Financial Report 2018

of Hamburg Commercial Bank AG

Information on the combined management report

To improve the clarity of presentation, the management reports of Hamburg Commercial Bank AG (formerly HSH Nordbank AG) and the Hamburg Commercial Bank Group have been combined in accordance with Section 315 (5) of the German Commercial Code (HGB) in conjunction with Section 298 (2) HGB, unlike in the previous year. The annual and Group financial statements of Hamburg Commercial Bank (including the combined management report) will be jointly submitted to the operator of the German Federal Gazette and published in the Federal Gazette.
In addition, the annual and Group financial statements of Hamburg Commercial Bank are available on the Internet at www.hcob-bank.com.
The following information in the combined management report relates to the Hamburg Commercial Bank Group as a general rule; in the event of material differences with regard to Hamburg Commercial Bank AG, separate explanations are provided.

Basis of the Group

Business activities

Successful sale of HSH Nordbank AG and conclusion of EU state aid proceedings

The federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9 % in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The sale was closed on 28 November 2018 after all of the conditions precedent had been fulfilled. The buyers are independent funds of Cerberus Capital Management, L.P., J.C. Flowers & Co. LLC and GoldenTree Asset Management LP as well as an Acquisition Company of Centaurus Capital LP and BAWAG P.S.K.

The sale marks the end of the long-standing EU state aid proceedings, which resulted in far-reaching structural relief for the Bank. This is reflected primarily in a significant improvement in the risk and capital structure. As part of the privatisation process the Bank was relieved of large parts of its non-performing legacy loans (portfolio transaction). These mainly included ship financing arrangements from the years prior to 2009. In addition, the second loss guarantee of € 10 billion provided by the federal state owners was terminated prematurely in return for a compensation payment of € -100 million and settled in full.

HSH Nordbank is the first successfully privatised Landesbank in Germany. The privatisation lays a solid foundation for the next stage in the forward-looking transformation process, during which the Bank will gradually develop into an agile commercial bank with a business model that is sustainable in the long run. The privatised bank has changed its name and has been operating under the name Hamburg Commercial Bank AG since 4 February 2019.

Headquarters, regional focus, clients and products

Hamburg Commercial Bank AG, formerly known as HSH Nordbank AG, emerged in June 2003 from the merger of Hamburgische Landesbank Girozentrale with Landesbank Schleswig-Holstein Girozentrale. It is managed in the legal form of a corporation (*Aktiengesellschaft*). The Bank has its registered office in Hamburg and Kiel. In line with the process of focussed transformation, its registered office is to be located in Hamburg in the future.

Hamburg Commercial Bank is one of the leading banking partners for upper medium-sized companies in the core region of Northern Germany. The Bank is also active throughout Germany in the Real Estate, Project Finance, Corporate Clients, Shipping and Capital Markets & Products segments. In the project and real estate financing business, the focus is also on other European countries. The Bank conducts business with shipping clients throughout the world. Based on conventional loan financing, Hamburg Commercial Bank offers tailored products and individual financial solutions for its customers.

Segments, divisions and locations

The operating business activities of Hamburg Commercial Bank are divided into the Corporate Clients, Real Estate, Shipping and Treasury & Markets segments. In addition, the reporting date marks the last time the Bank is reporting on the results of the Non-Core Bank, in which the legacy portfolios, which have since been sold and are non-strategic and predominantly non-performing, were bundled. The administrative divisions and overall bank positions are disclosed as segments not subject to reporting requirements in the "Other and Consolidation" division.

The Bank has branches in Singapore, Athens and Luxembourg as well as a representative office in Hong Kong in line with its focused direction. In Germany, over and above the offices in Hamburg and Kiel, the Bank has offices in Berlin, Düsseldorf, Frankfurt am Main, Munich and Stuttgart.

The branches listed above are of secondary importance for understanding the Group situation.

Equity holdings and scope of consolidation

In addition to the parent company, the scope of consolidation for the Group financial statements comprised 32 fully consolidated subsidiaries as at the reporting date (31 December 2017: 53 fully consolidated subsidiaries). There were no additions compared with the previous year's reporting date. The company CAPCELLENCE Vintage Year 18 Beteiligungen GmbH & Co. KG, which was newly established during the year, was incorporated into a Group company during the year under review.

The decrease in the scope of consolidation by 21 subsidiaries is due to:

- The sale of the shares in FSL Holdings Pte. Ltd. in the first quarter of 2018 as part of the winding-down of legacy burdens. This sale also resulted in the companies FSL Asset Management Pte. Ltd. and FSL Trust Management Pte. Ltd. leaving the scope of consolidation.
- The liquidation of 2200 Victory LLC in the third quarter of 2018 and the liquidations of Castellum ABF S.A. and Stratus ABF S.A., which were used as refinancing vehicles, in the fourth quarter of 2018.
- The closing of the portfolio transaction in the fourth quarter of 2018, which led to a loss of control over a total of 15 subsidiaries. In addition to the investments in GODAN GmbH and Ilex Integra GmbH, this involved five single ship companies, four single-purpose companies from the aviation sector, the Life Insurance Group (three companies) and Senior Preferred Investments S.A.

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

Shareholder structure

Following the sale of the Bank by HSH Beteiligungs Management GmbH (94.9 % of the shares) and the nine trusts initiated by J.C. Flowers & Co. LLC (5.1 % of the shares), Hamburg Commercial Bank has been owned since 28 November 2018 by renowned, globally active institutional private investors that have a high level of expertise in the banking business, in particular. The shareholder structure is as follows:

Ownership structure

Several funds initiated by **Cerberus Capital Management, L.P.**			One fund advised by **J.C. Flowers & Co. LLC**	One fund initiated by **GoldenTree Asset Management LP**	**Centaurus Capital LP**	**BAWAG P.S.K.** Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft
Promontoria Holding 221 B.V.	Promontoria Holding 231 B.V.	Promontoria Holding 233 B.V.	JCF IV Neptun Holdings S.à r.l.	GoldenTree Asset Management Lux S.à r.l.	Chi Centauri LLC	
9.89 %	13.88 %	18.73 %				
42.5 %			**35.0 %**	**12.5 %**	**7.5 %**	**2.5 %**

Restructuring of the Management Board and Supervisory Board

In the context of the Bank's privatisation, the following changes were made to the Management Board and Supervisory Board. Since 1 January 2019, the Management Board of Hamburg Commercial Bank has consisted of Stefan Ermisch (CEO), Ulrik Lackschewitz (CRO), Oliver Gatzke (CFO) and Nicolas Blanchard (CCO), who has been responsible for all client business and products since December 2018. At the same time, Torsten Temp, the long-standing Management Board member responsible for the Market divisions, resigned from his position at the end of 2018. Ulrik Lackschewitz is the Deputy Chair of the Management Board. Juan Rodríguez Inciarte has been the new Chair of the Supervisory Board since 28 November 2018.

Further information on the members of the boards is set out in Note 62 (Related companies and parties).

Deposit guarantee fund

With the successful closing of the privatisation process for HSH Nordbank AG on 28 November 2018, the legal requirements for Hamburg Commercial Bank's membership of the German Savings Bank Association (DSGV) ceased to apply and its membership subsequently expired (Section 5 of the DSGV Articles of Association).

Pursuant to the agreement concluded on the basis of Section 94 (4a) of the Framework Statute, membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) will continue for a further three years until 31 December 2021. 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 continue to fall under the voluntary institutional protection of the guarantee fund of the Savings Banks Finance Group (Section 39 (1) of the Framework Statute) until 31 December 2021.

The German Savings Banks Finance Group has an institutional guarantee scheme: This scheme protects deposits held at a savings bank, Landesbank or a Landesbausparkasse. The objective of the protection scheme is to stabilise the member institutions and avert emerging or existing financial difficulties at these institutions. Under the voluntary institutional protection there is no legally binding entitlement to support measures vis-à-vis the protection scheme in the event of the occurrence of a guarantee case.

The seamless transition of Hamburg Commercial Bank to the deposit protection fund for private banks is planned for 1 January 2022. This deposit guarantee fund consists of the Compensation Scheme of German Banks ("EdB", statutory deposit guarantee fund") and the voluntary deposit protection fund of the Association of German Banks ("ESF"). The scope of ESF deposit guarantee fund is governed in particular by Section 6 of the Statute of the deposit guarantee fund.

Hamburg Commercial Bank will be admitted to the EdB as of 1 January 2022 on the basis of the German Deposit Protection Act (EinSiG) by way of a referral by BaFin. The inclusion of Hamburg Commercial Bank in the ESF on 1 January 2022 presupposes the Bank to meet the requirements, as set out in the Statute, for participation in the ESF at the end of 2021. If this is the case, the Bank, like all other banks, will in principle contribute to the ESF based on the maximum deposit guarantee per depositor set out in the Statute, corresponding to 15 % of the Bank's regulatory capital. From as early as 1 January 2019, the Auditing Association of German Banks (*Prüfungsverband deutscher Banken e.V.*) will support Hamburg Commercial Bank during the three-year transition period.

This procedure, which has been agreed with the German Savings Banks Finance Group and the Association of German Banks (*Bundesverband deutscher Banken*), ensures continuity in the security of deposits at Hamburg Commercial Bank.

External influencing factors and processes

The following aspects are of particular relevance to Hamburg Commercial Bank's business: The development of the economy and the financial markets (including interest rate levels, EUR/USD exchange rate changes), developments in the relevant sectors such as the real estate market and shipping, regulatory requirements and discretionary decisions by the supervisory authorities, assessments by rating agencies and capital market participants and other stakeholders, such as the ESF, as well as the further development of the transformation process.

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

Objectives and strategy

Hamburg Commercial Bank is committed to clarity; in line with the Hanseatic tradition, the now privatised commercial bank makes clear, binding commitments and grows together with its clients in the long term. The Bank is committed to its clients and stands for reliability and honesty. Its actions are straightforward, decisive and precise. Central to this perceived role is a focussed and entrepreneurial approach that creates added value for clients, society, shareholders, and the Bank and its employees.

The Bank's overarching objective is to slowly but surely continue to develop its business model, which is anchored in northern Germany, and to consolidate its market position in the German banking market. In view of the demands placed on the Bank by a rapidly changing banking environment, the Bank is focusing on its transformation in order to achieve a sustainable and agile corporate structure. This will be based on a cost-effective and, at the same time, needs-based service and product portfolio that concentrates on competitive areas and is continuously optimised in line with client needs.

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

Strategy architecture

The Strategic Risk Framework (SRF) describes the focus of risk management and forms the foundation for the Bank's risk culture. As a consistent guideline, it effectively brings the organisation and business operations into line with the key risk strategy principles. Details on the SRF and the bank-specific risk types are explained in the Risk report.

The business strategy is defined by the Management Board and describes the overriding strategic direction with regard to the business model and business area portfolio. This transforms the mission statement into a concrete strategy. It describes the objectives for each key business activity and the measures to be taken to achieve these objectives.

Taking into account the business strategy, a consistent risk strategy is defined on the basis of the SRF. This takes into account the development of key business activities, including risk strategy guidelines and liquidity aspects.

The funding strategy provides the framework for the refinancing of Hamburg Commercial Bank. It is a core component of the Bank's business strategy. As part of the definition process, the requirements regarding liquidity resources are geared towards sustainability to ensure that regulatory and rating requirements are met at all times. Risk and liquidity management is geared towards the gradual optimisation of the liabilities side, taking profitability requirements into account.

Further functional strategies are defined for the Bank's core business strategies.

The stated objectives and strategies are basically aimed at ensuring the Bank's sustainable development. When it comes to defining and implementing them, the Bank's employees use fundamental rules of conduct summarised in the "Code of Conduct" as a guide. The "Code of Conduct" is a binding code of behaviour. As a normative basis, it provides employees with reliable guidance for responsible action that meets the statutory requirements, but also ethical and social standards. This allows economic, ecological and social aspects to be taken into account in a balanced way. The combined separate non-financial report (pursuant to Sections 315b, 315c in conjunction with Sections 289b to 289e HGB) is available on the Bank's website at https://www.hcob-bank.com/groupreporting and is not part of this combined management report.

Realignment of the Bank

The Bank is undergoing a profound and extensive process of transformation spanning a period of several years. Its objective is to establish a business model that is client-focused and competitive in the long run. Now that the privatisation process has taken pressure off the Bank's balance sheet structure, in particular, the activities of the now privatised Hamburg Commercial Bank will focus on increasing profitability and general efficiency.

The focus is on the strategic vision, which is characterised in particular by a profitable and competitive product range, as well as efficient structures and processes. The realignment process will be based on existing customer relationships and business areas, which are being further developed in line with Hamburg Commercial Bank's principles and, following the abolition of the EU restrictions, are being carefully expanded and also selectively internationalised in some cases.

The Bank is bundling its efficiency and earnings enhancement activities in a cross-bank transformation project. The measures focus on five key areas: Development of profitable and risk-oriented growth strategies ("Go-To-Market"), strict focus on profitability and earnings ("Portfolio Management"), diversification and optimisation of the funding structure ("Liability Optimisation"), consistent cost management as well as moves to boost efficiency ("Operating Efficiency") and optimisation of the organisational structure ("Organisational Vitality"). A Transformation Office with a corresponding structure that falls under the direct responsibility of the CEO has been established. The stringent project structure ensures consistent development and rapid implementation of the individual measures. In general, the operating business model will be streamlined considerably in line with the risk-relieved structure. The reduction of complexity in processes and products, as well as in the organisational structure, in particular after the conclusion of the EU proceedings and the fact that the Bank has now been relieved of the Non-Core Bank, offers considerable potential.

The strategic realignment is being combined with digital transformation. The focus in this regard is on the development of digitalised value-adding processes focusing on clients, products, internal business processes and corporate culture. The Bank is pursuing a holistic and systematic approach with the aim of developing client groups and markets more efficiently in the future. This will also allow processes to be streamlined on the basis of increasing automation, allowing further efficiency gains to be achieved.

Digitisation also plays a central role when it comes to matters relating to customer relations. On the basis of the digitalisation strategy that has been adopted, several courses of action are being implemented in parallel, starting from the client perspective. The aim is to bring the acquisition and sales process, client onboarding, digital collaboration with clients and also back office processes into line with cutting-edge digital developments, substantially improving their competitiveness in the process. With regard to the selected fields of action, the Bank is focusing on a manageable number of key issues, the implementation of which is being driven forward in an agile and cross-sectoral manner.

The Bank's competitive realignment in the long term is characterised by solid financial key figures. In this respect, the Bank has defined a strategic target vision. It is characterised by a CET1 capital ratio of at least 16 %, an NPE ratio of a maximum of 2 %, a cost-income ratio of a maximum of 40 % and a pre-tax profitability of above 8 %. All strategic measures in the transformation process will be brought into line with this objective, which is to be achieved in full by 2022 at the latest.

Strategic direction for the business areas

The divisions are being developed on an ongoing basis and their business portfolios and positioning are being adjusted to reflect the changing underlying conditions in the market and competitive environment. In line with its strategic objectives, Hamburg Commercial Bank wants its business portfolio to meet stringent return requirements.

In addition to its business in Germany, the Bank is planning to carefully drive the expansion of its activities outside of Germany and across Europe for selected projects and sectors in the interests of ensuring a balanced portfolio structure. In addition, product sales will be optimised and adapted further to create a competitive offering.

In the **Corporate Clients** segment, the Bank will continue to pursue the approach of gearing business to segment-specific return and risk requirements nationwide. At the same time, the potential in the core region of northern Germany as well as in the project financing business in the Energy & Utilities and Logistics & Infrastructure business areas abroad is to be exploited in a focused manner. In particular with regard to the business with German corporates, market access is being enhanced further by way of digitisation strategies.

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

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

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

The customer departments are supported by products and services provided by the Treasury & Markets, Transaction Banking and Structured Finance divisions in order are to ensure a holistic offering.

Management system

Key value drivers and ratio system

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

In addition, a multi-level contribution margin accounting system is also used to manage the individual business areas. Other components of the Overall bank management system are the annual strategy and planning process, plan/actual comparisons and targets agreement and assessment process. Further information on management is included in the Risk report under "Risk management by central committee structure" and "Risk reporting and measurement systems".

Management indicators of the IFRS Group

The Bank's internal control system is based on key management indicators relating to the individual value drivers of the IFRS Group. In the Bank's external reporting, the development of these indicators is compared, on the one hand, against the previous year and the prior-year forecast ("Economic report" section). On the other hand, their expected development in 2019 and the strategic objectives for 2022 are also described ("Forecast, opportunities and risks report" section).

Compared with the previous year, changes have arisen with regard to the most important key management indicators, in particular as a result of privatisation. With the sale of the non-performing loans as part of the portfolio transaction and the termination of the second loss guarantee, significant risk relief was achieved for the Bank's balance sheet, together with an improvement in the capital structure. Against this backdrop, the Bank is streamlining the most important key management indicators and will focus, on the future, on the development of the key management indicators in line with its strategic objectives. The key management indicators thus comprise the RoE, the CIR, the CET1 ratio, the NPE ratio, the LCR and the rating. Following the implementation of the portfolio transaction and the associated disposal of the assets allocated to the Non-Core Bank, it is no longer opportune to look at these indicators on a segment-by-segment basis. As a result, the Bank will report on the development of the key management indicators at Group level as it moves to achieving the strategic objectives. Hamburg Commercial Bank's integrated management system ensures a comprehensive view of the key value drivers to an adequate extent. The most important key management indicators are defined as follows:

Definition of the most important key management indicators

Financial key management indicators	
RoE (Return on Equity)	RoE is calculated as the ratio of income before taxes to average equity capital disclosed on the balance sheet and shows the return on capital. The risk-adjusted allocation of the average equity capital disclosed on the balance sheet is determined on the basis of the regulatory capital committed.
CIR (Cost-Income Ratio)	The CIR is a cost efficiency ratio that measures administrative expenses as a percentage of total income plus other operating income.
CET1 Ratio (Common Equity Tier 1) phase-in, in-period[1)]	The CET1 ratio is defined as the quotient of the core Tier 1 capital excluding hybrid instruments and the sum of the risk-weighted assets, expressed as a percentage. The CET1 ratio is determined in the same period calculation (i.e. taking the Group financial statements into account) in accordance with the transitional rules (phase-in) of the Capital Requirements Regulation (CRR).
NPE Ratio (Non Performing Exposure)	The NPE ratio measures the sum of the risk positions (EaD, exposure at default) of borrowers in default as a percentage of the sum of the Bank's risk positions.
LCR (Liquidity Coverage Ratio)	The LCR represents the security provided to the Bank in the event of a short-term acute liquidity stress scenario of more than 30 days by maintaining a liquidity buffer (short-term stress test ratio). The LCR is calculated as the ratio of highly liquid assets to net cash outflows over the next 30 days. It is calculated at Group level for the purposes of internal control. The LCR is calculated without taking the institutional protection into account, i.e. taking into account the limit on the deposit guarantee for client deposits of € 100,000 per client.
Non-financial key management indicators	
Rating	Credit ratings awarded by the rating agencies in relation to the issuer rating (long-term).

[1)] The regulatory CET1 ratio, which is calculated on a "not in-period" basis, can be found in the Risk report.

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

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

Economic report

Underlying economic and industry conditions

Global economy loses momentum, high level of volatility on the financial markets

The global economy lost some of its momentum in 2018 compared with the previous year. Following growth of 3.8 % in 2017, it is likely to have expanded by 3.7 %. The decisive factors behind this less dynamic growth are the economic cycle, which is already well advanced in many countries, as well as a number of risk factors that have led to mounting uncertainty. On the one hand, there are the trade disputes, especially between the US and China, which have torn value chains apart at the expense of growth. On the other hand, the negotiations for a Brexit agreement between the EU and the United Kingdom have been very tough, which has significantly increased the risk of a hard Brexit. There were also other trouble spots to deal with - such as the currency crisis in Turkey or the budget dispute between the EU and Italy.

The international financial markets did not escape these conflicts unscathed. The stock markets suffered noticeable losses in the year under review, while interest rates in the eurozone - measured against ten-year German government bonds - fell again. Their US counterparts were able to close 2018 with moderately higher yield levels compared with the beginning of the year on balance - after what were significant increases at times. The US dollar has been able to appreciate significantly against the euro as a "safe haven".

Recent increase in economic risks
The US grew at a comparatively fast pace in 2018. In particular, the tax relief for companies passed by the US government at the end of 2017 had a stimulating effect. Growth in 2018 should therefore have accelerated further from 2.2 % in the previous year to just under 3 %. Compared with the previous quarters, however, GDP growth is likely to be somewhat lower at the end of the year, as some economic indicators are sending out the first few signals of a slowdown. The economic situation is still very robust, however, which is underscored by a very low unemployment rate of 4.0 %.

After China was able to expand at a slightly faster pace in 2017, the rate of expansion is likely to have slowed to 6.6 % in the year under review. In particular, the trade disputes with the US are putting the brakes on economic activity. Although the Chinese administration is trying to counteract this by taking both monetary and fiscal policy measures, the effect cannot be completely mitigated. Emerging markets in particular were affected by the stronger US dollar, rising US dollar interest rates and fears of a trade war, with Argentina, Turkey and South Africa in particular suffering hefty currency losses due to high current account deficits and/or political instability.

Compared with 2017, economic momentum in the eurozone slowed noticeably in the year under review. After 2.4 % in the previous year, 2018 is expected to bring growth of 1.8 %. Hopes of stabilisation in the summer failed to materialise. On the contrary, economic indicators have cooled further, meaning that the second half of the year was somewhat weaker than the first. This development was corroborated by the ongoing protests staged by the "yellow vests" against the reform policy in France, the paralysing Italian budget dispute with the EU and the fact that the automotive industry in Germany which was put out of action due to a one-off effect (the unsuccessful introduction of a new exhaust test procedure in the automotive industry). But it is not only this particular one-off effect, which led to a GDP contraction of 0.2 % in the third quarter of 2018 as against the previous quarter, that is putting pressure on the German economy. Trade disputes via third countries would also appear to be having a greater impact on the export-oriented economy than expected. There was no rebound in the fourth quarter of 2018, with the economy stagnating instead. At 1.5 %, total GDP growth in 2018 was significantly lower than in 2017 (2.2 % before adjustments for calendar effects).

