OTHER DISCLOSURES

49. 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, as well as 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. According to IAS 24.25 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 16 for more details.

Under the informal agreement reached with the European Commission, the formal decision was made on 2 May 2016 to sell a loan portfolio to the resolution institution (hsh portfoliomanagement AöR) formed by the federal states of Hamburg and Schleswig-Holstein. The loan portfolio was transferred in June 2016. In connection with this transaction, there are other contractual service relationships in place, e.g. the servicing of the loans transferred and the provision of IT systems, for which remuneration is paid in line with standard market conditions.

II. Subsidiaries

The transactions with unconsolidated subsidiaries are shown below:

SUBSIDIARIES – ASSETS

(€ m)	**30.06.2017**	31.12.2016
Loans and advances to customers	10	24
Loan loss provisions	– 1	– 11
Financial investments	–	1
Other assets	1	–
Total	**10**	**14**

SUBSIDIARIES – LIABILITIES

(€ m)	**30.06.2017**	31.12.2016
Liabilities to customers	–	2
Other liabilities	1	1
Total	**1**	**3**

SUBSIDIARIES – INCOME STATEMENT

(€ m)	**January – June 2017**	January – June 2016
Net interest income	–	1
Other operating income	2	2
Total	**2**	**3**

III. Associates

The following table shows the transactions with associates:

ASSOCIATES – LIABILITIES

(€ m)	30.06.2017	31.12.2016
Liabilities to customers	1	1
Total	**1**	**1**

IV. Joint ventures

The following tables show the transactions with joint ventures:

JOINT VENTURES – ASSETS

(€ m)	30.06.2017	31.12.2016
Loans and advances to customers	448	178
Loan loss provisions	– 147	–
Trading assets	–	13
Total	**301**	**191**

JOINT VENTURES – LIABILITIES

(€ m)	30.06.2017	31.12.2016
Liabilities to customers	21	25
Total	**21**	**25**

JOINT VENTURES – INCOME STATEMENT

(€ m)	January – June 2017	January – June 2016
Net interest income	14	–
Loan loss provisions	– 133	–
Net trading income	– 21	– 4
Total	**- 140**	**– 4**

Irrevocable loan commitments to joint ventures amount to € 14 million(31 December 2016: € 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:

OTHER RELATED PARTIES AND COMPANIES – LIABILITIES

(€ m)	30.06.2017	31.12.2016
Liabilities to customers	1	1
Total	**1**	**1**

50. BOARD MEMBERS

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

Hamburg/Kiel, 22 August 2017

Stefan Ermisch Oliver Gatzke

Ulrik Lackschewitz Torsten Temp

REVIEW OPINION

To HSH Nordbank AG, Hamburg and Kiel

We have reviewed the condensed interim consolidated financial statements of HSH Nordbank AG, Hamburg and Kiel, comprising the statement of financial position, the income statement, the statement of comprehensive income, the statement of changes in equity, the condensed cash flow statement and selected explanatory notes – together with the interim group management report of HSH Nordbank AG for the period from 1 January to 30 June 2017, that are part of the semi annual financial report according to § 37w WpHG "German Securities Trading Act". The preparation of the condensed interim consolidated financial statements in accordance with International Accounting Standard IAS 34 "Interim Financial Reporting" as adopted by the EU, and of the interim group management report in accordance with the requirements of the WpHG applicable to interim group management reports, is the responsibility of the Company's management. Our responsibility is to issue a report on the condensed interim consolidated financial statements and on the interim group management report based on our review.

We performed our review of the condensed interim consolidated financial statements and the interim group management report in accordance with the German generally accepted standards for the review of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the review so that we can preclude through critical evaluation, with a certain level of assurance, that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with IAS 34, "Interim Financial Reporting" as adopted by the EU, and that the interim group management report has not been prepared, in material respects, in accordance with the provisions of the WpHG applicable to interim group management reports. A review is limited primarily to inquiries of company employees and analytical assessments and therefore does not provide the assurance attainable in a financial statement audit. Since, in accordance with our engagement, we have not performed a financial statement audit, we cannot issue an auditor's report.

Based on our review, no matters have come to our attention that cause us to presume that the condensed interim consolidated financial statements have not been prepared, in material respects, in accordance with IAS 34, "Interim Financial Reporting" as adopted by the EU, or that the interim group management report has not been prepared, in material respects, in accordance with the requirements of the WpHG applicable to interim group management reports.

Without qualifying this opinion, we refer to the discussion in the interim group management report in the section "Opportunities and risks resulting from the formal decision in the EU state aid proceedings". It is stated there that the going concern assumption for accounting and measurement purposes and the assumption of the continued going concern of HSH Nordbank and significant group companies is based in particular on the following assumptions:

(i) the agreements required for the implementation of the decision taken by the EU Commission in the EU state aid proceedings on the replenishment of the second loss guarantee are entered into comprehensively and on a timely basis and that the decision will be implemented by HSH Nordbank AG and its shareholders in full and on a timely basis,

(ii) the operating company, HSH Nordbank AG, is sold at a positive sale price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline, or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company 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 during the privatisation period, 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.

(iii) as part of the ongoing privatisation process of HSH Nordbank AG, HSH Nordbank AG will be sold in full as a whole bank, i. e. the shares in the Bank held by the seller will be disposed of, including all assets and liabilities, without any material early disposals of assets or sub-areas at prices below the carrying amount in the case of offers for the entire business having been received. If extensive sales of loan portfolios, particularly in the Non-Core Bank, are required, then this could result in significant additional loan loss provision expenses that are not compensated for by the guarantee, and could require the material depreciation of deferred taxes.

(iv) the minimum capital requirements at all regulatory levels can be adhered to in accordance with the corresponding SREP resolutions passed by the European Central Bank and the statutory provisions during the forecast period. If there is a need for significant additional loan loss provision expenses and the material depreciation of deferred taxes (e.g. in the scenario described above) or if the recovery of the shipping market that has been assumed in the Bank's corporate planning does not materialise as planned, or if the regulatory treatment of the second loss guarantee as a securitisation position is no longer approved by the banking supervisory authority, this could put considerable pressure on the capital ratios and additional measures may need to be taken by the owners and/or third parties to strengthen the capital ratios in order to be able to adhere to the minimum capital requirements, particularly at the level of the financial holding group.

If such measures are not taken, this could result in the winding-down of HSH Nordbank.

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

Hamburg, 22 August 2017

KPMG AG
Wirtschaftsprüfungsgesellschaft

Leitz	Thiede
Wirtschaftsprüfer	Wirtschaftsprüfer

RESPONSIBILITY STATEMENT BY THE MANAGEMENT

We hereby affirm that to the best of our knowledge that the interim 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 interim 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, 22 August 2017

Stefan Ermisch Oliver Gatzke

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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 Interim Report was published on 31 August 2017 and is available at www.hsh-nordbank.com. This is an English translation of the original German version of the Interim Report.

FORWARD-LOOKING STATEMENTS

This Interim 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 Interim Report. Furthermore, we are not obliged to update the forward-looking statements following publication of this information. In addition, information contained in this Interim 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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