ECB puts an end to its asset purchases, uncertainty sends the stock markets south and the bond markets reap the benefits
In 2018, the ECB took the first few steps towards normalising its monetary policy, gradually reducing its net asset purchases over the course of the year and discontinuing them completely at the end of the year. Maturing bonds will, however, continue to be reinvested in the capital market. The cautious stance taken by the central bank with regard to tightening monetary policy and the high level of uncertainty among investors once again benefited long-term German government bonds in 2018 overall. Their yields fell below 30 basis points at the end of the year.

In 2018, the US Federal Reserve systematically continued with its policy of interest rate hikes, lifting the key interest rate by 0.25 percentage points each quarter, meaning that the Fed Funds Rate currently lies within the target range of 2.25 % to 2.50 %. At the same time, the US Fed is steadily and gradually reducing its total assets by reinvesting only part of the maturing bonds on its balance sheet. The Fed's interest rate hikes have boosted Treasury yields, but in view of the uncertainty caused by the trade conflict, yields on long-term US government bonds have risen to a lesser extent than short-term yields, meaning that the yield curve has flattened considerably. The difference between the yields on ten-year and two-year T-notes briefly touched on a low of eleven basis points.

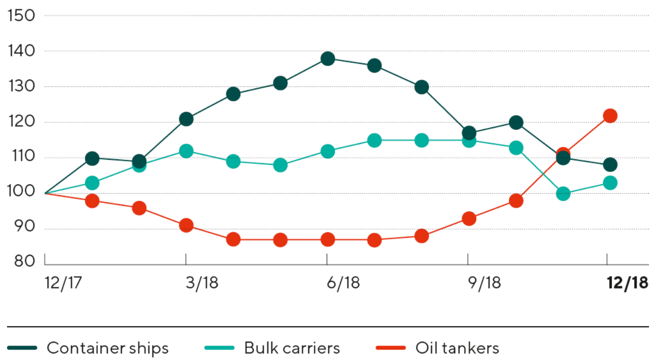
International stock markets came under considerable pressure in 2018 following solid performance in the previous year. At the beginning of the year, the German stock market (Dax) initially reached a level of more than 13,500 points, before falling considerably to below 10,500 points by the end of the year. Over the year as a whole, this equates to significant losses of around 18 %. The Euro Stoxx 50 was also hit by losses. With losses of 14 %, however, the result was not quite as negative as for the Dax. The US stock market fared somewhat better, meaning that the Dow Jones fell by only 6 % in 2018. At the beginning of the year, the euro was still trading well above 1.20 against the US dollar on the currency market, before the euro lost significant ground due to the economic slowdown in the eurozone and the trade disputes, particularly in May, only achieving lower levels against the US dollar for the remainder of the year. At the end of the year, the currency pair was trading at 1.14.

Development in relevant markets still encouraging overall

The **shipping markets** were volatile in the year under review and showed uneven development. Despite setbacks in the second half of the year, the market for container vessels and bulkers continued on a positive trajectory overall. On the oil tanker market, however, charter rates continued to decline before a boom set in at the end of the year.

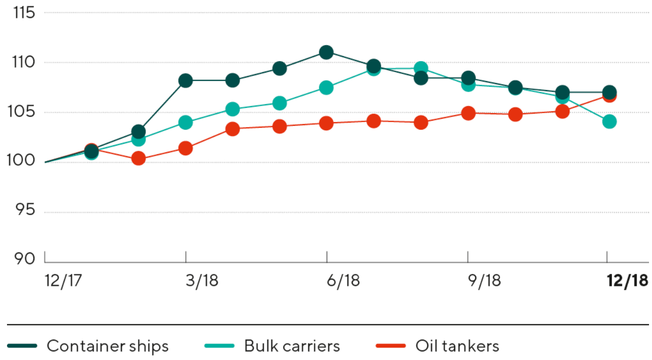
Time charter rates

(Indexed market average, 12/2017=100)



Secondhand prices

(Indexed market average, 12/2017=100)



In the market for **container vessels**, the recovery of charter rates up until mid-2018 was followed by a phase of weakness in the second half of the year. Second-hand prices followed the pattern set by charter rates with lower volatility. Demand for container transport showed robust development in line with the good macroeconomic environment, although growth had already started to slow. The uncertainty caused by import tariffs that had come into force, the threat of trade conflicts coming to a head and problems in a number of emerging markets had a corresponding impact.

On the supply side, fleet growth accelerated significantly again compared with 2017. The number of deliveries remained high, while only a few ships were scrapped. Despite consolidation, the shipping line companies are still fighting hard for market share, but recently stepped up their efforts to tighten capacity management, which increased the number of laid-up vessels at the end of the year.

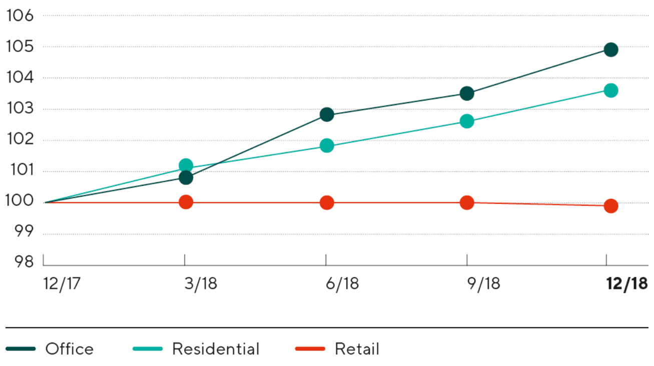
As far as **bulkers** are concerned, the upward trend continued in 2018. The last quarter of the year, however, saw a setback in charter rates and a weaker trend in second-hand prices. In particular, the rates for the large Capesize ships fell significantly of late – just like Chinese imports of coal and iron ore. Overall, however, demand for transport showed robust development. Although trade restrictions with the US led to shifts in trade flows, this ultimately did not have any negative impact on the volumes transported. Another positive factor for the market was the fact that the fleet of bulker grew at only a moderate pace, with relatively few new ships being delivered.

Charter rates for **oil tankers** had stabilised at a low level after a weak first quarter of 2018. At the end of the year, there was a genuine rally to the highest level seen in two years. The increase in second-hand prices, which had been cautious in the past, also accelerated noticeably. The main reason for this was the fluctuating oil production within "OPEC+" (consisting of the fifteen member countries of the "Organisation of Petroleum Exporting Countries (OPEC)" and ten cooperating states, including Russia). In October and November, production was upped significantly before a decision was taken to cut it back again. US crude oil exports, on the other hand, rose steadily. The strong scrapping activity, especially in the first half of the year, also brought relief, meaning that fleet growth almost came to a complete standstill in a year-on-year comparison.

The trends in the German **real estate markets** were once again predominantly positive in 2018. Rents and property prices continued to rise, particularly on the residential and office property markets in the country's major cities, with the latter rising at a faster rate. Not least thanks to the persistently low interest rates, real estate remained an attractive investment alternative for investors, although the return advantage is now becoming much less pronounced.

Rents

(Indexed market average, 12/2017=100)



Construction activity picked up considerable speed in 2018, especially for commercial real estate. In the **residential real estate** sector, the number of building permits for multi-storey residential buildings increased, while the number of building permits for owner-occupied houses dropped. This means that in the country's large cities, the supply of housing is moving in line with demand, which remains high. Nevertheless, the markets in Germany's major cities remained characterised by excess demand, while the rent restrictions imposed on apartments proved largely ineffective, with the result that rents rose significantly in almost all cities. For the first time in four years, however, the pace of growth slowed noticeably.

On the **office property markets**, net demand for space continued to rise thanks to the positive labour market situation and continued expansion initiatives by companies renting space. Although office completions increased significantly, they were not sufficient to meet the high demand. Vacancies fell for the eighth year in a row, even dropping below the fluctuation reserve in some major cities, mainly in Berlin and Munich. This caused rents in all major cities to rise sharply in some cases, primarily in Berlin. It was not uncommon for increases in peripheral locations and locations on the outskirts to exceed those in the top locations.

On the **retail property markets**, on the other hand, even rents in the prime inner-city locations of the largest conurbations stagnated, while they declined slightly in medium-sized and small cities. This is not least due to the ongoing structural change in stationary retailing in favour of online retailing, which is putting pressure on the demand for rental space among retailers, especially in the non-food sector. Rents were noticeably more resistant in city districts where the local food supply is located, an area that has barely felt any competition from online trading so far.

In many large cities, rents in these secondary locations rose at least at a moderate pace. The market values of commercial properties and retail parks, in particular, increased significantly despite the lack of or modest growth in rents. On the other hand, shopping centres recorded slight losses in value.

On the **European office property markets**, the number of emerging markets increased significantly in 2018. Thanks to what is often still positive economic development overall, vacant space fell in many large cities, meaning that rents rose sharply in some cases, especially in Scandinavia, France and Spain. A high vacancy rate only translated into slower rental growth on a small number of markets. On the office property market in London, demand for space weakened in the course of the year, although it was still sufficient to reduce vacancies somewhat. In anticipation of the unforeseeable consequences of the United Kingdom's withdrawal from the European Union in 2019, however, rents did not increase. They stagnated, as did market values, which bears testimony to the cautious approach adopted by investors. In the vast majority of cities in the rest of Europe, on the other hand, office real estate reported increasing values, and in some cases even strong growth, such as in the Netherlands and Scandinavia.

Although production growth in the German **manufacturing sector** was still noticeably higher than in the same period of the previous year in the first eleven months of 2018, it slowed in the course of the year. With the exception of the automotive industry and energy supply, the main sectors showed positive development, albeit to varying degrees.

Following a record year in 2017, **wholesale** companies recorded a further increase in sales at the beginning of 2018 compared with the same period of the previous year, although growth momentum slowed significantly as the year progressed. The **retail sector** is still benefiting from consumer-driven economic growth in Germany and also recorded a positive sales trend in 2018, although the growth momentum has weakened compared to the previous year.

The **health market** is growing constantly, including the hospital market, as a result of demographic trends and medical advances. The financial situation of many hospitals remains strained despite increasing revenues. The profitability of hospitals is, however, expected to increase in the medium term thanks to the entry into force of the Hospital Structure Act (Krankenhausstrukturgesetz) at the beginning of 2016.

In the **logistics sector**, sales in 2018 (in real terms) continued to show strong development, but at a slightly slower pace than in the same period of the previous year. The measured economic climate remains above the long-term average in the third quarter of 2018, meaning that it is still in expansive territory overall.

After a weak start to the year, the global **project financing volume** remained stable at the previous year's level in the first three quarters of 2018 and was down by only 0.1 % on the volume for the same period of the previous year. While the project financing volume in the Americas increased significantly year-on-year (+43.8 %), the financing volume in the "Europe, Middle East and Africa" (EMEA) region declined slightly (-4 %), with a sharp decline in the Asian region (-27.1 %).

Investments in **transport infrastructure** were relatively stable and accounted for 25 % of the project financing volume in the EMEA region in the first three quarters of 2018 (2017: 18 %). The major institutional investors include pension funds and insurance companies, which consider infrastructure investments to be a supplementary investment alternative in the low interest rate environment.

The expansion of **renewable energies** made further progress in the course of 2018, both in Europe and in Germany, although developments varied considerably: The changeover to the bidding procedures implemented in connection with the amendment to the Renewable Energies Act (EEG) had led to an increase in demand for the transitional year of 2017, especially in Germany, and has now led to the expected significant slowdown in 2018. The gross capacity increase in the onshore wind energy segment was 50 % lower than in the same period of the previous year.

The expansion in the solar segment continued in Europe. In Germany alone, new installations in the photovoltaics segment came to around 2,960 megawatts in 2018, up considerably on the prior-year value of 1,750 megawatts. The political target corridor of 2,500 megawatts of new photovoltaic output a year, which was clearly missed in previous years not least due to the cuts under the Renewable Energies Act (EEG), has thus been exceeded again for the first time since 2013.

Banking market faced with weak profitability, consolidation pressure and strategic realignment

The macroeconomic and monetary policy uncertainties were reflected in increasing risks in the banking environment over the course of the year, which were reflected not least in the share prices of banks on both sides of the Atlantic. US banks, however, once again outperformed their European and, in particular, their German counterparts by far. Key issues in Europe included the risks resulting from Brexit and – as in previous years – the stability of Italian banks. Measured based on the respective indices, European and German financial institutions both showed much weaker performance than the market as a whole. At the same time, although interest rates remained at a low level, bank funding spreads increased significantly in the course of the year against the backdrop of mounting uncertainty.

In view of these developments, the issues that are all too familiar in the European banking market are becoming more urgent than ever. German banks, in particular, which have come bottom of the European ranking list in terms of profitability for some time now, are being called upon to review their strategic orientation. This is because the high pressure on margins, which also places tight constraints on the ability to retain profits, increasingly harbours the risk of loan financing not being priced in a risk-commensurate manner. In addition, the expansion of non-banks, mainly FinTechs, is creating additional competitive pressure. At the same time, the need for investments in the future viability of institutions are leaving their mark on the cost side in the form of high project and IT costs. 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 sustainable basis. It is clear that conventional moves to cut costs alone are not enough to improve profitability in the long term. Rather, the aim is to ensure that business models are the best possible fit for client profiles, to exploit the potential of digital technologies and to develop a forward-looking corporate culture.

At the same time, financial investors, in particular, would also appear to be expressing more of an interest in playing an active role in the existing consolidation process, particularly in Germany. After all, from an investor perspective, the challenging market environment resulting from the low interest rates, weak earnings and intense competition creates not only risks, but also opportunities that can be exploited by ongoing consolidation. This applies both to the purchase of problem loan portfolios, as well as to takeovers of smaller and medium-sized institutions. All in all, these solutions have the potential to strengthen the German banking market and accelerate the process of transformation in the future.

Fresh impetus for future bank financing conditions came from the legislator and the rating agencies. While a decision had already been made back in November 2017 to harmonise the European regulations regarding the design of the national liability cascades within the context of the BRRD for MREL-eligible liabilities (Minimum Requirements for Eligible Liabilities), the regulations were transposed into German law at the end of July 2018. The arrangement provides for the introduction of a new class of instruments, non-preferred senior unsecured liabilities, which can count towards the requirements for bank MREL ratios, meaning that they contribute to the liability buffers in the event of insolvency. In Germany, the new regulations led to an extensive rating operation performed by Moody's with regard to the existing German senior unsecured liabilities, which, unless they contain structured components, were transferred to the liability class of senior non-preferred liabilities.

Underlying conditions influence Hamburg Commercial Bank's business

The highly competitive environment, which remains challenging for banks, was also reflected in Hamburg Commercial Bank’s business performance. Trends in the markets relevant for the Bank remained encouraging overall. The real estate environment in Germany, for example, remained largely positive. The situation on the shipping markets was volatile but still satisfactory overall. In the Corporate Clients division, however, the solid liquidity base of clients and the low level of interest rates still had a tangible impact in an environment that remained competitive. In view of these market developments, the development in the volume of new business concluded painted a mixed picture. Margin development remains under pressure due to the intense competition. Nevertheless, thanks to its strict focus on earnings, the Bank succeeded in significantly increasing new business margins compared with the previous year, partially escaping price competition as a result.

The first-time adoption of the new accounting standard IFRS 9 on 1 January 2018 only had a minor impact on the capital position of Hamburg Commercial Bank at Group level, as was the case at most German banks. The Bank is responding to the ongoing challenge of maintaining a cost base that is commensurate with the market environment by implementing cost-cutting measures consistently and systematically, most recently as part of the transformation project that has been implemented. In this way, the Bank is also countering the cost increases triggered by a large number of new regulatory requirements and laying the foundation for a streamlined and efficient privatised bank.

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

Business development – Significant developments and events in the 2018 reporting year

Successful completion of privatisation and completion of EU state aid proceedings

The privatisation process was successfully completed on 28 November 2018 after the Bank secured both regulatory approval and the European Commission's approval of the acquisition following a viability review of the new corporate structure. The sale of the Bank to renowned private investors marks the end of the long-standing EU state aid proceedings, which resulted in far-reaching structural relief. The privatised bank has changed its name and has been operating under the name Hamburg Commercial Bank since 4 February 2019. This marks the completion of the first privatisation of a Landesbank in Germany. The privatisation lays a solid foundation for the next stage in the forward-looking transformation process, during which the Bank will gradually be developed into an agile commercial bank with an appropriate level of profitability and a business model that is sustainable in the long run.

Significant structural improvements in risk and capital structure achieved
In light of the future viability of the Bank and the good portfolio quality that it is aiming to achieve in this regard, largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) were sold to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018 within the context of the privatisation process (signing). The sale largely relieved the Bank of non-performing legacy loans and the NPE ratio fell significantly as a result. The closing of the portfolio transaction was subject to a condition precedent and was finalised immediately after the sale of the shares on 29 November 2018.

In addition, an agreement was reached with the guarantor HSH Finanzfonds AöR and HSH Beteiligungs Management GmbH on the premature termination of the second loss guarantee in return for a compensation payment of € -100 million as part of the privatisation process. With the closing of the share purchase agreement on 28 November 2018, the guarantee agreement was also cancelled accordingly. Within this context, the guarantor made payments that were still outstanding which, together with the loss compensation already paid for defaulted loans in 2018, amounted to approximately € -6.2 billion.

Seamless transition agreed from the guarantee scheme of the German Savings Banks Finance Group to the guarantee scheme for private banks
One of the central conditions for the sale of the Bank was the extension of the full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement, and the associated seamless transition of the Bank to the guarantee scheme for private banks. In June 2018, the German Savings Banks Association (DSGV) amended its Articles of Association, opening up the fundamental option for the Bank to extend its membership of the guarantee scheme of the German Savings Banks Finance Group for an additional third year after closing. At the same time, the Bank applied for admission to the guarantee scheme of private banks (BdB). After protracted and complex negotiations, an agreement on the Bank’s seamless transition was finally reached in October 2018. Accordingly, in November 2018, the BdB approved the seamless transition to full membership of the deposit guarantee fund (ESF) as of 1 January 2022. The Bank’s admission was tied to clear conditions, which are also reflected in the Bank's strategic objectives and are aimed in particular at the successful implementation of the transformation process.

Extensive transformation process implemented

The completed privatisation process paves the way for the transformation process, which is intended to lead the Bank to efficiency and higher profitability in the long turn after the focus of late was on winding down extensive legacy burdens and, as a result, securing the Bank's continued survival. In view of the persistently challenging banking environment, which is characterised by intense competition and increasingly more demanding regulatory requirements, a stringent and sustained increase in efficiency, taking feasible digitisation initiatives into account, is an absolute must.

The Bank had already launched corresponding activities in the first quarter of 2018, and a cross-bank transformation project has since been implemented. The packages of measures covers five key areas and relates to fundamental aspects of the profound transformation. The primary objectives are to develop profitable, needs-based and risk-oriented new business strategies, to make existing portfolios profitable, to simplify and optimise the product and process structure, to diversify the Bank’s funding structure and to establish a more performance-oriented and agile corporate culture.

The idea is that these measures will allow the Bank to achieve its strategic objectives and, at the same time, comply with the agreements reached with the BdB. The strong commitment of the new owners, whose primary objective is to establish an optimised and sustainable business model in the long term, provides additional security in the implementation of the transformation process.

Satisfactory group development overall influenced by one-off effects

The Bank achieved its main operational targets and exceeded them in some respects, taking special factors into account. The Bank continued to implement the cost reduction programme that has been in place since 2014 in a stringent manner and in line with its planning. As a result, administrative expenses fell significantly (-16 %) compared with the previous year. As far as new business activities are concerned, developments were mixed. In this highly competitive environment, the Bank selects new business based on strict risk and return requirements. The development in new business margins during the reporting period shows that the systematic focus on return is already bearing considerable fruit. New business profitability is also in line with the current ambition level. At the same time, receivables are lagging behind expectations. All in all, the new business volume is moderately below the projected value. While the Bank deliberately slowed down the dynamics of the mediumsized corporates business in the face of competitive pressure on margins, activities in the Real Estate and Shipping segments developed satisfactorily. The central earnings and cost ratios were, however, also influenced by one-off effects. These include both positive effects, which are reflected in the high net income from hybrid financial instruments, and effects with a pronounced negative impact, which mainly relate to expenses for privatisation and restructuring, as well as loan loss provisions. Further details on the development of key management indicators are provided in the chapters below.

Earnings, net assets and financial position

Group key management indicators	2017	2018 forecast	2018
Net income before taxes (€ m)	-453	Loss before taxes of around € -100 million	97
RoE (%)	-9.7	Negative due to expected loss	2.2
CIR (%)[1]	30.7	Increase despite lower cost base, as ratio was positively overstated in 2017	27.2
NPE ratio (%)	10.4	Around 2 %	2.0
NPE Coverage Ratio AC (%)[2]	63.8	Remains at the good level seen in 2017	61.0
CET1 capital ratio (%) (in-period)[3]	15.4	Clearly above SREP requirements	18.5
LCR (%)	169	Constant compared to 2017 year-end	225
NSFR (%)	114	Constant compared to 2017 year-end	121

[1] Following change in presentation according to Note 3 paragraph B).

[2] The calculation of the coverage ratio has changed since the introduction of IFRS 9 and is therefore defined as the ratio of specific loan loss provisions on defaulted loans measured at amortised cost (AC) and the exposure at default (EaD) of these defaulted loans (NPE). For comparison purposes, the value as at 31 December 2017 has been adjusted pro forma.

[3] From March 2018, the capital ratios will no longer be shown taking into account the regulatory relief effect of the federal state guarantee. To enable a comparison with the key capital figures as at December 2018, pro forma ratios are shown as at 31 December 2017. "Pro forma" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, valuation allowances that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.

Satisfactory group development influenced by one-off effects

The following aspects, in particular, contributed to the satisfactory business development overall:

- **Net income before taxes** showed significantly positive development compared with the expected loss. On the one hand, this was thanks to satisfactory operating performance overall. Net operating interest income was moderately above expectations. While the average interest-bearing receivables portfolio increased slightly, gross new business, which also includes the volume earmarked for syndication, was slightly down on the previous year at € 8.4 billion (€ 8.6 billion). On the other hand, one-off effects also had a significant impact on the net result. The revaluation of hybrid instruments contributed € 994 million to the net result. Furthermore, there are significant burdens, primarily resulting from the compensation payment for the early termination of the second loss guarantee (€ -100 million), privatisation and restructuring expenses (€ -366 million) as well as substantial loan loss provisions that were higher than planned. In addition, the funding structure, which has to be optimised further, and the refinancing costs for the portfolio transaction, which were borne by the Bank until the disposal of the portfolio, had a marked impact on earnings.
- The development of **RoE** and **CIR** was also influenced by one-off effects. The RoE reported exceeds expectations due to the fact that net income was higher than planned, while the CIR is down due to the extraordinary positive earnings effects. In view of the influencing one-off effects, neither figure provides any information on actual performance development. The Bank expects that it will be able to achieve sustainably adequate ratios (RoE of at least 8 % and CIR of max. 40 %) by 2022 thanks to the measures launched as part of the transformation programme.
- The **NPE ratio** fell significantly, as was to be expected. This was due to the disposal of the non-performing legacy loans as part of the portfolio transaction, which led to a significant reduction in risk on the face of the Bank's balance sheet. In arithmetical terms, the NPE ratio came to 1.6 % as at the reporting date. Findings after the reporting date led to adjusting events resulting in further defaults. Even taking these cases into account, however, the NPE ratio is still in line with the strategic objective and amounts to around 2.0 %.
- The **NPE Coverage Ratio AC** came to a solid 57.6 % as at the reporting date. Taking into account the results of adjusting events and the loan loss provisions set up for macroeconomic and political risks, the NPE coverage ratio AC came to 61 % at the beginning of the new year.
- The **CET1 ratio** remains at a good level. As at 31 December 2018, it amounted to 18.5 % (in-period), clearly in line with expectations.
- The solid liquidity ratios (**LCR**: 225 % and **NSFR**: 121 %) significantly outstrip the Bank's forecasts. Within this context, the improvement in the deposit structure and the lower liquidity requirements relating to the volume of receivables had a positive effect.

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

Net earnings

Since 1 January 2018, Hamburg Commercial Bank has been applying the provisions set out in IFRS 9 – Financial Instruments in full when preparing the Group financial statements. As a result, the current Group statement of income features changes compared with the structure as at 31 December 2017. Accordingly, some figures for the comparative period have been restated. Further information on the changes in accordance with IAS 8.14 can be found in the section entitled "Adjustments to the prior-year figures" in the notes to the Group financial statements.

Statement of Income

(€ m)	2018	After adjustment 2017	Change in %
Interest income from financial assets categorised as AC and FVOCI	923	1,130	-18
Interest income from other financial instruments	1,592	1,657	-4
Negative interest on investments categorised as AC and FVOCI	-21	-30	-30
Negative interest on other cash investments and derivatives	-227	-275	-17
Interest expenses	-1,893	-2,202	-14
Positive interest on borrowings and derivatives	224	296	-24
Net income/loss from hybrid financial instruments	994	304	>100
Net interest income	**1,592**	**880**	**81**
Net commission income	35	65	-46
Result from hedging	-9	-18	50
Net income from financial instruments categorised as FVPL[1]	-136	254	>-100
Net income from financial investments	102	62	65
Result from the disposal of financial assets classified as AC	2	302	-99
Net income from financial investments accounted for under the equity method	–	2	-100
Total income	**1,586**	**1,547**	**3**
Loan loss provisions	-316	-2,086	-85
Hedging effect of credit derivative second loss guarantee	-51	810	>-100
Total income after loan loss provisions	**1,219**	**271**	**>100**
Administrative expenses	-402	-481	-16
Other operating income	-107	21	>-100
Expenses for regulatory affairs, deposit guarantee fund and banking associations	-89	-49	82
Net income before restructuring and privatisation	**621**	**-238**	**>100**
Net income from restructuring and privatisation	-366	-66	>-100
Expenses for government guarantees	-158	-149	6
Net income before taxes	**97**	**-453**	**>100**
Income tax expenses	-20	-75	-73
Group net result	**77**	**-528**	**>100**
Group net result attributable to non-controlling interests	7	7	–
Group net result attributable to Hamburg Commercial Bank shareholders	70	-535	>100

[1] In the previous year, under IAS 39, the item Net trading income.

Total income influenced by one-off effects

Total income increased marginally in the 2018 financial year to € 1,586 million compared to € 1,547 million in the previous year. On the one hand, net operating interest income, which was above plan contributed to total income. On the other hand, one-off effects from the revaluation of hybrid instruments had a positive effect. So the termination for the existing silent participations with effect from the end of 2018 and potential buyback offers result in a reassessment of the cash flows from the hybrid instruments. The silent participations were terminated subject to a notice period of two years. As a result, the outstanding hybrid capital instruments will either be redeemed in 2021 at the HGB carrying amount for the 2020 financial year or will be bought back by the Bank prior to the redemption date in 2021 as part of potential voluntary buyback offers. Against this backdrop, the reassessment of the cash flows from the hybrid instruments, taking into account the discounting and compounding effects, leads to positive net income from hybrid financial instruments in the amount of € 994 million. In the previous year, the revaluation had a positive effect on total income in the amount of € 304 million. In addition, the Bank had achieved unrealised gains of € 356 million in the previous year in order to partially offset the considerable burdens resulting from non-performing legacy loans attributable to the former Non-Core Bank. The following developments in the individual income line items were relevant:

Net interest income contributed € 1,592 million (previous year: € 880 million) to total income. Net interest income includes interest income from operating activities that exceeded expectations, as well as positive valuation effects, mainly due to the fair value measurement of the portfolio transaction and the hedging of the liquidity position. In addition, the change in the net income from hybrid instruments of € 690 million contributed to the year-on-year increase. Net interest income was hit significantly by expenses incurred to build up liquidity and for the funding structure, which the Bank is counteracting during the transformation period with measures to optimise the liabilities side. Furthermore, refinancing costs incurred in connection with the portfolio transaction had a marked negative impact in the period leading up to the disposal of the portfolio.

Net commission income came to € 35 million as at reporting date (previous year: € 65 million). The decline is attributable, in particular, to lower income from loan commission. In addition, net commission income in the previous year included significant income for the restructuring of non-performing legacy loans in the Non-Core Bank.

Net income from financial instruments categorised as FVPL had a negative impact on total income in the amount of € -136 million (previous year: € 254 million). This development was mainly due to subsequent valuation effects, most of which arose as a result of the portfolio transaction. These are offset by interest income of the same amount arising from the recognition of interest on defaulted portfolios measured at FV in accordance with IFRS 9, which has to be reported accordingly under net interest income. In addition, the previous year's result benefited significantly from the positive net income from foreign currency and increases in the value of the credit investment portfolio. Net operating trading income from cross-selling activities and the management of central liquidity and market price risks also declined compared with the previous year.

Net income from financial investments including other income items contributed € 104 million (previous year: € 366 million including € 302 million in the result from the disposal of financial assets classified as AC) to total income. It mainly includes gains from the sale of securities.

Mounting geopolitical risks put pressure on loan loss provisions

Loan loss provisions amounted to € -287 million as at the reporting date (previous year: € -1,402 million).

On the one hand, this development is due to specific loan loss provisions set up in the Shipping division, which are largely related to restructuring measures for a significant loan exposure. On the other hand, the increasing geopolitical and economic uncertainties are reflected in the substantial general loan loss provisions that were set up. By setting up these provisions, the Bank is taking precautions in view of the increasing probability of downside scenarios due to the risk of a hard Brexit or the possible escalation of the trade conflict between the US and China, which could have a negative impact on economic development in Europe and in the sectors relevant to the Bank (in particular shipping and real estate). In addition, the Bank has set up corresponding loan loss provisions for ships on the basis of the emission requirements that will apply as of 2020. In the previous year, furthermore, significantly higher amounts allocated for legacy loan exposures, especially in the shipping portfolio of the Non-Core Bank, had a considerable negative impact on the Group net result.

After currency effects and compensation, and taking into account the hedging effect from the credit derivative, the total loan loss provisions come to € -367 million (previous year: € -1,276 million).

Marked reduction in administrative expenses

Administrative expenses came to € -402 million as at the reporting date (previous year € -481 million). The Bank is continuing to successfully implement its cost-cutting programme, which has been ongoing since 2014 and counteracts the increasing pressure on earnings and margins in the highly competitive banking market and the increasing expenses for regulatory requirements, stringently and in line with its plans. During the reporting period, the Bank once again made the progress it planned to make in implementing measures for operating expenses. The ongoing cost reduction program will be consolidated with the measures forming part of the trans formation project, which aim to reduce costs and increase efficiency, and will be implemented resolutely until an appropriate CIR of 40 % at the most has been achieved. Corresponding negotiations with the Bank's social partners commenced directly after the closing date and are still ongoing.

Operating expenses came to €-186 million (previous year: € -215 million). Depreciation of property, plant and equipment and amortisation of intangible assets came to € -18 million (previous year: € -36 million).

As far as personnel costs are concerned, the planned reduction from the 2018Plus programme was agreed almost entirely with employees and the ambitious personnel cost targets continued to be consistently implemented. The further reduction in the number of employees as planned is reflected in the corresponding reduction in personnel expenses from € -230 million to € -198 million. Compared to the end of 2017, the number of employees within the Group continued to drop considerably by -210 to 1,716 (computed on a full-time equivalent (FTE) basis).

Other income line items

Other operating income amounted to € -107 million (previous year: € 21 million) and mainly includes provisions for litigation risks. Further details can be found in Note 17 in the notes to the Group financial statements.

The expenses for regulatory affairs, the deposit guarantee fund and banking associations amounted to € -89 million (previous year: € -49 million). The marked increase is mainly due to provisions set up for expected one-off payments to be made to the Association of German Banks (Bundesverband deutscher Banken) due to the planned change in the guarantee scheme as at 1 January 2022.

Rising restructuring and privatisation costs reflect transformation measures

Earnings were also hit considerably by restructuring and privatisation expenses amounting to € -366 million (previous year € -66 million). Net income from restructuring and privatisation includes, in particular, provisions for personnel measures planned as part of the transformation project (€ -259 million). In addition, the Bank has set up restructuring provisions for measures to reduce operating expenses. What is more, expenses from the privatisation process amounting to € -66 million (previous year: € -52 million), which were incurred in connection with external consulting in particular, had a significant negative impact on earnings.

Guarantee premium includes substantial special charge for early termination of the second loss guarantee

The expense for the guarantee premium had a significant impact on the Bank's net result in the amount of € -158 million (previous year: € -149 million). In addition to the base premium, the Bank made a compensation payment of € -100 million due to the premature termination of the second loss guarantee. The compensation payment was part of the cancellation agreement concluded between HSH Finanzfonds AöR, HSH Beteiligungs Management GmbH and Hamburg Commercial Bank AG as part of the privatisation process.

Group net result outstrips expectations by far

As at 31 December 2018, Hamburg Commercial Bank generated net income before taxes of €97 million (previous year: € -453 million). The net result exceeded expectations due to the satisfactory operating performance and in view of the aforementioned one-off effects. Significant burdens from restructuring provisions for the comprehensive and far-reaching transformation programme, as well as provisions for credit risks which were set up to reflect increasing geopolitical and economic uncertainties, were offset in full by total income.

After taxes, the Group net result comes to € 77 million (previous year: € -528 million). Income tax expense includes tax income from current taxes of € 15 million and tax expense from deferred taxes of € -34 million. Income from current taxes relates mainly to previous years. The deferred tax expense comprises the reversal of deferred taxes on temporary differences and offsetting income from the recognition of deferred tax assets on loss carryforwards.

Net assets and financial position

Since 1 January 2018, Hamburg Commercial Bank has been applying the provisions set out in IFRS 9 – Financial Instruments in full when preparing the Group financial statements. As a result, the current Group statement of financial position features changes compared with the structure as at 31 December 2017. Further information can be found in the section entitled "Adjustments to the prior-year figures" in the notes to the Group financial statements.

Material items on the statement of financial position

(€ m)	2018	2017	Change in %
Assets			
Cash reserve	5,362	6,625	-19
Loans and advances to banks	3,167	3,838	-17
Loans and advances to customers	32,791	39,174	-16
Loan loss provisions	-831	687	>100
Credit derivative under the second loss guarantee	–	1,014	-100
Trading assets	3,094	3,641	-15
Financial investments	10,100	13,647	-26
Non-current assets held for sale and disposal groups	65	139	-53
Other assets	1,373	1,617	-15
Total assets	**55,121**	**70,382**	**-22**
Liabilities			
Liabilities to banks	5,470	8,271	-34
Liabilities to customers	28,093	36,205	-22
Securitised liabilities	9,458	12,444	-24
Trading liabilities	2,812	3,875	-27
Liabilities relating to disposal groups	–	47	-100
Subordinated capital	1,614	2,252	-28
Equity	4,437	4,373	1
Other liabilities	3,237	2,915	11
Total liabilities and shareholders' equity	**55,121**	**70,382**	**-22**

Drop in total assets in the course of the year
The Group's total assets fell, as planned, by around one-fifth in the 2018 financial year to € 55,121 million (31 December 2017: € 70,382 million). The following developments were decisive for the decline in total assets:

The cash reserve fell compared with the previous year-end to € 5,362 million (31 December 2017: € 6,625 million). Loans and advances to banks also decreased and amounted to € 3,167 million (31 December 2017:€ 3,838 million). The Bank's active liquidity management, which aims, among other things, to gradually reduce the above-average liquidity reserves built up during the privatisation period, led to a moderate decline in extensive balances at central banks.

Loans and advances to customers came to € 32,791 million (31 December 2017: € 39,174 million), also below the level seen in the previous year. The decline is mainly due to the closing of the portfolio transaction. In connection with the closing of the privatisation process, the portfolio transaction agreed to relieve the Bank of large parts of its non-performing legacy loans and the early termination of the second loss guarantee were implemented at the same time. As a result, the loan loss provisions disclosed on the balance sheet are once again free of effects resulting from the guarantee and amount to € -831 million (31 December 2017: € 687 million).

Trading assets decreased to € 3,094 million (31 December 2017: € 3,641 million). While securities held for trading increased slightly, the positive fair values of derivatives in trading assets declined. Financial investments dropped to € 10,100 million (31 December 2017: € 13,647 million). This was due, in particular, to the winding down of securities portfolios in the context of liquidity management.

Almost all line items on the liability side of the balance sheet decreased as well, as was to be expected. Liabilities to banks, for example, fell considerably to € 5,470 million (31 December 2017: € 8,271 million). The repo transactions business in particular, but also time deposits, declined due to lower refinancing requirements. In line with the gradual reduction in liquidity, liabilities to customers also declined to € 28,093 million (31 December 2017: € 36,205 million).

Securitised liabilities were also down on the previous year-end to € 9,458 million (31 December 2017: € 12,444 million). This is due, among other things, to the termination of the hybrid instruments contained therein subject to a notice period of two years with effect from 31 December 2020, and to the resulting reassessment of the cash flows as at 31 December 2018. Trading liabilities comprising negative market values of derivatives (€ 2,812 million, 31 December 2017: € 3,875 million) were down in line with the positive fair values of trading assets. The subordinated capital came to € 1,614 million, down on the previous year (31 December 2017: € 2,252 million). The main reason behind this is the reassessment of cash flows following the termination of the hybrid instruments. Reported equity remained virtually unchanged and amounted to € 4,437 million (31 December 2017: € 4,373 million).

Business volume also down

In line with the declining total assets, business volume decreased to € 64,496 million (31 December 2017: € 78,611 million). By contrast, off-balance sheet business was higher than in the previous year: sureties and guarantees amounted to € 1,748 million (31 December 2017: € 1,862 million) and irrevocable loan commitments increased to € 7,627 million (31 December 2017: € 6,367 million). The increase is mainly due to effects from the first-time application of IFRS 9 in the 2018 financial year. Further explanations can be found in the financial information as at 31 March 2018 in the section entitled “Accounting and measurement principles” in the chapter entitled “Application of accounting methods IFRS 9 - Financial instruments”, sub-section “IV. Loan loss provisions and impairment of financial instruments” in the notes to the Group financial statements.

Structure of liabilities by financial instruments

(€ m)	2018		2017	
	Total	of which >1 year	Total	of which >1 year
Secured: Pfandbriefe and asset-based funding	**13,074**	**11,148**	**15,485**	**11,008**
Pfandbriefe	8,021	6,772	9,014	7,096
Other secured funding	5,053	4,376	6,470	3,912
Unsecured liabilities (senior preferred)	**23,212**	**2,873**	**31,897**	**5,884**
Unsecured liabilities (senior non-preferred)	**6,555**	**4,441**	**9,030**	**6,657**
Profit participation certificates and other subordinated liabilities	**1,067**	**1,067**	**1,060**	**1,060**
Hybrid instruments	**727**	**687**	**1,700**	**1,700**
Total	**44,635**	**20,216**	**59,172**	**26,309**

The above table breaks down Hamburg Commercial Bank’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 balance sheet line items liabilities to customers, liabilities to banks, securitised liabilities and subordinated capital. The carrying amounts of financial instruments excluding principal repayments and accrued interest are assigned to maturity bands in the above table.

One focal point within the framework of long-term refinancing relates to securitised debt instruments (covered bonds (Pfandbriefe), 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 € 13,074 million as at 31 December 2018 (31 December 2017: € 15,485 million).

The unsecured liabilities that can be classified as senior preferred and senior non-preferred include call and time deposits mainly comprising client deposits and other unsecured financing instruments. They totalled € 29,767 million as at the reporting date (31 December 2017: € 40,927 million). Call and time deposits are shown together with structured unsecured financial instruments in the "Senior Preferred" category and amount to € 23,212 million in total (December 31, 2017: € 31,897 million). The "Senior Non-Preferred" category mainly consists of bearer and registered bonds that do not have any structured elements and amounts to € 6,555 million as at 31 December 2018 (31 December 2017: € 9,030 million).

The two line items Profit participation certificates and other subordinated liabilities (€ 1,067 million, 31 December 2017: € 1,060 million) and Hybrid instruments (€ 727 million, 31 December 2017: € 1,700 million) in total represent subordinated capital. Out of the hybrid instruments (Resparc I and Resparc II), € 180 million (31 December 2017: € 508 million) is reported in the balance sheet item Securitised liabilities. The main reason for the significant reduction in hybrid instruments is the termination of the instruments subject to a notice period of two years with effect from 31 December 2020 and the resulting reassessment of cash flows as at 31 December 2018.

Capital and funding

RWA, regulatory capital and capital ratios

(in-period)[1]	31.12.2018	31.12.2017[2]
Risk-weighted assets (RWA) (€ bn)	22.1	26.2
Regulatory capital (€ bn)	5.2	6.7
of which: CET1 capital (€ bn)	4.1	4.0
Overall capital ratio (%)	23.4	25.8
Core capital ratio (%)	18.5	19.7
CET1 capital ratio (%)	18.5	15.4

[1] In-period: ceteris paribus calculation taking full account of the balance sheet amounts as at the reporting date.

[2] From March 2018, the capital ratios will no longer be shown taking into account the regulatory relief effect of the federal state guarantee. To enable a comparison with the key capital figures as at December 2018, pro forma ratios are shown as at 31 December 2017. "Pro forma" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, valuation allowances that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.

CET1 ratios at a good level

The CET1 ratio rose significantly to 18.5 % compared with 31 December 2017 (pro forma 15.4 %). The main reason behind the development compared with 31 December 2017 (pro forma) is a reduction in RWA of around € 4 billion, which is mainly attributable to the decline in market risks and the decline in the business volume, particularly in the Non-Core Bank. As a result, this is significantly higher than the internal level of ambition of at least 16 %.

The Tier 1 capital ratio and the total capital ratio declined compared with 31 December 2017. The reason for the development compared with 31 December 2017 lies in the termination of the hybrid instruments. The existing hybrid instruments are subject to the regulatory phase-out regulations for additional Tier 1 capital pursuant to Art. 486 CRR. As part of the privatisation process, the capital structure is being restructured and optimised. Within this context, the hybrid instruments were terminated at the end of 2018 subject to a notice period of two years. As a result, regulatory recognition of hybrid instruments as AT1/T2 capital for the regulatory capital ratios under the CRR and SREP requirements ceases to apply at the end of the 2018 at the same time. The termination of the existing hybrid instruments results in a reassessment of the cash flows associated with the hybrid instruments. The resulting positive valuation effect leads to a significant strengthening of the Common Equity Tier 1 capital in 2018. In 2019, SREP requirements (Pillar 2 Requirement "P2R" incl. the combined capital buffer requirements) for CET1 capital in the amount of around 10.6 %, Tier 1 capital (T1) of around 12.1 % and an overall capital requirement of 14.1 % apply to the Bank. The Pillar 2 Guidance "P2G" (incl. early warning buffer) for the CET1 ratio in 2019 comes to around 11.6 % (previous year: 11.2 %). The increase is due primarily to the phasing-in of the CRR requirement for the capital conservation buffer. The CRR and SREP requirements for AT1/T2 are significantly exceeded by the strengthened Tier 1 capital/available subordinated capital.

Reference is made to the Risk report for information on compliance with the regulatory requirements.

Hamburg Commercial Bank's leverage ratio (in-period) came to a very solid 7.4 % as at 31 December 2018 (31 December 2017: 7.7 %). The development is negatively affected by the termination of the existing hybrid instruments, whereas this is offset by the reduction in the leverage exposure (in-period) to € 55.6 billion in the reporting period (31 December 2017: € 67.6 billion), which reduces the drop in the leverage ratio. The leverage ratio is still well above the internal ambition level of at least 4 % and, as a result, is also in excess of the regulatory reference value of 3 %.

Funding activities further expanded

In the 2018 financial year, the Bank raised around € 3.4 billion in long-term funds, significantly exceeding the budgeted figure.

The Bank issued two benchmark mortgage Pfandbriefe, thus continuing the series of successful capital market issues. The Pfandbriefe have maturities of three and a half years and five years and a volume of € 500 million each. The Bank also expanded its range of asset-based funding transactions. Secured by real estate loans, almost GBP 250 million in long-term funds were raised.

Since the end of 2017, the Bank has been offering private clients fixed-term deposits via various online platforms (Zinspilot, Check24, DB, ZinsMarkt) and has gradually expanded its group of sales partners. Multi-channel funding has led to a continuous increase in the portfolio, which amounted to € 3.2 billion as at the reporting date.

Besides the issuing activities, the level of deposits also contributed to the implementation of the funding strategy. The volume of deposits was reduced as planned in order to further optimise the balance sheet. This allowed the Bank to achieve a structural improvement in the deposit and depositor structure.

Depositor structure

(in %, previous year figures in brackets)

The regulatory requirements for the liquidity ratios were exceeded by far during the reporting period. This was due to the improvement in the deposit structure and lower volume of receivables related liquidity requirements.

In addition to successful fundraising, the Bank also received inflows from the settlement of losses and the termination of the second loss guarantee, as well as purchase price payments for the sold portfolios.

Key liquidity ratios

	31.12.2018	31.12.2017
Total deposits (€ bn)	16.7	25.0
LCR (%)	225	169
NSFR (%)	121	114

Rating

Rating overview as at 31 December 2018

	Moody's	S&P
Issuer rating (long-term)	Baa2, stable	BBB, stable
Short-term liabilities	P-2, stable	A-2, stable
Stand-alone rating (financial strength)	ba2, stable	bbb-, stable
"Preferred" Senior Unsecured Debt	Baa2, stable	-
"Non-Preferred" Senior Unsecured Debt	Baa3, stable	-
Public Pfandbrief	Aa2, stable	-
Mortgage Pfandbrief	Aa2, stable	-

Hamburg Commercial Bank is rated by Moody's and S&P. Both rating agencies regard the successful privatisation and conclusion of the EU state aid proceedings, as well as the structural measures implemented within this context, which have led to a significant improvement in the financial and risk profile, as a decisive milestone on the road towards a business model that is sustainable in the long term. Against this backdrop, Moody's upgraded its rating to Baa2 (issuer rating) on 28 November 2018. S&P awarded the Bank a BBB (issuer rating) rating for the first time on 6 December 2018. In light of the intensive transformation process and the agreed seamless transition of the deposit guarantee fund, the agencies are focusing on the implementation of the measures, particularly with a view to improving operational performance.

Moody's has awarded the Bank long-term and deposit ratings of Baa2. The outlook has been raised to stable. In addition, Moody's has introduced a rating for unsubordinated and unsecured liabilities of banks that are considered, in the event of the insolvency of a German bank, before non-subordinated liabilities of this bank within the meaning of Section 46 f (6) of the German Banking Act (KWG). This rating is referred to as "Preferred" Senior Unsecured Debt and is at the Baa2 level for Hamburg Commercial Bank.

S&P's short-term rating is A-2. No further issue ratings have been commissioned.

The Risk report contains supplementary information on the capital and refinancing situation of Hamburg Commercial Bank.

Segment results

Segment overview[1)]

(€ m)		Corporate Clients	Real Estate	Shipping	Treasury & Markets	Core Bank[3)]	Non-Core Bank	Other and Consolida-tion[4)5)]	Group
Total income	**2018**	**222**	**189**	**108**	**218**	**737**	**-11**	**860**	**1,586**
	2017	250	215	107	573	1,145	79	323	1,547
Loan loss provisions (including credit derivative)[2)]	**2018**	**-54**	**-55**	**-205**	**16**	**-298**	**7**	**-76**	**-367**
	2017	-53	2	63	1	13	-1,295	6	-1,276
Administrative expenses	**2018**	**-122**	**-57**	**-35**	**-74**	**-288**	**-117**	**3**	**-402**
	2017	-118	-51	-39	-84	-292	-190	1	-481
Net income before taxes	**2018**	**34**	**67**	**-156**	**149**	**94**	**-253**	**256**	**97**
	2017	73	157	110	482	822	-1,550	275	-453
Segment assets (€ bn)	**31.12. 2018**	**12**	**12**	**5**	**19**	**48**	**0**	**7**	**55**
	31.12. 2017	12	10	5	21	48	12	10	70

[1)] After changes in the allocation of transformation costs for liquidity provisioning and the funding structure, as well as changes in presentation according to Note 3 (Changes in the Group statement of income); previous year's figures adjusted accordingly.
[2)] Summary of "Loan loss provisions" and "Hedging effect of credit derivative under the second loss guarantee".
[3)] Core Bank is the total of the four segments: Real Estate, Shipping, Corporate Clients and Treasury & Markets.
[4)] Net income before taxes including result from restructuring and privatisation.
[5)] Consolidation also includes the effects from differences in accounting.

Core Bank development

The development of the Core Bank has to be viewed in a differentiated manner. On the one hand, **operating performance** was satisfactory overall. Net operating interest income was moderately above expectations. The average interest-bearing receivables portfolio increased slightly as against the previous year. New business amounted to € 8.0 billion during the reporting period (previous year: € 8.5 billion). Gross new business, which also includes the volume earmarked for syndication, amounted to € 8.4 billion (€ 8.6 billion). The underwriting book and the deals concluded showed encouraging development that was in line with the business strategy guidelines during the reporting period. The Bank systematically selects its business transactions on the basis of stringent internal risk and return requirements and focuses primarily on profitability ambitions. As a result, new business margins rose noticeably in the period under review, whereas the volume of new business fell just short of expectations. The cross-selling result was in line with requirements, mainly due to investment products.

On the other hand, **one-off effects** had a significant impact on the development of the Core Bank. **Total income** fell considerably, by around € 400 million, to € 737 million . On the one hand, this development is attributable to lower income from the sale of securities. In the previous year, the Bank realised unrealised gains in order to partially compensate for the considerable burdens resulting from non-performing legacy loans attributable to the former Non-Core Bank. On the other hand, the previous year included positive valuation effects relating to client derivatives, which had a marked positive impact on net income from financial instruments categorised as FVPL.

Loan loss provisions increased significantly to € -298 million (previous year: € 13 million). This was due both to economic risks, which resulted in substantial general loan loss provisions being set up in the segments, and to loan loss provisions relating to individual cases, which had a significant negative impact on the Shipping segment in particular.

Guarantee expenses, which include a considerable one-off payment for the early termination of the second loss guarantee, also had a noticeable impact on the development of the Core Bank in the amount of € -41 million. Guarantee expenses are calculated based on originally guaranteed portfolios that were also included in the Core Bank and are incurred for the last time during the reporting period.

By contrast, **other income line items** developed in line with expectations. Administrative expenses are being reduced in line with the targets, and the Bank is implementing its cost-cutting programme rigorously. Regulatory expenses amount to € -27 million.

Taking one-off effects into account, the **Core Bank's net income before taxes** fell significantly as a result to € 94 million as against € 822 million in the previous year, putting it well below the planned figure as well.

The development of the **key Core Bank figures that are relevant from a management perspective** is shown in detail below:

Key management indicators - Core Bank	2017	2018 forecast	2018
Net income before taxes (€ m)	822	Below net result for 2017	94
RoE	23.4%	Below the value achieved in 2017	2.6%
CIR	25.3%	Increase despite lower cost base, as the ratio was positively overstated 2017	38.5%
New business (€ bn)	8.5	Moderately above the previous year's level	8.0

The **return on equity** amounts to 2.6 % (previous year: 23.4 %). The decline is due in particular to the one-off effects described above. In its planning, the Bank had assumed a decline in earnings and, as a result, also a lower RoE, although the extent of the negative effects (including expenses for privatisation and restructuring, as well as loan loss provisions) exceeded its expectations by far.

By contrast, the **cost-income ratio** developed in line with expectations, and the implementation of cost savings went according to plan during the reporting period. This results in a corresponding drop in administrative expenses.

Following the successful completion of the privatisation process and the structural improvements that it has achieved, the Bank is entering the next phase of its transformation. One focal point in this respect will also be on increasing operating performance in the segments, taking into account the cost structures within the entire Group. Against this backdrop, the Bank has defined a strategic target vision at Group level and is consistently bringing its business activities into line with these guidelines. The Bank is aiming to achieve its long-term target ratios for the Group, namely a return on equity before tax of more than 8 % and a cost-income ratio in excess of 40 %, by 2022 at the latest. The measures implemented as part of the transformation project are geared towards this objective and will be implemented intensively now that the EU state aid proceedings have been completed.

Total assets of the Core Bank amounted to around € 47.7 billion as at the reporting date (31 December 2017: € 48.4 billion). In preparation for the closing, a total of € 2.5 billion (thereof € 0.4 billion in NPE volume) of transactions not included in the portfolio transaction was transferred from the Non-Core Bank to the Core Bank in the first half of 2018. Most of these loans were healthy portfolios that were previously allocated to the non-strategic business but are to remain within the Bank. The transfer did not result in any significant change in the segment results.

Segment results in the Core-Bank

The **Corporate Clients** segment is well diversified and is organised on a sector-specific basis. It combines the Energy & Infrastructure, Trade, Food & Healthcare, Industry & Services and Wealth Management business areas. In addition, the business unit offers the consultancy areas of structured financing, leveraged buy-out and mergers & acquisitions from a single source for all clients of the Bank.

In the Corporate Clients segment, net income before taxes amounted to € 34 million (previous year: € 73 million). This development is due to total income that down to € 222 million (previous year: € 250 million). This primarily reflects lower net income from financial instruments categorised as FVPL, which in the previous year included significant positive valuation effects on client derivatives. In addition, net commission income fell short of expectations and the previous year. This is due to the business development in an environment that has been highly competitive for years now.

The net result was hit, in particular, by loan loss provisions of € -54 million (previous year: € -53 million), most of which relate to individual exposures and, to a lesser extent, to general loan loss provisions.

New business showed subdued development in line with the competitive market environment. It amounted to € 2.6 billion in total (previous year: € 3.1 billion). The Bank systematically selects its business transactions on the basis of stringent internal risk and return requirements and focuses primarily on profitability requirements. As a result, and due to the considerable pressure on margins, momentum was deliberately reduced, particularly in the business with medium-sized corporates. As a result, new business in the individual segments is down on the prior-year results. One encouraging exception is the development in the Industry & Services business segment. New business in this segment increased in a year-on-year comparison. Cross-selling income also fell short of that achieved in the previous year, although the decline was less pronounced than the drop in the new business volume. In the energy sector, the volume of receivables increased compared with the end of the previous year. The focus here was on the financing of wind turbines. Following the successful market entry in Portugal in the previous year, the renewable energy segment managed to consolidate its market position in Netherlands and strength its position in France again in 2018. In the business with corporates, the Bank was partially successful in stabilising its credit margins and exploiting the improved refinancing opportunities to increase margins.

The **Real Estate Clients** segment once again made a significant contribution to earnings of € 67 million (previous year: € 157 million) in 2018. The repayment of existing high-margin transactions had a negative impact on net interest income, which amounted to € 168 million compared with € 178 million in the previous year. In addition, total income in the previous year included positive valuation effects from client derivatives that boosted the result. In addition, net income before taxes as at the reporting date was hit by considerable allocations to general loan loss provisions. The Bank is taking precautions because the German real estate market is approaching its zenith after a long-standing upswing and economic uncertainty is generally on the rise.

New business totalled € 4.6 billion in a competitive environment that remained intense (same period of the previous year: € 4.7 billion), ahead of expectations. The Bank succeeded in continuously improving new business margins and significantly increasing the profitability of new business. The RoE achieved in the Bank’s new business exceeds the ambition level and makes a positive contribution to developments in the Overall Bank. The positive development in business with international institutional investors continued and the high market penetration in the northern German core region was expanded. The division is also exploiting its good market position in the metropolitan regions of western Germany. In the medium term, the resumption of international business will further improve the portfolio mix and the risk profile.

In the **Shipping** segment, net income before taxes amounted to € -156 million (previous year: € 110 million). The significant decline is attributable in particular to the significant burden of € -205 million from loan loss provisions. By contrast, the Bank had reversed € 63 million in loan loss provisions in the previous year. The development as at the reporting date is due in particular to specific loan loss provisions, most of which were set up in connection with restructuring measures for a major loan exposure. In addition, the Bank also set up general loan loss provisions to reflect economic uncertainties and the emission requirements for ships that will apply from 2020 onwards.

Developments on the shipping markets varied from sub-segment to sub-segment during the reporting period. Despite a market environment that remains challenging, new business with national and international shipping companies with good credit ratings, in which margins have risen over the course of time, came to € 0.9 billion, above both the previous year's level and the planned level. The profitability of new business improved significantly.

The **Treasury & Markets** segments generated net income before taxes of € 149 million (previous year: € 482 million). Income from the client business with capital market products and income from the management of liquidity and market price risks contributed to this result. The net result also includes valuation gains and income realised from securities portfolios.

The reason for the significant decline in the net result compared with the previous year lies in the one-off effects included in the previous year from the realisation of unrealised gains, which were realised in order to partially compensate for the considerable burdens resulting from non-performing legacy loans in the Non-Core Bank.

Development of the Non-Core Bank

Key management indicators for the Non-Core Bank	2017	2018 forecast	2018
Net income before taxes (€ m)	-1,550	Loss, but significantly lower than in 2017	-253
Total assets (€ bn)	11.7	Will fall considerably	0.2

With the successful completion of the privatisation process, the non-performing portfolios previously separated in the Non-Core Bank have been almost completely disposed of, meaning that the Non-Core Bank has fulfilled its function. Developments within the Non-Core Bank are being reported for the last time as at 31 December 2018.

As expected, the Non-Core Bank reported a loss of € -253 million as at the reporting date, down significantly year-on-year (previous year: € -1,550 million). The net result in the previous year had been influenced by the very substantial loan loss provisions in connection with the portfolio transaction. On the other hand, the net result as at the reporting date was mainly affected by guarantee charges (€-118 million) incurred for the last time that are largely attributable to the early termination of the second loss guarantee, as well as administrative expenses, which amounted to € -117 million (previous year: € -190 million). The decline in operating expenses was much more pronounced than expected. Refinancing costs for the portfolio transaction that had to be borne by the Bank between the signing and closing of the transaction also put pressure on the net result.

As at 31 December 2018, total assets of the Non-Core Bank amount to € 0.2 billion, which represents a considerable drop. In addition to IFRS 9 changeover effects, the decline is attributable to the transfer of Non-Core Bank portfolios to the Core Bank (€ 2.5 billion in the first half of 2018) and to the original winding-down of non-performing loans that were not sold as part of the portfolio transaction. Furthermore, as expected, the sold loan portfolios were transferred to the sphere of the buyers following the closing of the share purchase agreement, and the second loss guarantee was settled with definitive effect. In connection with these measures, the outstanding receivables (compensation item: € 6.2 billion on 31 December 2017) were paid to the Bank by the guarantor, Finanzfonds AöR. The amount of € 0.2 billion reported relates to loan exposures that have not yet been transferred as part of the portfolio transaction.

“Other and Consolidation” division

Administrative functions and overall bank positions are disclosed in Other under “Other and Consolidation” as segments not subject to reporting requirements. “Consolidation” also comprises items that reconcile the internal reporting results presented in the segment report to the Group financial statements prepared in accordance with IFRS. In addition to the measurement and disclosure differences, the result from restructuring and privatisation is allocated in full to this division. From 31 March 2018, the costs for transformation-related liquidity provisioning and funding structure incurred during the privatisation period and during the Bank's realignment are reported under "Other and consolidation". The prior-year and budgeted comparative figures have been adjusted accordingly. This is the Bank’s way of improving transparency with regard to the expenses associated with the transformation process and at the same time highlights the operating performance of the customer segments more clearly.

The Group net result before taxes amounts to € 256 million as at the reporting date (previous year: € 275 million). Various one-off effects contributed to this net result.

At € 994 million, the valuation of hybrid instruments had a significant positive impact on total income. By way of example, the termination for the existing silent participations with effect from the end of 2018 and potential buyback offers result in a reassessment of the cash flows from the hybrid instruments. In the previous year, the valuation of the hybrid instruments had a positive effect on total income in the amount of € 304 million.

By contrast, the net result was hit to a considerable degree by the above-mentioned costs of building up liquidity reserves and the funding structure, which are reflected in total income. What is more, the net result was impacted considerably by restructuring expenses of € -366 million (previous year: € -66 million), other operating income of € -106 million (previous year: € 23 million), as well as the expenses for regulatory affairs, the deposit guarantee fund and banking associations of € -60 million.

The figure reported under loan loss provisions of € -76 million (previous year: € 6 million) arose due to settlement-related guarantee effects. Since the introduction of IFRS 9 in 2018, the hedging effect of the second loss guarantee on the balance sheet has resulted in compensation effects relating to the items Net income from financial instruments categorised as FVPL and Loan loss provisions. All in all, these effects are virtually neutral for the two income statement items and are shown under "Other and consolidation". They arose in connection with the guarantee settlement, meaning that they will no longer apply in the future.

The segment assets of “Other and Consolidation” mainly include the liquidity reserve. Segment assets as at 31 December 2018 came to € 7.2 billion (31 December 2017: € 10.3 billion).

Final assessment of the situation of Hamburg Commercial Bank

The development of the Hamburg Commercial Bank Group in the 2018 financial year was characterised by various effects, some of which were extraordinary. Overall, the situation was satisfactory. The Bank achieved its main objectives, and in some cases even exceeded them, taking into account one-off effects.

In operational terms, the Bank's development in a highly competitive environment was encouraging overall. This was thanks to the stringent focus on earnings, which led to rising new business margins and improved profitability, as well as new business driven by real estate clients, project financing and shipping. The implementation of the ongoing cost-cutting programme was also satisfactory, and administrative expenses fell considerably again (-16 %).

In addition, one-off effects in connection with the privatisation process, the far-reaching transformation process and the ongoing optimisation of the liabilities side also played a significant role in shaping the Bank's development. These include significant burdens resulting in particular from restructuring expenses, the guarantee compensation payment, loan loss provisions and refinancing costs for the portfolio transaction, as well as costs relating to the liquidity and funding structure, which is in need of improvement. In addition, significant positive effects resulting from the revaluation of the hybrid instruments contributed to the Bank's development. Ultimately, the considerable burden was compensated for and the earnings forecast at Group level was exceeded.

Other key management indicators relating to capital and liquidity exceed clearly defined levels of ambition in some cases. The in-period CET1 ratio comes to 18.5 %, which is also a good level in a peer group comparison. As expected, the development of the risk ratios is in line with the risk structure, which has been optimised as part of the privatisation process. The NPE ratio is making the expected progress and has improved significantly to 2.0 % (31 December 2017: 10.4 %).

Overall, the successful completion of the privatisation process has resulted in the expected structural relief. In addition, the agreements reached with the guarantee schemes provided a reliable framework for the seamless transition to the deposit guarantee fund for private banks as of 1 January 2022.

The Bank is in the midst of a far-reaching transformation process as it moves towards establishing a profitable business model that is sustainable in the challenging banking environment in the long run and for which a solid foundation was laid in 2018.

After the reporting date, and with regard to the calculation of the NPE ratio and the coverage ratio, events occurred that were described in the chapter entitled "Earnings, net assets and financial position" under the information on the development of the key Group figures that are relevant from a management perspective. Other than that, there were no incidents worthy of reporting after the reporting date.

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

Employees of Hamburg Commercial Bank

The human resource strategy supports the overall bank strategy and provides the framework for operational human resource functions. It attaches great importance to ensuring that quantitative and qualitative staffing levels are in place and to managing and avoiding related personnel risks. This is associated with moves to retain and attract motivated and committed employees, particularly in view of the challenges posed by the ongoing transformation process.

The Human Resources division is responsible for its governance function, especially in managing personnel expenses and implementing, complying with and enhancing the legal and regulatory principles and guidelines. Modern and reliable operating processes form the basis for all topics relating to human resource functions.

Effective resource management

The successful implementation of the programmes initiated by the Management Board in 2015/2016 to permanently reduce administrative expenses continued in 2018. The target for the planned workforce reduction in 2018 was almost reached in a socially responsible manner with the help of the arrangements agreed with the Works Council. The number of employees had decreased to 1,716, based on full-time equivalents (FTE), by the 2018 year end in the course of the ongoing reduction in staff within the Hamburg Commercial Bank Group (31 December 2017: 1,926). Changes to the scope of consolidation also had an impact on the headcount. The number of employees (FTE) at Hamburg Commercial Bank AG (single entity) decreased to 1,510 by the end of 2018 (31 December 2017: 1,690).

Group employees

	31.12.2018	31.12.2017
Full-time equivalents (FTE) in the Group[1]	**1,716**	**1,926**
of which: Women	631	719
of which: Men	1,085	1,207
of which: Employees in Germany	1,648	1,838
of which: Employees abroad	68	88
Total number of employees in the Group (headcount)	**2,021**	**2,295**
Key employee figures		
Part-time employees (%)	26.7	26.7
Average age in years[2]	46.0	45.9
Average period of employment (years)	14.8	14.5

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

Focus on modern HR development

In 2018, HR development focused on deepening and further developing the expertise of the Bank's employees. The training courses required for regulatory purposes were supplemented by future-oriented content. We prepared our managers for changes in their leadership role using seminars such as "Leadership of the coming Y and Z generations" or "Social media for managers". A range of health and communication-oriented seminars rounds off Hamburg Commercial Bank's HR development programme.

Young professionals programme expanded further

In addition to the development of all employees, measures were taken again in 2018 to further strengthen the recruitment and promotion of our young professionals. Hamburg Commercial Bank offers high-quality education for the Bachelor of Arts/Science degrees in business management/information systems and for the office management specialist occupations. A total of 23 dual students/apprentices were employed in 2018.

In the past year, ten dual students and one office management apprentice completed their dual studies/vocational training at Hamburg Commercial Bank with a very good or good overall score and received an open-ended job offer. These young professionals now have further promotion possibilities following their training.

For new entrants to the profession, Hamburg Commercial Bank offers a 24-month trainee programme covering a wide range of topics. High-quality training is hereby ensured by giving the participants a comprehensive insight into each of the Bank's fields of activity. A total of 22 trainees were employed in 15 business units in 2018.

Due to the exceptional young professionals programme, Hamburg Commercial Bank was again honoured in 2018 by Absolventa GmbH as a provider of a career-enhancing and fair trainee programmes as was also recognised as a "Fair Company" for its good treatment of interns and university graduates. The young professionals programme is a key element for counteracting the demographic trend and increasing average age of Hamburg Commercial Bank's employees.

Further expansion of exemplary health care and social management services

Employees are provided with extensive health care and social management services in an integrated approach. Besides in-house seminars, these also include individual counselling for employees, managers and whole teams. In addition, Hamburg Commercial Bank helps its employees to strike a balance between work-related and family commitments by offering comprehensive advice and information on topics such as maternity and parental leave, childcare and caring for relatives. The services offered are regularly reviewed and flexibly tailored to employee requirements.

Remuneration paid to employees

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

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

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

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

The InstVergV, which has applied since 2010 and sets out provisions on the regulatory requirements that the remuneration systems of institutions have to meet, has been implemented on an ongoing basis and in full in the Bank's collective agreements. Negotiations with the Bank's co-determination bodies on the new requirements of InstitutsVergV 3.0, which was published in 2017, and on moves to revamp the current remuneration system were commenced in 2018, but had not been completed in full by the reporting date.

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

Management Declaration pursuant to Sections 289f and 315d of the German Commercial Code (HGB)

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

- At the level of managers reporting directly to the Management Board, Hamburg Commercial Bank was aiming to achieve a ratio of 16 % women. This objective has been achieved. The department head ratio also meets the target at 17 % (target of 15 %). The efforts made to promote young female professionals in particular will allow the Bank to fill vacant positions at the next higher level from the group of female department heads in the future.

Statistics on equal opportunities as at 31 December 2018[1)]

	Number			Ratio	
	Women	Men	Total	Women	Men
Managers reporting directly	3	16	19	16%	84%
Heads of department	9	44	53	17%	83%
Total	**12**	**60**	**72**	**17%**	**83%**

[1)] Head Office excluding employees released from their duties.

- In August 2015, the Supervisory Board approved a target of 20 % for the proportion of women on Hamburg Commercial Bank's Management Board, which was to be achieved by 30 June 2017. This objective has not yet been achieved. In July 2017, however, the Supervisory Board renewed its objective of appointing a female member of the Management Board by 30 June 2022, which would correspond to a quota of 25 % based on the current size of the Bank's Management Board.
- Under the requirements of Section 111 (5) AktG, also newly introduced in 2015, Hamburg Commercial Bank is required to set targets for the proportion of women at the Supervisory Board level as well. In line with the requirements of the German Corporate Governance Code (GCGC), the objective pursued by the Supervisory Board since 2011 has been to ensure that the proportion of women does not fall below 20 %. As a result of the privatisation and the associated replacement of the shareholder representatives on the Supervisory Board, the proportion of women has fallen from 31 % (31 December 2017) to 15 %.

One of Hamburg Commercial Bank's top priorities is to ensure a composition of the Management Board and Supervisory Board that is appropriate for the Bank and meets the different requirements of the responsible boards and, as a result, to ensure the adequate exercise of management and control functions. This means that, in addition to the described targets for the proportion of women on the Management Board and Supervisory Board, there are additional requirements aimed at achieving the balanced composition of the Management Board and Supervisory Board. The rules of procedure for the Supervisory Board, for example, state, in Section 6 (3c) (aa), that when filling a post on the Management Board, consideration should be given to ensuring balanced and varied knowledge, skills and experience for all Management Board members.

Forecast, opportunities and risks report

Forecast report including opportunities and risks

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

Anticipated underlying conditions

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

Economy as a whole and financial markets

WEAKER GROWTH EXPECTED WORLDWIDE

Growth is likely to slow further across the globe in 2019. This is due to what is already a relatively high level of production capacity utilisation in many regions, the uncertainty associated with the trade conflict and Brexit, higher US interest rates and a relatively strong US dollar.

In the US, the high pace of growth seen last year is unlikely to be maintained in 2019, as the first early indicators would already suggest. This is because the positive economic effect of the tax reform passed at the end of 2017 is gradually coming to an end, and bottlenecks in the labour market are also starting to come to light. Moreover, trade policy and retaliatory tariffs imposed by key trading partners, the relatively strong US dollar and higher interest rates are likely to put a damper on growth. Overall, the Bank expects to see growth of 2.1 % for the current year, which represents a significant loss of momentum compared with the strong previous year. In China, the slowdown in growth is likely to continue. The Bank anticipates an expansion rate of 6.2 %. In general, in addition to an escalation in the trade conflict, the emerging markets will have to expect tighter financing conditions in view of higher US dollar interest rates and a relatively strong US dollar. This is expected to slow growth in this group of countries.

In the eurozone, the economic slowdown continued unchanged at the end of 2018. Nevertheless, the Bank does not expect to see any recession in the EMU area in 2019. Rather, growth is likely to continue to lose momentum, coming in at a rate of 1.3 % compared with the previous year. The trade conflict, the prospect of a Brexit deal at the end of March, the protests against the government's reform policies in France and the lack of growth-stimulating policies in Italy are having a negative impact. In the event of a hard Brexit, the economic drag would be even more pronounced. The ECB's low interest rate policy, which ensures favourable financing conditions for the corporate sector and households alike, is still having a stimulating effect. Unemployment is on a downward trajectory in the eurozone, meaning that private consumption should prop up growth.

MORE CAUTIOUS FED, ECB WRESTLES WITH FIRST INTEREST RATE HIKE, CAUTIOUS RISE IN YIELDS

In view of the first economic warning signals in the US and the existing risks, the Fed has recently become more cautious about further interest rate hikes in 2019. It wants to adopt a patient and flexible stance, meaning that market participants have currently priced out further interest rate steps. In the Bank's view, however, the Fed's new rhetoric only points to fewer increases than originally envisaged. In this respect, the Bank still expects to see an interest rate hike of 25 basis points to a target range for the Fed Funds Rate of between 2.50 % and 2.75 %. The ECB has committed itself to not implementing any initial interest rate hike before the end of summer 2019. Thereafter, however, it could continue to normalise its monetary policy and raise the deposit rate and the key interest rate slightly. The overall upward trend in economic risks is likely to play a key factor. Long-term yields should increase, albeit only moderately due to uncertainties.

The euro is likely to remain weaker against the US dollar to begin with, not least due to the high level of uncertainty among market participants. In the future, the euro could make gains against the US dollar again, because, unlike the eurozone, the US could move into a slight recession in 2020.

Outlook for relevant markets

SHIPPING MARKETS

The outlook for the shipping markets is characterised by greater uncertainty. This relates, on the one hand, to the global economy and, on the other, to impending regulatory changes.

The market for container vessels is expected to recover in general in 2019, as demand growth is expected to be as robust as in the previous year. The risk of setbacks, however, has increased: trade restrictions could be stepped up considerably, geopolitical risks could intensify, and a possible hard Brexit could put a damper on the European economy. On the supply side, fleet growth will taper off significantly as scrapping activities accelerate. New ships resulting from the recent increase in the number of new orders again will only be launched on the market subject to a time lag. This means that 2019 is likely to bring higher fleet utilisation. Both charter rates and ship values can therefore be expected to rise in general, although they will be subject to pronounced fluctuations.

The demand growth for bulkers is likely to weaken continuously over the next few years. This is mainly due to Chinese imports of coal and iron ore, which are expected to continue to lose momentum. If trade disputes were to escalate or persist for a prolonged period, this could have more serious implications. On the supply side, growth rates remain at the moderate level seen in the previous year. There will only be a noticeable increase in the number of ships entering the market again after a certain time lag. Ultimately, fleet utilisation as a whole should increase moderately in 2019 and support the development in charter rates and ship values.

The oil tanker market is expected to move into a volatile upward trend in 2019. Although the renewed production cut by OPEC+ adopted in December is likely to have a negative impact, further increases in US crude oil exports could partly compensate for this, although this would be called into question if trade disputes were to intensify. Demand growth for oil tanker tonnage is expected to be solid overall. On the supply side, the scrapping of ships is likely to decline significantly in view of the improved ship earnings situation. Given the stable low level of deliveries, fleet growth is likely to be subdued. With a moderate increase in capacity utilisation, both charter rates and second-hand prices should rise tentatively overall.

Although the overall trend for the shipping markets is expected to be moderately positive, the risks have increased. The economic cycle is at its peak in some regions and the economy could be hampered further by the ongoing trade war and the imminent prospect of Brexit. The costs associated with meeting the emission targets for ships that will apply as of 2020 will also pose a burden for the markets. These increased risks are expected to lead to greater fluctuations in charter rates and ship values during the year in general.

GERMAN REAL ESTATE MARKETS

After almost a decade of an upswing, the German real estate markets are approaching their zenith in 2019. This is because the extremely low interest rates have bottomed out and the domestic economy, which has remained robust to date, is likely to lose momentum in view of the marked deterioration in the foreign trade environment since last year. This is likely to put a damper on growth on the real estate markets:

On the **housing markets** in most large cities, demand is likely to grow at a slower pace than in the past few years due to a further drop in the influx of inhabitants. It will still, however, cover the growing supply of housing resulting from brisk new construction activity, meaning that vacancy levels will remain low for the time being. The retail sector is benefiting from consumer sentiment that remains robust, as well as from rising household incomes as a result of the good labour market situation. At the same time, the growth in retail sales is declining, not least in shops in central inner-city locations. The ongoing above-average growth in online trading remains the decisive factor driving this trend. The local supply sector, especially as far as food is concerned, has so far been able to largely escape this competition.

On the **office real estate markets,** a slowdown in recruitment is likely to lead to less demand for space, albeit at a level that is still slightly above average. The number of office completions, on the other hand, is expected to rise sharply again. This is likely to satisfy most of the demand, meaning that vacancy rates will hardly fall any more. Office rents should continue to rise as a result, both in central and peripheral locations, albeit at a noticeably slower pace than in previous years.

Rents for **retail properties,** on the other hand, are likely to stagnate for the most part, especially in the prime inner-city locations, only increasing slightly in a small number of city district locations with a strong local supply situation. Rents are expected to increase more slowly, but still moderately, as the number of completions increases. The statutory limits on rent increases when apartments are re-let should also have more of a dampening effect following the supplementary measures resulting from the amendment to the legislation in 2018. Given the price level reached after the very strong increases in previous years and based on gradually rising interest rates, which will remain relatively low nonetheless, house prices and the market values of office properties will still show only a very moderate increase in 2019. The market values of retail properties are likely to dip from the current level in view of the ongoing structural change and depending on the location and the type of business.

OTHER SECTORS

The overall conditions for German growth will remain challenging in 2019, also due to foreign trade risks (such as the risk of a hard Brexit or the possible escalation of the trade conflict between the US and China). Although growth is likely to continue, economic momentum is expected to slow further.

Robust private consumption, based on a positive employment trend, strong wage increases and fiscal policy impulses argue in favour of a continuation of growth, which should support demand and, as a result, **retail trade**. A further increase in equipment investment also appears likely because companies in Germany are struggling with capacity bottlenecks, order books are still well filled and financing conditions remain favourable. Although this points to a further upward trend in industrial activity, the **manufacturing sector** and **wholesale and foreign trade** companies are also likely to lose further momentum in 2019. The **logistics sector,** in particular, is subject to the risks of a general macro-economic downturn and a weakening in global trade. **Construction output** is likely to be close to the capacity limit, meaning that no further substantial expansion is to be expected.

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

The prospects for the expansion of **renewable energies** remain mixed as far as 2019 is concerned: whilst the capacity added is likely to stagnate at a good level overall in Europe, there are definitely growth opportunities globally. A distinction, however, has to be made between wind and solar energy as well: in the German wind energy segment, the significant correction in new capacity should continue in 2019. New installations are likely to increase again in the rest of Europe. The absolute increase in generation capacity in the solar energy sector in Germany – and also in Europe as a whole – is likely to be continue to expand in 2019 due to the European climate protection targets and cost degression. On the one hand, however, restrictions on state subsidies have produced a gloomier outlook, while on the other hand, special depreciation for a total volume of four gigawatts are planned in Germany for the years from 2019 to 2021.

BANKING ENVIRONMENT

Against the backdrop of increasing geopolitical and economic uncertainties, as well as potentially high volatility in the financial markets, the overall banking environment is expected to remain challenging in 2019. Even though the growth forecasts are currently still relatively positive, the downside potential is classed as increasingly critical due to the complex and difficult situation (e.g. trade conflicts, Brexit).

Although, with regard to monetary policy, signs are emerging of a gradual turnaround in Europe, too, this is likely to be further delayed if the economic uncertainties become more entrenched. The ECB is likely to maintain its expansive monetary policy in the first instance, meaning that the pressure on net interest income resulting from the low interest rate environment is likely to continue to increase for the time being.

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

Regulators and market participants will continue to focus even more so than in the past on an increasingly comprehensive view of bank's capital and liquidity resources. This is particularly important regarding the extent to which banks are prepared for the new regulatory standards for bail-in eligible liabilities. These relevant capital and liquidity requirements that form part of the resolution mechanism include in particular the institution-specific minimum requirements for regulatory capital and eligible liabilities (MREL) defined by the national banking supervisory authorities and resolution authorities. This should provide banks with an even stronger incentive than in the past to optimise the increasingly granular liability side of their balance sheets as they attempt to strike a balance between regulatory requirements on the one hand and cost considerations on the other.

In addition, further fundamental adjustments are already emerging. The changes summarised under Basel IV, which, amongst other things, will serve to improve the comparability of RWA profiles and the reduction of complexity concerning risk identification, are at the same time aimed at the harmonisation of supervisory practices in the EU and are designed to improve transparency vis-à-vis the markets. The focus here is on the banks' internal models for calculating risk.

Expected business development of Hamburg Commercial Bank

Financial key management indicators			
	2018	2019 forecast	Strategic objective for 2022
RoE (%)	2.2	A ratio of between 1 % and 3 % is expected	>8
CIR (%)	27.2	A significant increase in the CIR is planned, as favourable one-off effects will not occur again	<40
CET1 ratio (%) (in-period)	18.5	The CET1 ratio is expected to be significantly above the regulatory requirements	≥16
LCR (%)	225	The ratio is expected to continue to be comfortably above the regulatory requirements	>140
NPE ratio (%)	2.0	A ratio of around 2 % is expected	<2
Non-financial key management indicators			
	2018	2019 forecast	Strategic objective for 2022
Rating	Baa2/BBB	Stable at the level already achieved	Baa1/BBB+

Key basis for the forecast
In its corporate planning, the Bank generally assumes that:

- the interest rate environment in Europe will slowly return to normal in the coming years and the ECB will begin to raise interest rates for the first time in 2020,
- the seamless transition to the deposit protection fund for private banks that has been agreed for 1 January 2022 will be achieved as planned and the Bank will meet the conditions set out in the Statute for participation in the ESF by the end of 2021,
- operating performance will be gradually improved by implementing the transformation programme and, above all, the earnings and cost ratios will improve significantly,
- the reduction of administrative expenses and the planned reduction in personnel can be implemented within the planned period and scope. Within this context, the Bank communicated the transformation programme immediately after the closing date at the start of December 2018, providing its social partners with all of the necessary information. In order to implement the HR objectives accordingly, negotiations on the social plan and reconciliation of interests with the works council need to be concluded,
- the bank-specific funding costs will fall as a result of the optimisation of the funding structure.

The Bank is systematically implementing its transformation programme. The business strategy, which is strictly geared towards an appropriate return on equity, and the systematic restructuring moves will support the achievement of the strategic objectives and, as a result, the sustainable realignment of the business model.

In 2019, one key focal point will be measures to optimise the organisational and cost structure. The Bank is currently negotiating a reconciliation of interests and a social plan with the works councils with the aim of clarifying the situation for employees as quickly as possible and implementing the measures as soon as possible. With regard to planned operating cost reductions, the optimisation of the IT infrastructure is extremely important. In this respect, establishing an efficient IT platform is a top priority. The current IT landscape is geared to the individual needs of the past. Now that the capital structure has been restructured, the Bank must become more standardised and streamlined if it wants to achieve its ambitious cost targets and, at the same time, open up scope for new business approaches. The forthcoming IT transformation programme will introduce a state-of-the-art, integrated and standardised application landscape. The workstation infrastructure will be aligned towards mobility and cloud use. This will reduce complexity and costs and increase flexibility and scalability. Hamburg Commercial Bank relies on the capabilities of a strategic partner to operate the application landscape and meet the challenges associated with transformation. Successful IT transformation is to be used to cut IT costs by around 40 % by 2022 as against the actual costs in 2018.

In addition, all other packages of measures under the transformation program will be vigorously pursued in order to establish a sustainably viable and flexible business model and, in doing so, lay the foundation for the Bank's successful survival in a rapidly changing and challenging environment.

In view of the operational measures identified and taking into account the fundamental aspects referred to above, the Bank expects to generate a slightly positive pre-tax net result in 2019 and, on this basis, a low positive RoE for the Group. The cost-income ratio, on the other hand, will increase considerably to begin with, as it was significantly overstated on the reporting date due to positive one-off effects. After adjustments to reflect the positive one-off effects, the cost-income ratio came to well in excess of 60 %. The Bank will gradually achieve its strategic target of a maximum of 40 % as part of the restructuring process. With regard to the CET1 ratio and the LCR, the Bank assumes that these ratios, which were at a good level as at the reporting date, will both comfortably exceed the regulatory requirements in 2019, too. On the basis of the risk-relieved balance sheet structure, it is assumed that the NPE ratio will come in at around 2 %, in line with the Bank's strategic objective. In general, the Bank expects that the planned progress made in the transformation process will have a positive effect on the rating agencies' assessment, meaning that its rating position, which improved after the closing, will be strengthened further.

The Bank addresses the main opportunities and risks associated with the forecasts below. Opportunities are defined as possible future developments or events that may give rise to a positive divergence from the forecast or an objective for the Bank. 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. The bank-specific risk types are then separately explained in the Risk report.

General opportunities and risks

A) ECONOMIC FACTORS

In view of the aforementioned global economic risks (in particular the risk of a hard Brexit or the possible escalation of the trade conflict between the US and China and the resulting economic risks for Europe as well), there is a danger that growth will be significantly weaker and developments on the financial markets significantly more volatile than the Bank has assumed in its planning. In general, macroeconomic risks are currently on the rise, meaning that the probability of downside scenarios and resulting burdens on earnings is increasing.

On the other hand, a more rapid resolution of the existing uncertainties would have a positive impact on the development of macroeconomic factors taken into account in the planning, thereby favouring the Bank's profitability.

B) INDUSTRY-SPECIFIC FACTORS

Against the backdrop of the risks to global trade, developments on the shipping markets could slow considerably. The export-oriented German economy could also suffer more in such a scenario than assumed in the planning. On the other hand, a more hesitant turnaround in the ECB's monetary policy would generally have a positive impact on the development of the real estate markets, in particular.

In addition, there is the risk that interest rates will remain low and that funding spreads for banks will also increase, which could have a negative impact on funding costs and, as a result, on earnings.

C) REGULATORY ENVIRONMENT

New regulatory initiatives, but in particular the discussion regarding the risk parameterisation of internal models in the run-up to Basel IV, could potentially result in higher capital requirements for banks.

D) COMPETITION/DIGITALISATION

The fierce competition in the German banking market, especially in the persistently low interest rate environment, is still putting pressure on asset margins and profitability in the lending business. On the other hand, digitalisation offers opportunities for optimising business processes, tapping into new sources of income and positively influencing IT developments, a trend that earnings and cost ratios, in particular, could benefit from.

Company-specific opportunities and risks

A) TRANSFORMATION PROGRAMME

If the transformation programme and, in particular, the planned cost-saving measures are not implemented as planned, it is impossible to rule out a scenario in which some costs cannot be reduced to the extent desired or not as quickly as planned. Similarly, delays in the transformation process, which could arise in connection with the ongoing negotiations with social partners or in the implementation of the measures, could have a negative impact on the extent and timing of planned savings measures. Furthermore, it cannot be excluded that the reduction in headcount associated with the efficiency measures is not implemented as planned or results in higher operational risk. The risk of losing key expertise may also be increased as a result of the personnel measures taken. Furthermore, a higher than expected employee turnover in sales divisions could make it more difficult to achieve the new business and income objectives.

On the other hand, if the transformation programme is implemented successfully, there will be an opportunity to continue to adapt the current cost-reduction structures and realise additional cost potential. This potential could arise from possible synergies and, where appropriate, from new strategic options. The measures to have the individual locations focus on particular areas - business centre in Hamburg and tasks relating to operations and IT in Kiel - could also make a positive contribution in this regard. The Bank is confident that it will achieve its stated objectives after also taking account of the successes already achieved in the past. The rapid and success ful implementation of the transformation programme would make a significant contribution to a sustained increase in efficiency and the long-term stabilisation of the Bank's business model.

B) TRANSITION/MEMBERSHIP OF DEPOSIT PROTECTION FUNDS

Agreements have been reached regarding Hamburg Commercial Bank's inclusion in the deposit protection fund for private banks as of 1 January 2022 that provide a reliable framework for its seamless transition to full membership of the deposit protection fund (ESF). If the agreements reached are not adhered to and, as a result, or for other reasons, the Bank is not admitted to the guarantee system of the Association of German Banks as of 1 January 2022 as planned, this could lead to a notable outflow of deposits and a marked increase in funding costs.

Also as a result of the different manner in which the deposit guarantee funds work, i.e. institutional protection under the protection system of the German Savings Banks Finance Group versus protection of deposits, there is a risk of liquidity outflows associated with the change in the deposit guarantee fund.

Hamburg Commercial Bank 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.

C) TRANSFORMATION PHASE

The objective being pursued with the Bank's realignment is the sustainable and profitable restructuring of its business model. In order to achieve the ambitious strategic objective, both the successful implementation of the transformation programme and acceptance among market participants - in particular for the implementation of the funding targets - and other relevant stakeholders are essential.

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

Overall appraisal and net income forecast

The overarching financial objective of Hamburg Commercial Bank is to achieve a return on equity of more than 8 % in order to considerably increase the value of the equity contributed and, as a result, the value of the company. The privatisation process led to the launch of an extensive transformation programme spanning a period of several years that is scheduled to be concluded in full in 2022 and will involve the operational and financial restructuring of the Bank. In 2019, the Bank will be focusing on boosting its operational performance. In order to achieve this objective, it will be forging ahead systematically with the measures developed as part of the transformation programme. Due to the existing and increasing uncertainties and the challenges faced by the banking environment, the Bank has to implement the restructuring process in a stringent and rapid manner. This will ensure that the corporate structure is developed further in a cost-effective and sustainable manner and, at the same time, will ensure the agreed seamless transition to the deposit protection fund for private banks will be ensured.

On the basis of what was generally satisfactory performance of the IFRS Group in the 2018 financial year, the Bank is confident, from today's perspective, that it will be able to achieve the targets it has set for 2019 as a whole. The 2019 financial year will be characterised by the implementation of the operating income and cost measures and, in particular, by the planned reduction in personnel. The individual measures implemented, such as organisational changes and extensive adjustments in the area of HR, will be continuously reviewed as part of the measures controlling process and adjusted where appropriate to ensure the successful implementation of the transformation programme.

Taking into account the restructuring provisions set up as at the reporting date, the Bank expects to achieve slightly positive IFRS net income before taxes in 2019. The earnings forecast is subject to any unforeseeable effects resulting from the implementation of the restructuring process.

The earnings forecast and future development of Hamburg Commercial Bank are associated with major challenges, which are described in detail in both the forecast and the Risk report.

Risk report

Risk management system

Principles of risk management
Active risk management represents a core component of the overall bank management at Hamburg Commercial Bank. The current version of the Minimum Requirements for Risk Management (MaRisk) laid down by the Supervisory Authorities serves as the main framework for the design of our risk management system. In addition, comprehensive requirements of the European Supervisory Review and Evaluation Process, SREP, and the henceforth applicable ECB guides for the Internal Capital Adequacy Assessment Process (ICAAP) and Internal Liquidity Adequacy Assessment Process (ILAAP) must be observed.

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

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

In addition to insolvency risk (financial risk) as a second type of liquidity risk other material risk types of Hamburg Commercial Bank include business strategy risk and reputation risk as so-called "Other NFR". Default risk is the most significant risk type based on Hamburg Commercial Bank's business model.

Determination of risk appetite and risk guidelines
The Strategic Risk Framework (SRF), which serves as the foundation of the risk culture, sets out the focus of the Bank's risk management activities and defines the objectives of risk management based on the planned development of key business activities and measures taken to achieve these objectives. The focus is on securing and allocating scarce resources as well as ensuring a sustainable revenue optimisation taking into account the risk appetite, business strategy objectives, the market environment and both the existing and planned portfolio.

The transformation into a profitable private bank, implementation of the objectives of the new owners and meeting of the requirements of other stakeholders (especially the banking supervisory authorities, Deposit Guarantee Fund of the Association of German Banks) is supported by the SRF guidelines.

The SRF contains the risk strategy principles as the key guidelines for risk-conscious action and cornerstone of a sustainable risk culture. These form the framework for the formulation of the risk appetite statement (RAS) and risk strategy. The RAS is broken down into a financial and non-financial RAS on the basis of the risk inventory and is aimed at providing a condensed description of selected risk appetite areas in order to achieve the Overall Bank's objectives. The financial RAS consists of a catalogue of key figures and ratios, the non-financial RAS of qualitative targets regarding the risk culture. Their implementation is ensured via the risk strategy and limit system, whereby the risk strategy describes the management of risks based on the risk inventory in accordance with the business strategy and RAS. It provides the framework for the sub-risk strategies (counterparty default for performing and non-performing exposure respectively, market and liquidity risks, non financial risk {NFR} along with reputation risk and operational and business strategy risks) and forms the foundation of the business strategy and a key basis for planning within the Bank.

Key risk indicators of the Group

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

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

Key risk indicators of the Group

	31.12.2018		Limit		Guideline
ICAAP utilisation from an economic perspective/RBC	**43 %**	**<**	**90 %**		**–**
Economic capital required (in € bn)	**1.6**	**<**	**2.5**		**–**
of which: for default risks	1.1	<	1.4		–
for market risks	0.2	<	1.0		–
for liquidity risks	0.1	<	0.3		–
NPE ratio	2.0 %[1]		–	<	3,0%
CET1 ratio (same period calculation, including Pillar 2 requirement)	18.5 %	>	11.5 %		–
T1 ratio (same period calculation)	18.5%	>	13.0 %		–
Overall capital ratio	23.4 %	>	15.0%		–
MREL	47.0 %	>	32.2 %		–
Leverage ratio	7.4 %	>	4.0 %		–
Liquidity coverage ratio (LCR)	225.0 %	>	125.0%		–
Net stable funding ratio (NSFR)	121.0 %	>	102.0 %		–
NLP2 in the stress case (in € bn) Month 1	9.4	>	0.5		–
Month 2	10.3	>	0.5		–
Month 3	9.7	>	0.5		–

[1] The NPE ratio was 1.6 % as at the reporting date. Further defaults were recognised as a result of adjusting events identified on the basis of knowledge obtained after the reporting date, whereby the NPE ratio remains in line with the strategic objectives even after taking these defaults into account.

Organisation of risk management

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

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

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

The Group Risk Management division is responsible for the risk strategy, the risk controlling function required for regulatory purposes and the methodological guidelines and models for calculating all risk-relevant components. The division develops the methods and tools for identifying, measuring, managing and monitoring risks and, by setting risk limits and risk guidelines, supports operative portfolio management, for which BU Bank Management is largely responsible.

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

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

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

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

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

A regular, internal review of the ICAAP is performed at Hamburg Commercial Bank in accordance with the requirements of Articles 73 and 74 CRD IV across 3 lines of defence, including the business divisions and independent internal control functions (Risk Management and Controlling, Compliance and Internal Audit amongst others) based on their respective tasks and responsibilities. Accordingly, the operating activities of all divisions form the first line of defence. In principle, a distinction is made between risk takers and risk managers pursuant to SREP GL 276b in the demarcation of the control and monitoring units.

The risk manager is responsible for managing the risks for which he is responsible within the framework of the applicable standards and guidelines (risk ownership). This task results from the responsibility for, e.g., processes, clients, employees, products, models and/or systems.

The risk taker is primarily responsible for the appropriate use of systems and/or models as well as for process-compliant conduct in order to avoid or reduce operational risk related to his activities.

By means of the PDCA cycle, i.e. Plan (planning of objectives, measures), Do (implementation), Check (measuring the effectiveness of the measures and report), Act (identification of corrections) – only within the 1st line –, this separation can be described as follows: The risk manager plans and checks, the risk taker does and acts when necessary.

The task of the first line of defence is to also provide the divisions in the second line of defence (II a and II b) with all relevant information, so that this can be analysed, evaluated and processed by them. The first line of defence's obligation to cooperate is therefore highly relevant for a functional risk management process.

The II a line of defence is basically responsible for monitoring and controlling as well for determining the procedures for setting the limits for the relevant risks. It is defined by the officer functions required by law but also by similar monitoring activities in other areas of the Bank. The divisions in the II a line of defence also act as risk managers in specific cases, such as BU Legal & Taxes for legal and tax risks or BU Human Resources for personnel risk.

The overarching II b line of defence is the responsibility of the GRM (responsible for OpRisk controlling) and Compliance (works towards legal and regulatory compliance) divisions.

Internal Audit forms the third line of defence and provides independent and objective auditing and advisory services, which are aimed at creating added value and improving the business processes. It supports the organisation in achieving its objectives by evaluating the effectiveness of risk management, the controls in place and the management and monitoring processes under a systematic and targeted approach and helping to improve these. Internal Audit monitors and validates the timely elimination of deficiencies identified by the Bank's own activities or external audits. As a tool used by Hamburg Commercial Bank's Overall Management Board it is an essential component of corporate governance. It regularly provides the Overall Management Board and Audit Committee of the Supervisory Board with information on the findings of its audits, which are carried out on the basis of a risk-based audit plan that is approved by the Overall Management Board on an annual basis.

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

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

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

Hamburg Commercial Bank uses an "economic scope of consolidation" as the basis for the Group-wide risk management. It includes those entities that are to be specifically monitored at the Group level due to material risks.

Risk management by a central committee structure

Committees with the following composition and tasks were in place in 2018 to support the Management Board in monitoring and managing all significant risks: In addition to the members of the Management Board the committees are composed of the heads of the risk and other departments, which ensures that information regarding questions on risk is regularly exchanged. Insofar as internal or external regulations do not permit delegation of decisions to the committees, such decisions are prepared by these committees for approval by the Overall Management Board.

The Overall Bank Management committee (OBM committee), which is chaired by the Chief Financial Officer (CFO) and Chief Risk Officer (CRO), is the committee responsible for managing and allocating financial resources within the risk limits, risk guidelines and plan targets. Its duties include, inter alia, the monitoring and management of risks associated with bottleneck resources (including risk concentration, credit, liquidity as well as FX and interest rate risks). The OBM committee also looks at market risk positions that serve the Bank's strategic goals. This means that the OBM drafts decisions on strategic guidelines, the type of management, objectives restrictions and other targets for the corporate investment portfolio. The relevant decisions are made by the Overall Management Board. The risk limits adopted by the Management Board are monitored by the units with operational responsibility. Risk limit overdrafts are escalated to the Management Board together with recommended courses of action and the implementation of measures to reduce such overdrafts is monitored. Furthermore, the OBM Committee is the body responsible for monitoring the recovery plan indicators and drafting all resultant decisions.

The Scenario Steering Committee (SSC), in which the trend of market indicators is monitored and decisions made regarding simulation assumptions and scenarios (macroeconomic and segment-specific), provides significant support to the OBM committee. The simulation scenarios together with their key assumptions and an analysis of the results are also presented to the Overall Management Board in addition to the OBM Committee. The OBM has also been supported by the Model Steering Committee (MSC) since 2018. MSC's objective is to discuss model developments and validations and model risk governance across GRM and to approve such–in accordance with the relevant decision-making competence–or draft a decision for the OBM Committee.

The Credit Committee (CC) is an independent, decision-making body at the level of individual lending transactions, which is chaired by the head of the Credit Risk Management (CRM) division with the participation of the CRO on a case-by-case basis. Operating profitability is managed at the individual deal level by the CC in order to meet the Overall Bank's profit targets. The committee also performs an active portfolio management function to achieve ongoing improvements in portfolio quality (diversification, granularity) and makes individual lending decisions from a credit risk perspective. When necessary, the committee also operationally manages the utilisation of limited bottleneck resources. The CC is guided by the requirements for Group resource management defined in the OBM committee.

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

The completed transformation of the Bank and associated change in the organisational structure will also entail a change in the committee structure.

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

The following key reports are prepared for the overall risk:

– The management report, which as an integrated financial and risk report provides information on Hamburg Commercial Bank's overall situation with regard to the key value drivers, particularly income, costs, liquidity, capital and risk as well as on the trend of the recovery plan indicators, is submitted to the OBM committee, Management Board and also the Risk Committee (relevant extracts thereof). Adherence to the risk limits and risk guidelines laid down in the SRF and relevant for managing economic capital is monitored by means of this report. The management report also includes reports on problem loans and new business in addition to information on the trend of the relevant key default risk figures, structural analyses on business areas and conspicuous individual commitments. It also includes the profit centre accounting, rating validation results and rating migration development as well as information on the monitoring and management of country risk. The management report is generally prepared on a monthly basis. In addition, it is updated on a weekly basis for selected key figures and ratios.
– The Risk Committee also receives for its quarterly meetings the trend of aggregated risk parameters of Hamburg Commercial Bank in the form of the "current risk trend" report.

The management reporting policy sets out the management requirements regarding the structure, contents, frequency, deadlines and form of the internal reporting combined in the management report.

Other overall risk reports include the Disclosure Report under Part 8 of the Capital Requirements Regulation (CRR) and the Risk Report in the Annual Report. In addition to risk reports on the overall risk there are reporting instruments based on the risk type. The Management Board is informed on a daily basis of the market risk and earnings trends as well as the extent to which limits are utilised and the CRO and the divisions concerned are informed of the insolvency risk trend in the Normal Case and Stress Case. The OpRisk Steering Committee receives a quarterly report regarding the development of the risk position, material loss events and management measures addressed. The Overall Management Board is informed once a year regarding the capital required, the loss event trend and material loss events and loss potential as well as any measures required.

Internal control system

BANK-WIDE INTERNAL CONTROL SYSTEM
The Management Board of Hamburg Commercial Bank bears the overall responsibility for ensuring that a proper business organisation is in place at the Hamburg Commercial Bank Group, including an appropriate and effective internal control system (ICS).

The ICS of Hamburg Commercial Bank is based on a bank-wide main and sub-process structure (process map), which also includes the domestic and foreign branches. A person responsible for the process is designated for all main processes.

The top priorities of this ICS assessment are the structured and systematic examination of potential or known process risks together with the definition of and decision on measures to be taken to mitigate them. Furthermore, the ICS makes a contribution to the effectiveness of the processes by specifying uniform rules for the Bank as a whole. An implemented ICS cycle also ensures that the ICS is continuously enhanced with respect to its correctness and functionality as well as its appropriateness and effectiveness. Clear roles and responsibilities are defined within the ICS cycle to ensure that the tasks are performed in a proper manner.

Central responsibility for the management and monitoring of the ICS as well as for methodology guidelines and their enhancement lies with the ICS Office in the Corporate Compliance organisational unit.

It is also responsible for carrying out random quality assurance checks and appropriate reporting to the Management Board and Supervisory Board.

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

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

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

INTERNAL CONTROL SYSTEM WITH REGARD TO THE ACCOUNTING PROCESS

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

The accounting process is reviewed on a regular basis by the responsible member of staff in charge of the process and adjusted to the current framework conditions and requirements. In addition the accounting process is audited by the Internal Audit division from a process-independent perspective.

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

Regulatory requirements

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

In accordance with the requirements of Part 8 CRR in conjunction with Section 26a (1) Sentence 1 KWG Hamburg Commercial Bank publishes material qualitative and quantitative information on equity capital and risks incurred in a separate Disclosure Report. As an institution that uses the IRB Advanced Approach for nearly the whole portfolio, particular requirements apply to Hamburg Commercial Bank in this context. The document provides more information than that disclosed in this Annual Report on the basis of the accounting principles applied, as it provides a comprehensive insight into the regulatory framework and the Bank's current risk situation based on regulatory figures. The Disclosure Report as at 31 December 2018 is available on our website, www.hcob-bank.com, four weeks following publication of this Annual Report. The Disclosure Report does not form part of the Management Report. With its publication Hamburg Commercial Bank has implemented the requirements of the third pillar of the Basel Accord (market discipline). The requirements regarding the disclosure of risk management objectives and policies in accordance with Article 435 (1) CRR and (2)(e) CRR are implemented in this risk report. The description of the approach required in accordance with Article 438 (a) CRR, under which the institution assesses the adequacy of its internal capital to support current and future activities (capital adequacy process), is also included in this risk report. The same applies to the description of the approaches and methods adopted for determining specific and general credit risk adjustments under Article 442 (b) CRR.

REQUIREMENTS UNDER THE SUPERVISORY REVIEW AND EVALUATION PROCESS

The objective of the Supervisory Review and Evaluation Process is the review of the business model, governance, risk situation as well as the capital and liquidity utilisation. Based on the analyses the supervisory authorities may specify requirements for capital and liquidity utilisation that exceed the existing minimum regulatory requirements.

As part of the supervisory process within the Banking Union, Hamburg Commercial Bank was assigned individual minimum capital ratios by the ECB that are reviewed annually as part of the SREP process. These capital ratio requirements were adhered to at all times during the reporting period. The regulatory disclosure pursuant to the CRR is on a "not in-period" basis, i.e. balance sheet amounts as at the reporting date only included in part. In addition, the minimum regulatory capital ratios are tested under the normative perspective in the ICAAP over a multi-year time horizon in a base and stress scenario in the future. Since January 2018, a CET1 SREP requirement of around 10.2 % and a total SREP capital requirement of 13.7 % (Pillar 2 Requirement "P2R" including the combined capital buffer requirements) have applied to the Bank. The capital buffer requirement was reduced by the supervisory authorities by 0.32 percentage points as at the 2018 year end, as the Bank is no longer classified as systemically important as defined in the capital buffer requirements.

Regulatory capital ratios[1)]

(%)	31.12.2018	31.12.2017
Overall capital ratio	23.3 %	31.4 %
Tier 1 capital ratio	18.4 %	23.2 %
CET1 capital ratio	18.4 %	18.7 %
CET1 capital ratio (full Basel III implementation)	18.4 %	17.8 %

[1)] Not in-period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only partially included).

Regulatory capital[1)]

(€ bn)	31.12.2018	31.12.2017
Regulatory capital	5.2	7.0
of which Tier 1 capital	4.1	5.2
of which CET1 capital	4.1	4.2
of which Additional tier 1 capital	–	1.0
of which supplementary capital	1.1	1.8

[1)] Not in-period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only partially included).

Risk weighted assets (RWA)[1)]

(€ bn)	31.12.2018	31.12.2017
Market risks	1.0	2.0
Operational risks	1.7	1.3
Credit risks	19.0	18.6
Other RWA	0.4	0.3
Total RWA	**22.1**	**22.2**

[1)] Not in-period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only partially included).

The SREP requirement applicable to the financial holding group of HSH Beteiligungsmanagement GmbH as holding company up to the closing of the privatisation was adhered to at all times. As at the 2018 year end the Bank is no longer part of the financial holding group. Adherence to the previous SREP requirements therefore also ceases to apply at the year end.

The regulatory CET1 capital ratio calculated on a not in-period basis for the single entity in accordance with HGB accounting standards was 18.2 % as at 31 December 2018 (previous year: 21.2 %). The decrease in the aggregate RWA in particular had a positive impact in this regard. The corresponding Tier 1 capital ratio reached 18.2 % (previous year: 25.4 %), the corresponding overall capital ratio amounted to 22.9 % (previous year: 30.7 %). The single entity (HGB) regulatory requirements for capital ratios were adhered to at all times during the reporting period.

Risks for the capital ratio trend

Risks may arise from the regulatory environment, for instance from interpretation decisions or audits, in addition to the risks for the capital ratios set out in the stress test section.

It is possible, for example, that additional individual and increased capital requirements could arise from the regular SREP process carried out within the Banking Union. Additional discretionary decisions made by the supervisory authorities and industry-wide capital requirements (capital buffer for systemic and anti-cyclical risks) could therefore result in higher capital requirements. Discretionary decisions made by the supervisory authorities with regard to model risks and validations may result in increases in RWA and thereby adversely impact the capital ratios for future LGD/PD estimates in the internal models.

As part of the restructuring and optimisation of the capital structure all of the Bank's silent participations were cancelled as at the end of 2018. Outstanding hybrid capital instruments will be either cancelled in 2021 at the HGB carrying amount recognised in the 2020 financial year or repaid by the Bank before the redemption date in 2021 as part of a voluntary buy-back offer. The cancellation of the existing silent participations result in a reassessment of the cash flows of the hybrid instruments. The reassessment of the cash flows results in carrying and repayment amounts significantly below the nominal value as well as in non-eligibility of these instruments for the regulatory capital as at the 2018 year end. Individual and groups of investors in hybrid instruments have taken legal action against the Bank and, in addition to establishing that their cancellation is invalid, request that they be written up to their nominal value and are claiming compensation for missed interest payments. In the event that, contrary to expectations, the plaintiffs are successful in court, the income statement and ultimately the future capital ratios could be adversely impacted to a significant extent.

If several of the risks presented (including those described in the stress test section) occur in combination with each other, the owners may be required to take additional measures to strengthen capital at all regulatory levels.

Under CRR II further burdens for the capital ratios could result from the proposed changes to the regulatory requirements – partly referred to as "Basel IV" – probably on a gradual basis from 2022 until 2027.

For Hamburg Commercial Bank, stricter rules concerning counterparty risk resulting from Basel IV will be of particular relevance. Hamburg Commercial Bank extensively uses models approved by the supervisory authorities to map counterparty risk (Internal Ratings Based Approach – IRBA). Under Basel IV, it is planned to significantly restrict the use of IRBA models by basing the capital backing more closely on the standardised 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).

ICAAP under the economic perspective/risk-bearing capacity

Hamburg Commercial Bank has implemented the ECB guide for the Internal Capital Adequacy Assessment Process (ICAAP) as at the reporting date. Accordingly, capital adequacy is to be assessed under a normative and an economic perspective. The Bank defines capital adequacy as the ongoing safeguarding of financial stability, in the sense that risks are adequately covered by capital, in order to ensure the implementation of the objectives of the business model. By determining it on a regular basis capital adequacy forms part of the internal reporting and is closely managed and reported to the Bank's supervisory authorities.

The economic perspective serves as a basis for reviewing at a given date whether all material risks are backed by internal capital. Compared to the regulatory perspective (CRR) it is based on a significantly qualified concept of capital and a broadened concept of risk. The measurement of risks is based on refined economic methods and procedures. As part of the monitoring of the risk-bearing capacity Hamburg Commercial Bank regularly compares the total economic capital required for all material risk types quantifiable under internal procedures (overall risk) to the available economic risk coverage potential.

In addition to the regulatory Tier 1 capital modified for economic purposes, the risk coverage potential includes, inter alia, a negative balance comprising unrealised gains and losses on all assets and liabilities. A positive balance and the effects of a positive credit standing are not recognised in compliance with the ICAAP requirements.

Hamburg Commercial Bank analyses its risk-bearing capacity comprehensively on a quarterly basis as well as within the framework of its annual planning process.

The risk coverage potential amounted to € 3.7 billion as at 31 December 2018 (previous year: € 7.5 billion according to regulatory requirements applicable at that time). The decrease is primarily attributable to the amended regulatory requirements described above under the new ECB ICAAP guideline (includes, amongst other things, the discontinuation of the recognition of a positive balance comprising unrealised gains and losses on all assets and liabilities as well as the effects of a positive credit standing).

The overall risk takes into account default risk, market risk, operational risk as well as the liquidity maturity transformation risk as an element of liquidity risk. Economic capital required as an expression of unexpected losses is determined monthly for default, liquidity and market risks in a methodologically consistent manner with a confidence level of 99.9 % and a risk horizon of one year. The economic capital requirements for the individual risk types are aggregated to an overall economic risk. Risk-reducing correlations are not applied for this.

Overall economic risk increased by € 0.2 billion compared to the 2017 year end and amounted to € 1.6 billion as at the reporting date (previous year: € 1.4 billion).

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 amounted to € 0.2 billion as at 31 December 2018 (previous year: € 0.4 billion).

Hamburg Commercial Bank 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. The liquidity value-at-risk (LVaR), as a measure of the economic capital required for liquidity risk, was € 50 million as at 31 December 2018 (previous year: € 46 million). On the other hand, insolvency risk, which is more important for the purposes of managing the liquidity risk in principle, is backed by a buffer of liquid funds. Information on managing insolvency risk is included in the section entitled "Liquidity risk".

Operational risks are determined by means of a modified standard approach, which also takes account of results from the scenario analyses. The corresponding economic capital required amounted to € 0.2 billion as at 31 December 2018 (previous year: € 0.2 billion).

Utilisation of risk coverage potential amounted to 43 % as at the reporting date (previous year: 19 %). The main reasons for the increase in the risk-coverage potential was the conversion to the new accounting standard (IFRS 9) as well as the new regulatory ICAAP requirements and non-inclusion of the risk-reducing second loss guarantee as at Q1 2018. The risk-bearing capacity was ensured at all times during the period under review.

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

ICAAP/risk-bearing capacity of the Group[1)]

(€ bn)	31.12.2018[1)]	31.12.2017
Economic risk coverage potential	**3.7**	**7.5**
Economic capital required	**1.6**	**1.4**
of which for default risks	1.1	0.8
for market risks	0.2	0.4
for liquidity risks	0.1	–
for operational risks	0.2	0.2
Risk coverage potential buffer	**2.1**	**6.1**
Utilisation of risk coverage potential (in %)	**43**	**19**

[1)] The information disclosed as at 31.12.2018 reflects the implementation of the final ICAAP guide published in November 2018.

The results determined under both the economic and normative perspective are reported to the banking supervisory authorities in accordance with the Regulation on Financial Information and Information on the Risk-bearing Capacity (Finanz- und Risikotragfähigkeitsinformationenverordnung, FinaRisikoV).

Scenario calculations

In addition to the above-described economic perspective, compliance with the regulatory capital requirements over a medium-term horizon (at least a 3-year perspective in the base and stress case) under the internal normative perspective is also assessed in accordance with the ECB Guide for the Internal Capital Adequacy Assessment Process (ICAAP). Adherence to the stipulated capital ratios and requirements is checked by means of the quarterly calculation of the regulatory capital ratios as at the reporting date and over a multi-year scenario horizon. These requirements refer explicitly to the capital planning and to dynamic scenarios in the baseline and adverse scenarios (base and downside planning). Whilst all key ratio requirements must be met in principle in the base planning, the capital buffer requirements may also not be complied with temporarily in the downside scenario. The normative approach is not limited to the Pillar I risks recognised by the regulatory capital requirements but also takes account of reciprocal relationships that have an economic effect on the key regulatory ratios.

In addition to stress tests specific to risk types, we also regularly conduct stress tests across all risk types in order to be able to better estimate the effects of potential crises on key parameters such as ICAAP/utilisation of the risk-bearing capacity, regulatory capital ratios and liquidity and thus Hamburg Commercial Bank's overall risk position. Based on observed market developments the Scenario Management Committee approves macroeconomic and segment-specific forecasts for the carrying out of dynamic stress tests. These expected and stress forecasts are also incorporated in different simulation scenarios and presented quarterly to the OBM committee and Overall Management Board.

Significant macroeconomic risks regarding the capital ratios and RWA result from a potential deterioration in the market and risk parameters in the Bank's core markets, including a stronger US dollar. The impact of macroeconomic scenarios, such as a severe economic downturn or a new crisis in the shipping markets, and a historical scenario on the Pillar I and II capital ratios and leverage ratio is regularly calculated.

If the further stabilisation of the shipping industry assumed amongst other things in the planning does not occur or there is a deterioration in the real estate market (especially real estate values) or a significantly weaker macroeconomic environment or significantly stronger USD exchange rate (downside scenario), this would result in a material deterioration in the risk parameters. In the event that this causes a deterioration in the key capital adequacy or SRF parameters or a breach of the SRF guidelines for the relevant MaSan indicators, measures would have to be taken to strengthen the capital ratios after transition into the MaSan early warning phase in order to comply with the internally required parameters and thus the regulatory requirements (Pillar 2 requirement) at the Hamburg Commercial Bank Group level. If capital buffer requirements (Pillar 2 requirement) are not met in such a scenario despite measures being taken, a capital conservation plan would then have to be prepared in accordance with Section 10i (3) of the German Banking Act (KWG). A ratio significantly above the internally set minimum figure of 15 % is expected for the overall capital ratio in the base scenario as well as in the downside scenario for the following year.

In addition, so-called ad hoc stress analyses are performed for purposes of the economic perspective, i.e. the impact of changes in risk parameters is investigated based on the current portfolio for a one year risk horizon.

The results are incorporated in Hamburg Commercial Bank's internal reporting system every quarter and analysed on a regular basis by the Management Board in terms of an action-oriented management dialogue. Besides the review of the capital adequacy for the buffer maintained for risk coverage potential, regulatory capital and liquidity maintained under the economic perspective as at the reporting date and in the different stress scenarios, this analysis is used to discuss the need for options to strengthen the financial stability of Hamburg Commercial Bank.

Hamburg Commercial Bank's recovery plan drawn up in accordance with the Act on the Recovery and Resolution of Credit Institutions (Sanierungs- und Abwicklungsgesetz, SAG) has a comparable objective. It serves both the purpose of the early identification of any resource bottlenecks using appropriate indicators and their elimination in crisis situations by means of pre-defined options. The effectiveness of the options identified, the selected recovery plan warning indicators and related processes are reviewed and 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 and internal guidelines even under stress conditions. In addition, Hamburg Commercial Bank carries out inverse stress tests at least once a year. Scenarios that could endanger Hamburg Commercial Bank's ability to survive are identified for these. This information is also used by Hamburg Commercial Bank's Management Board as guidance for explaining and deciding upon any action required in the event of developments that threaten the Bank's existence.

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

Default risk

Hamburg Commercial Bank breaks down its default risk into credit, settlement, country and equity holding risk.

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

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

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

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

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

Organisation of default risk management

Hamburg Commercial Bank's organisational structure reflects the functional separation of duties between market and back office departments and/or risk controlling, also at Management Board level.

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

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

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

The trading lines for counterparty and issuer risk are monitored by the Group Risk Management division. As part of the trading line monitoring the potential future exposure on currency, interest rate derivatives is recalculated daily for each client on the basis of a 95 % quantile and compared to the respective trading limit.

The Group Risk Management division is also responsible for the independent analysis and monitoring of risks at the portfolio level, independent reporting and management of country risk. This also includes ensuring portfolio transparency and independent business area analysis (including scenario simulations) and the operation of an early warning system at the individual transaction level for identifying commitments on a timely basis that are beginning to show signs of increased risk.

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

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

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

Default risk management

In line with the strategic focus of Hamburg Commercial Bank–as one of the leading bank partners of larger medium-sized enterprises–with lending as its anchor product, default risk accounts for the largest proportion of the Bank's overall risk potential. In order to measure and manage this risk, Group Risk Management uses procedures and methods that are continually reviewed and enhanced to ensure they are appropriate.

Key default risk parameters are the expected and unexpected loss. The expected loss is equivalent to the default which is expected within one year on a given probability of default (PD), loss given default (LGD) and exposure at default (EaD) for a borrower. The EaD is the expected loan amount outstanding taking into account a potential (partial) drawdown of commitments and contingent liabilities that will adversely impact the risk-bearing capacity in the event of a default. The maximum amount, by which an actual loss can exceed the expected loss with a specified probability (99.9 %) within a specified time period (one year) is described as the unexpected loss. PD, LGD and EaD are also relevant risk parameters in this context. Economic capital required is determined for internal management purposes on the basis of the calculation of the equity capital backing in accordance with CRR taking due account of any adjustments that are justified on economic grounds. In addition, institution-specific asset correlations, granularity surcharges for covering existing risk concentrations are taken into account in determining the economic capital required for default risk.

The economic capital required for default risks amounted to € 1.1 billion as at the reporting date (previous year: € 0.8 billion). The increase in the economic capital required for default risk is due to the transition to IFRS 9.

Non-performing exposure (NPE), which is the total of all risk positions of borrowers in default, serves as an important management indicator that has also been defined as a risk guideline in the SRF. The trend in the NPE ratio has been influenced significantly by the introduction of the IFRS 9 accounting standard and the associated fair value accounting. The NPE ratio has decreased significantly in line with expectations. This is due to the disposal of non-performing legacy loans as part of the portfolio transaction, which resulted in a substantial reduction in risk on the Bank's balance sheet. The NPE ratio was 1.6 % as at the reporting date. Further defaults were recognised as a result of adjusting events identified on the basis of knowledge obtained after the reporting date, whereby the NPE ratio remains at around 2.0 % and therefore in line with the strategic objectives even after taking these defaults into account.

In addition, the NPE coverage ratio AC (ratio of total loan loss provisions recognised on the non-performing exposure to the total non-performing exposure) is monitored at the overall bank level as a MaSan indicator. The NPE coverage ratio AC amounted to a solid 57.6 % as at the reporting date. The NPE coverage ratio AC was 61 % at the start of the new year after taking account of the results of the adjusting events and the loan loss provisions recognised for macroeconomic and political risks.

After the portfolio transaction in 2018 Hamburg Commercial Bank AG's NPE ratio decreased significantly at the Group level. Following this substantial improvement in the risk profile of the Bank's loan portfolios the trend of loan loss provisions and the NPE ratio has, in the future, an equivalent weight relative to to the Bank's other relevant management indicators. This also applies in particular in view of the fact that the shipping portfolio, which has hitherto been characterised by a high level of defaults, was significantly reduced.

The syndication of lending transactions also helps to actively shape the composition of the portfolio and align individual financing risks (so-called final takes) to the balance sheet ratios. The Bank subjects all potential new business from a certain volume limit to a market conformity review carried out in a committee and a syndication assessment performed by the credit syndication unit within the Credit Solutions department. The Credit Committee then makes a joint decision together with the credit syndication unit and the deal team sales employees as to whether syndication should be arranged as part of the new business or underwriting process. The Bank's existing portfolio is also reviewed for saleability on a quarterly basis as part of the MaSan procedure (and on an ad hoc basis where appropriate). The Bank amended the syndication process in view of the the rules regarding the business model laid down in IFRS 9 (initial adoption with effect from 01.01.2018). Underwriting financing is recorded based on a model with several accounts so that the final hold is assigned to the "Hold" business model and the syndication portion to the "Other" business model – with a corresponding retroactive effect on the holding category under IFRS 9. Any portfolio syndication activities are checked separately with regard to any non-compliance with the assigned business model.

RATING PROCEDURES, LGD AND CCF

In 2018 Hamburg Commercial Bank AG started a multi-year project to support the regulatory initiative regarding the internal estimate of the risk parameters (Future of the IRB).

IRBA governance was completely overhauled in the previous financial year and further methodological requirements developed (e.g. margin of conservatism, validation requirements). Hamburg Commercial Bank collaborates intensively with other banks in the further development and ongoing validation of various internal rating modules. This is done in the association of Landesbanks via RSU Rating Service Unit GmbH & Co. KG (RSU) and in cooperation with Sparkassen Rating und Risikosysteme GmbH (SR), a subsidiary of the German Savings Bank Association (DSGV).

Hamburg Commercial Bank uses rating modules for banks, corporates, international sub-sovereigns, country and transfer risk, insurance companies, leveraged finance, savings banks standard rating and leasing as well as for special financing for ships, real estate, projects and aircraft. Various qualitative in addition to quantitative characteristics are also used in each rating module. The result is a probability at default (PD) for each borrower and hence allocation to a concrete rating category. The Bank uses an identical rating master scale for all modules which not only allows comparison of differing portfolio segments but also mapping with external ratings.

So-called credit conversion factors (CCF) are calculated empirically and applied to determine the expected drawdown for contingent liabilities and commitments in case of a possible default. The loan amount outstanding weighted by CCF is described as the EaD.

Hamburg Commercial Bank uses a differentiated LGD methodology to forecast the loss given defaults (LGD). Collateral-specific recovery rates and borrower-specific recovery rates are estimated for these based on historic loss information. The respective default amount expected is determined from the EaD using the LGD.

As part of the annual validation process the predictive accuracy of the rating modules is reviewed in the reporting year with regard to the predicted probabilities of default using anonymous, aggregated data and the LGD and CCF procedures are validated in a comparable manner and continually enhanced.

RISK CONCENTRATIONS

Within the framework of regular business segment analyses potential counterparty default risk concentrations, for example with regard to groups of connected clients (GCC), regions or industrial sectors in a broader sense, are identified and their trend is monitored. At the 2018 year end, Hamburg Commercial Bank's material concentrations of credit risk were in the real estate portfolio, which accounted for 24 % of the overall portfolio (previous year: 20 %) and in the shipping portfolio, which accounted for 9 % of the overall portfolio (previous year: 14 %). Other concentration risks relate to the US dollar business, which accounted for 10 % of the overall portfolio (previous year: 15 %). Following the winding down of the portfolio, especially in the area of ship financing denominated in US dollars, the sensitivity of the capital and liquidity ratios to trends in the shipping market and the EUR/USD exchange rate has also decreased and is therefore no longer relevant.

There is an internal process, which ensures compliance with the regulatory requirements, for monitoring large exposure limits in accordance with Article 395 CRR. As a supplementary measure, material counterparty concentrations in the portfolio are identified by means of a risk-based parameter (risk of loss as the sum of the expected and unexpected loss) and reported quarterly to the Management Board and Risk Committee. Net rating-based upper limits are applied to new business to prevent future counterparty concentrations.

Country risk limits are an additional management dimension within the management of risk concentrations. Country limits are set for country risk concentrations at the Hamburg Commercial Bank Group level. Utilisation of the limits is monitored continuously and centrally by country risk management.

EQUITY HOLDING RISK

Hamburg Commercial Bank has significantly reduced its equity holding portfolio and thereby equity holding risk over recent years, thus successfully bringing it in line with the Bank's strategic realignment. New equity holdings are only acquired if they meet Hamburg Commercial Bank's strategic objectives. The opportunities and risks associated with a potential equity holding are analysed extensively prior to the conclusion of the transaction.

A regular company valuation represents an important instrument for monitoring and managing equity holding risk. Impairment tests are performed at least once a year on all equity holdings of Hamburg Commercial Bank. Important equity holdings are subject to a more detailed analysis in this context.

Furthermore, the articles of association and by-laws are formulated so as to ensure that the most intensive management possible can be exercised for the benefit of Hamburg Commercial Bank.

Hamburg Commercial Bank has issued a hard letter of comfort for three companies in the equity holdings portfolio and is therefore liable for the liabilities of these companies. These letters have so far not given rise to any liability on the part of Hamburg Commercial Bank. Hamburg Commercial Bank has concluded a profit-and-loss transfer agreement with a further two equity holdings.

MANAGEMENT OF DEFAULT RISK IN PRICING AND ACTUAL COSTING

Hamburg Commercial Bank applies a uniform method across the Bank for the pricing of lending transactions through calculating the present value of the expected and unexpected losses arising on default risk positions. In addition to liquidity and standard processing costs, the rating, LGD and CCF risk parameters determined internally on an individual transaction basis are incorporated in the pricing by means of the standard risk costs. In the same way, an actual costing (profit centre accounting) is made for all transactions on a monthly basis, taking the above-mentioned cost elements into account. Standard risk costs and the resulting contribution margins are determined based on the current risk parameters of the individual transactions. Furthermore, utilisation of the capital commitment set as part of the Bank's annual plan is determined regularly at the division level for the purposes of managing default risk. When bottleneck resources are overdrawn, new transactions and prolongations are subject to stricter approval requirements.

DEFAULT RISK EXPOSURE

The figures in the following tables showing default risk exposure are based on the exposure at default (EaD). The EaD corresponds to the volume of loan receivables, securities, equity holdings, derivative financial instruments (positive market values after netting) and off-balance-sheet transactions (taking credit conversion factors into account). Risk-mitigating effects (such as recognition of collateral) are not included in EaD. Total EaD amounted to € 56,641 million as at 31 December 2018.

The EaD broken down by internal rating categories is presented in the following table. EaD with an investment grade rating (rating category 1 to 5) accounted for 73 % of the total exposure at the Group level (previous year: 68 %).

Default risk structure by rating category[1)2)]

(€ m)	31.12.2018			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
1 (AAAA) bis 1 (AA+):	13,389	–	3,648	17,037
1 (AA) to 1 (A–)	7,992	–	2,104	10,096
2 to 5	14,005	–	175	14,180
6 to 9	10,642	–	1	10,643
10 to 12	1,848	–	–	1,848
13 to 15	1,539	–	5	1,544
16 to 18 (default categories)	699	183	–	882
Other[3)]	92	–	319	411
Total	**50,207**	**183**	**6,251**	**56,641**

1) The information disclosed as at 31 December 2018 has been prepared in accordance with IFRS 9 and does not include further adjustments on the basis of knowledge obtained after the reporting date, which were recognised as defaults. Information and explanations regarding the comparative period have not been adjusted and are the amounts determined under IAS 39 as at the described reporting date.

2) Mean default probabilities (in %): 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

3) 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)2)]

(€ m)	31.12.2017				
	Core Bank	Non-Core Bank	Other and Consolidation	Total	Of which covered by the guarantee (in %)
1 (AAAA) to 1 (AA+)	16,255	79	5,615	21,949	6
1 (AA) to 1 (A–)	7,160	239	2,284	9,683	11
2 to 5	16,158	680	444	17,282	11
6 to 9	10,732	1,009	1	11,742	21
10 to 12	1,425	228	–	1,653	54
13 to 15	1,151	845	3	1,999	59
16 to 18 (default categories)	840	6,649	–	7,489	78
Other[2)]	4	88	331	423	–
Total	**53,725**	**9,818**	**8,678**	**72,220**	**20**

1) Mean default probabilities (in %): 1 (AAAA) 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.

EaD broken down by sectors important for Hamburg Commercial Bank is presented in the following table:

Default risk structure by sector[1)]

(€ m)	31.12.2018			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Industry	7,930	7	–	7,937
Shipping	4,999	137	–	5,136
Trade and transportation	2,836	–	–	2,836
Credit institutions	3,603	–	3,276	6,879
Other financial institutions	2,135	–	16	2,151
Land and buildings	10,875	39	–	10,914
Other services	4,528	–	401	4,929
Public sector	12,912	–	2,546	15,458
Private households	389	–	13	402
Other	–	–	–	–
Total	**50,207**	**183**	**6,251**	**56,641**

[1)] The information disclosed as at 31 December 2018 has been prepared in accordance with IFRS 9 and does not include further adjustments on the basis of knowledge obtained after the reporting date, which were recognised as defaults. Information and explanations regarding the comparative period have not been adjusted and are the amounts determined under IAS 39 as at the stated reporting date.

Default risk structure by sector

(€ m)	31.12.2017			
	Core Bank	Non-Core Bank	Other and consolidation	Total
Industry	7,692	977	–	8,669
Shipping	5,056	4,170	–	9,226
Trade and transportation	3,123	322	–	3,445
Credit institutions	6,340	209	4,340	10,889
Other financial institutions	1,904	825	24	2,753
Land and buildings	9,595	2,262	–	11,857
Other services	4,686	392	542	5,620
Public sector	15,042	373	3,757	19,172
Private households	289	286	14	589
Other	–	–	–	–
Total	**53,725**	**9,818**	**8,678**	**72,220**

The following table shows the EaD broken down by residual maturities:

Default risk structure by residual maturity[1]

(€ m)	31.12.2018			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Up to 3 months	9,717	–	728	10,445
> 3 months to 6 months	1,864	–	156	2,020
> 6 months to 1 year	2,841	2	196	3,039
> 1 year to 5 years	20,944	4	3,379	24,327
> 5 years to 10 years	9,660	176	1,431	11,267
> 10 years	5,182	–	362	5,544
Other	–	–	–	–
Total	**50,207**	**183**	**6,251**	**56,641**

[1] The information disclosed as at 31 December 2018 has been prepared in accordance with IFRS 9 and does not include further adjustments on the basis of knowledge obtained after the reporting date, which were recognised as defaults. Information and explanations regarding the comparative period have not been adjusted and are the amounts determined under IAS 39 as at the stated reporting date.

Default risk structure by residual maturity

(€ m)	31.12.2017			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Up to 3 months	12,813	2,054	525	15,393
> 3 months to 6 months	1,528	403	354	2,285
> 6 months to 1 year	3,322	955	516	4,793
> 1 year to 5 years	20,440	3,096	4,776	28,312
> 5 years to 10 years	10,399	1,773	2,132	14,304
> 10 years	5,223	1,535	374	7,132
Other	–	–	–	–
Total	**53,725**	**9,818**	**8,678**	**72,220**

The following table provides an overview of the foreign exposure by region, which reached € 16.689 million as at 31 December 2018 (previous year: € 23,286 million).

Foreign exposure by region[1)]

(€ m)	31.12.2018			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Eurozone	7,889	8	868	8,765
Western Europe	3,481	39	905	4,425
Eastern Europe	245	2	–	247
Africa	530	49	–	579
North America	526	–	–	526
Latin America	401	–	–	401
Middle East	28	5	–	33
Asia-Pacific region	1,057	79	–	1,136
International organisations	69	–	508	577
Total	**14,226**	**182**	**2,281**	**16,689**

[1)] The information disclosed as at 31 December 2018 has been prepared in accordance with IFRS 9. Information and explanations regarding the comparative period have not been adjusted and are the amounts determined under IAS 39 as at the described reporting date.

Foreign exposure by region

(€ m)	31.12.2017			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Eurozone	7,515	2,648	1,226	11,389
Western Europe	3,232	1,557	1,190	5,979
Eastern Europe	296	446	–	742
Africa	543	263	–	806
North America	413	385	–	798
Latin America	262	191	–	453
Middle East	38	334	–	372
Asia-Pacific region	1,210	804	–	2,014
International organisations	129	–	604	733
Total	**13,638**	**6,628**	**3,020**	**23,286**

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. The country relevant for transfer risk is the country from where Hamburg Commercial Bank receives the cash flows.

A number of European countries are subject to increased monitoring due to their unfavourable fiscal and economic data. These include in particular Greece, Italy, Portugal and Spain.

As a result of economic developments and the EU sanctions, the exposure to Russia and Turkey is also being monitored more closely.

The following table shows the EaD of the exposures to the European countries shown.

Exposure at Default in selected European countries[1)]

(€ m)	Public sector		Banks		Corporates/Other		Total	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Greece	–	–	–	–	337	940	337	940
Italy	15	19	–	–	270	574	286	593
Croatia	–	–	–	–	87	94	88	94
Portugal	56	180	–	–	96	52	153	232
Russia	–	–	–	1	28	47	28	48
Spain	93	79	30	36	329	918	451	1,033
Turkey	–	–	27	59	31	173	58	232
Cyprus	–	–	–	–	385	434	385	434
Total	**164**	**278**	**57**	**96**	**1,563**	**3,232**	**1,786**	**3,605**

1) The information disclosed as at 31 December 2018 has been prepared in accordance with IFRS 9. Information and explanations regarding the comparative period have not been adjusted and are the amounts determined under IAS 39 as at the described reporting date.

The previously low direct country exposure to the countries shown above was further reduced in 2018. The commitments in the Corporates/Other sector for Greece and Turkey relate primarily to ship financing arrangements, which do not entail transfer risk due to the existing collateral. The exposure to Great Britain (€ 2,215 million) is also being monitored more closely due to a possible Brexit.

LOAN LOSS PROVISIONS

Hamburg Commercial Bank pays the most attention to default risk within the context of risk management. Impairments of a loan commitment are covered by the recognition of specific loan loss provisions for loans and advances and provisions for contingent liabilities in the amount of the potential loss in accordance with Group-wide standards. Furthermore, Hamburg Commercial Bank recognises loan loss provisions under Stages 1 and 2 to cover future risks, the amount of which is not yet known to the Bank.

All restructuring and workout commitments, as well as intensified loan management commitments with a rating greater or equal to 13, are subject every quarter to a comprehensive two-step review process. In a first step, a review is carried out on the basis of objective criteria (so-called trigger events) to determine whether the receivable could be impaired (impairment identification). If this is the case, the loans identified are reviewed in a second step to determine whether a loan loss provision is actually required and the amount thereof (impairment measurement). Loan loss provisions are only recognised for transactions categorised as AC under IFRS 9. As at 31 December 2018, there was no longer any hedging effect of the second loss guarantee (see Note 2).

The 2017 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. The amount of the loan loss provision is calculated by deducting the present value of all expected future incoming payments from the IFRS carrying amount of the receivable. The expected incoming payments comprise in particular all expected interest and redemption payments, as well as proceeds from the liquidation of collateral. The following table provides an overview broken down by segment.

Changes in loan loss provisions in the lending business

(€ m)	01.01.–31.12.2018								
	Stage 3 loan loss-provisions (former SLLP/ provisions)	Stages 1 and 2 loan loss provisions (former GLLP)	Loss provisions recognised for financial investments	Loan loss provisions (LLP) before currency translation income and compensation	Currency translation income on loan loss provisions	Compen-sation item	Total	Hedging effect of credit derivative second loss guarantee	LLP including hedging effect of credit derivative
Corporate Clients	–45	–9	–	–54	–	–	–54	–	–54
Shipping	–178	–26	–	–204	–1	–	–205	–	–205
Real Estate Clients	5	–60	–	–55	–	–	–55	–	–55
Treasury & Markets	–	14	2	16	–	–	16	–	16
Total Core Bank	**–218**	**–81**	**2**	**–297**	**–1**	**–**	**–298**	**–**	**–298**
Non-Core Bank	**5**	**–**	**–**	**5**	**2**	**–**	**7**	**–**	**7**
Other and Consolidation	**4**	**1**	**–**	**5**	**–**	**–30**	**–25**	**–51**	**–76**
Group	**–209**	**–80**	**2**	**–287**	**1**	**–30**	**–316**	**–51**	**–367**

[1] The information disclosed as at 31 December 2018 has been prepared in accordance with IFRS 9. Information and explanations regarding the comparative period have not been adjusted and are the amounts determined under IAS 39 as at the described reporting date.

Changes in loan loss provisions in the lending business

(€ m)	01.01. –31.12.2017								
	Specific loan loss provisions/ provisions	General loan loss provisions	Loss provisions recognised for financial investments	Loan loss provisions (LLP) before currency translation income and compensation	Currency translation income on loan loss provisions	Compensa-tion item	Total	Hedging ef-fect of credit derivative second loss guarantee	LLP including hedging effect of credit derivative
Corporate Clients	–47	4	–	–43	–	–10	–53	–	–53
Shipping	–115	159	–	44	5	14	63	–	63
Real Estate Clients	3	–	–	3	–	–1	2	–	2
Treasury & Markets	–	1	–	1	–	–	1	–	1
Total Core Bank	**–159**	**164**	**–**	**5**	**5**	**3**	**13**	**–**	**13**
Non-Core Bank	**–1,512**	**99**	**–**	**–1,413**	**39**	**–731**	**–2,105**	**810**	**–1,295**
Other and Consolidation	**6**	**–**	**–**	**6**	**–**	**–**	**6**	**–**	**6**
Group	**–1,665**	**263**	**–**	**–1,402**	**44**	**–728**	**–2,086**	**810**	**–1,276**

Loan loss provisions came to € –287 million as at the reporting date (same period of the previous year: € –1,402 million).

The developments are due to the recognition of specific loan loss provisions in the Shipping division, which for the most part relate to restructuring measures undertaken for a significant loan exposure. Furthermore, the increasing geopolitical uncertainties are reflected in the recognition of general loan loss provisions, which are also partially included in the Stage 3 loan loss provisions in accordance with the IFRS 9 classification. The Bank therefore recognises provisions due to the increasing probability that the downside scenarios will materialise, which is increased by the threat of a disorderly Brexit and the possible escalation of the trade war between the USA and China, and may have an adverse impact on economic developments in Europe and in the industry sectors relevant for the Bank (especially real estate and shipping). In addition, the Bank has recognised appropriate loan loss provisions due to the emission targets for ships that are applicable from 2020. In the previous year, significantly higher amounts allocated for legacy loan exposures, especially in the shipping portfolio of the Non-Core Bank, had a considerable negative impact on the Group net result.

After foreign exchange effects and compensation and taking account of the hedging effect under the credit derivative loan loss provisions amounted to € –367 million (same period in the previous year: € –1,276 million). The loss rate in the Group amounted to 1.0 % in the reporting year (previous year: 4.31 %).

The loss ratio is calculated as the ratio of the actual defaults incurred to the financial instruments not measured at fair value (only AC). The total amount of defaults in 2018 was € 470 million (previous year: € 3,114 million), financial instruments not measured at fair value amounted to € 47,111 million (previous year: € 72,254 million credit exposure). The individual elements of loan loss provisions are shown in the following table:

Total loan loss provisions[1]

(€ m)	2018	2017
Loans and advances to customers AC	30,057	39,174
Loans and advances to banks AC	3,000	3,838
Volume of impaired loans (gross carrying amount Stage 3)	955	6,813
Total loan loss provisions (Stage 3, formerly SLLP) for loans and advances to customers	–496	–4,355
Total loan loss provisions (Stages 1 and 2, formerly GLLP) for loans and advances to customers	–335	–138
Total loan loss provisions (Stages 1 and 2, formerly GLLP) for loans and advances to banks	–	–1
Total loan loss provisions for balance sheet items	**–831**	**–4,494**
Provisions for Stage 3, formerly individual risks in the lending business	–48	–60
Provisions for Stages 1 and 2, formerly portfolio risks in the lending business	–12	–7
Total loan loss provisions for off-balance sheet items	**–60**	**–67**
Total loan loss provisions (before compensation item)	**–891**	**–4,561**
Compensation item	–	5,181
Total loan loss provisions (including compensation item)	**–891**	**620**

[1] Comparability with the previous year is only possible to a limited extent due to the transition from accounting under IAS 39 to accounting under IFRS 9.

Total loan loss provisions determined under IFRS 9 amounted to € –891 million as at 31 December 2018 (previous year under IAS 39: € 620 million after compensation under the second loss guarantee). Total Stage 3 loan loss provisions (formerly SLLP) comprise total loan loss provisions of € –496 million for loans and advances to customers and banks (previous year under IAS 39: € –4,355 million), loan loss provisions for impaired creditworthiness (LECL, stage 3), provisions of € –48 million (previous year under IAS 39: SLLP of € –39 million for contingent liabilities and irrevocable loan commitments) and SLLP of € –21 million for other off-balance sheet transactions for the previous year and amounted in total to € –544 million (previous year under IAS 39: € –4,415 million).

Stage 1 and 2 loan loss provisions (formerly GLLP) amounted in total to € –347 million (previous year under IAS 39: € –146 million) and comprise 12 months LECL, LECL Stage 2 loan loss provisions of € –335 million (previous year under IAS 39: GLLP of € –139 million for loans and advances to customers and banks) and 12 months LECL, Stage 2, provisions of € –12 million (previous year under IAS 39: € –7 million PoWB for contingent liabilities and irrevocable loan commitments).

Details regarding the total loan loss provisions are presented in Notes 15, 27 and 41 in the notes to the Group financial statements.

PLANNING FOR LOAN LOSS PROVISIONS

Loan loss provisions are planned as part of the annual Bank plan under the plan assumptions specified therein and includes the annual changes in the amounts of the specific and Stages 1 and 2 loan loss provisions including new business.

In planning additions to as well as utilisations and reversals of loan loss provisions Hamburg Commercial Bank mainly relies on models that simulate the expected loss at the individual transaction level over the planning period based on parameters specific to the transaction. Scenario analyses based on cash flows and historical data regarding changes in loan loss provisions based on the expected loss are also taken into account.

Market risk

Market risk represents the potential loss that can arise as a result of adverse changes in market values on positions held in our trading and banking book. Market movements relevant to the Hamburg Commercial Bank are changes in interest rates and credit spreads (interest rate risk), exchange rates (foreign exchange risk) as well as share prices, indices and fund prices (equity risk) including their volatilities.

Organisation of market risk management

The Management Board determines the methods and processes for measuring, limiting and managing market risk and budgets a proportion for market risk from a limit that covers all risk types. Against the background of this upper loss limit, the risks of all business bearing market risk are limited by a dynamic system of loss and risk limits.

Market risk was actively managed in the Treasury & Markets division in the reporting year. The Bank Management division performs the central management function for interest rate and foreign exchange risks in the banking book. The Overall Management Board is responsible for selected strategic positions exposed to market risk.

An organisational separation between market risk controlling, financial controlling as well as settlement and control on the one hand and the trading divisions responsible for positions on the other is ensured at all levels in accordance with

MaRisk. All major methodological and operational risk measurement and monitoring tasks are consolidated in the Group Risk Management division.

Market risk management

MARKET RISK MEASUREMENT AND LIMITATION

Our system for measuring and managing market risk is based on the economic daily profit and loss and on a value-at-risk approach. The economic profit and loss is calculated from the change in present values compared to the end of the previous year. The market risk of a position represents the loss in value (in euros) which will not be exceeded until the position is hedged or realised within a predetermined period with a predetermined probability.

The value-at-risk (VaR) is determined by Hamburg Commercial Bank using the historical simulation method. It is calculated for the entire Group based on a confidence level of 99.0 % and a holding period of one day for a historical observation period of 250 equally weighted trading days. The VaR model used and continuously enhanced by Hamburg Commercial Bank contains all of the Bank’s significant market risks in an adequate form.

The material market risks at Hamburg Commercial Bank are primarily interest rate risk (including credit spread risk) and foreign exchange risk. In addition to these risk types, the VaR of Hamburg Commercial Bank also covers equity risk for both the trading book and banking book. The basis risk is also taken into account in determining the VaR. Basis risk constitutes the risk of a potential loss or profit resulting from changes in the price/interest rate relationship of similar financial products within a portfolio. Limits are set by a VaR limit for the Bank’s overall market risk and by a stop loss limit for any cumulative losses. There are clearly defined and fast processes for limit adjustments and overdrafts. As part of the VaR approach limits are also set for the overall VaR in the trading book, the interest rate VaR in the banking book and the credit spread VaR. The present value basis used in the measurement of market risk is expanded by an earnings-oriented perspective, under which the change in average interest income is simulated in different scenarios up to a five-year time horizon.

Where necessary, Hamburg Commercial Bank enters into hedging transactions to manage or reduce market risk in order to offset the impact of unfavourable market movements on its own positions. Derivative financial instruments in particular, such as interest rate and cross-currency interest rate swaps, for example, are used as hedging instruments. The effects of the hedging transactions entered into are included in the VaR disclosed. Further information on this and the type and categories of the hedging instruments and hedging relationships entered into by Hamburg Commercial Bank as well as the type of risks hedged is presented in the Notes. In particular we refer to Section I. F) of Note 7 "Accounting policies", Note 10 " Result from hedging", Note 28 "Hedge accounting under IFRS 9" and Note 59 "Report on business in derivatives".

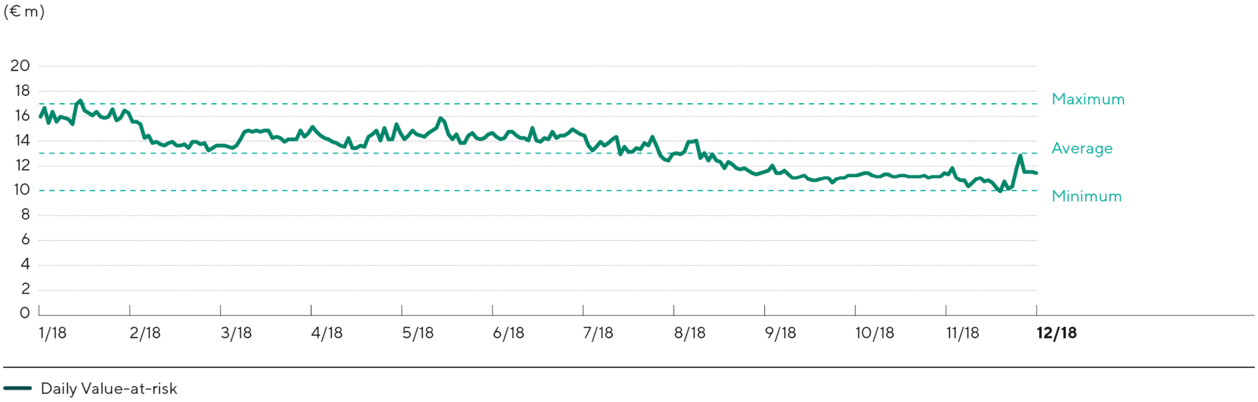
Market risks arising from Hamburg Commercial Bank's lending business and liabilities are transferred to the trading divisions and taken into account in the corresponding risk positions. There they are managed as part of a proactive portfolio management process and hedged through external transactions.

Positions are assigned to the banking and trading books on the basis of clearly defined guidelines, especially with regard to holding periods permitted in the trading book. The assignment of individual positions to the relevant book are clearly identifiable in the market risk systems. Different processes and controls were established to meet the requirements for proper management of the trading book, which are reviewed for appropriateness on a regular basis.

DAILY VALUE-AT-RISK DURING THE YEAR UNDER REVIEW

The following chart shows the movement in the daily VaR for the total trading and banking book positions of Hamburg Commercial Bank over the course of 2018.

Daily Value-at-risk in the course of 2018



The daily market risk of the trading book positions was € 0.5 million and that of the banking book positions € 11.3 million as at 31 December 2018. The overall market risk, which cannot be derived from adding the VaR of the trading and banking book positions due to risk-mitigating correlation effects, amounted to € 11.4 million. Due to the completed integration of the residual risks in the former Non-Core Bank into the Core Bank during the course of 2018 separate disclosure for these two segments is no longer meaningful. Furthermore, in addition to the risk determined by the system, the Value at Risk of the Hamburg Commercial Bank includes a VaR add-on of € 1.4 million for residual risks for corporate bonds, Pfandbriefe and government bonds (only included at the Hamburg Commercial Bank Group level) as at 31 December 2018.

The following table shows the change in overall VaR by individual market risk type. The maximum and minimum represent the range over which the respective risk amount moved over the course of the year under review

Daily value-at-risk of the Group

(€ m)	Interest rate risk[1]		Credit spread risk[1]		Foreign exchange risk		Equity risk		Total[2]	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Average	5.6	5.2	7.3	15.6	8.9	11.1	1.2	1.2	13.3	20.0
Maximum	7.1	9.7	9.3	26.7	14.9	20.8	1.9	1.6	17.2	33.7
Minimum	3.8	2.9	5.9	8.1	3.3	0.8	0.7	0.8	9.9	9.9
Period end amount	5.8	5.3	6.1	9.1	4.2	14.5	0.8	1.5	11.4	16.7

[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 Hamburg Commercial Bank.
[2] Due to correlations the VaR does not result from adding up individual values.

The market risk of the Hamburg Commercial Bank is primarily characterised by interest rate and foreign exchange risk arising from the lending business, funding and the trading book, which predominantly contains positions resulting from trading in interest rate and currency derivatives with customers and bond trading. Market risk also includes credit spread risk on securities held in the liquidity buffer and cover pool portfolios that have good credit quality.

Market risk has continued to decrease in 2018. There are significant decreases in credit spread and currency risk across risk types. A key factor in the reduction in the credit spread risk was the winding down of the securities portfolios held in the liquidity buffer, in Treasury and the former Non-Core Bank. Currency risk decreased primarily as a result of the reduction in mapping differences between accounting and risk measurement in the context of the transformation of the privatised bank.

BACKTESTING

Hamburg Commercial Bank performs regular backtests to verify the appropriateness of its VaR forecasts. On the assumption of unchanged positions, the daily profit and loss achieved in theory due to the market developments observed are compared with the VaR values of the previous day, which were forecast using historical simulation. Based on the assumption of the confidence level of 99.0 % applied by Hamburg Commercial Bank, up to four outliers indicate that the forecasting quality for market risks is satisfactory. This threshold was maintained at all times at the Hamburg Commercial Bank Group level in 2018.

STRESS TESTS

In addition to the limit-based management of the daily VaR, stress tests are performed that analyse the effects of unusual market fluctuations on the net present value of the Bank's positions.

Hamburg Commercial Bank makes a distinction for market risk between standardised, historical and hypothetical stress scenarios. Whereas standardised scenarios are defined for specific risk types (e.g. shift in or rotation of the interest rate curve), historical and hypothetical stress tests apply to several market risk factors at the same time. In this regard historical scenarios actually map correlations between risk factors that occurred in the past, whereas hypothetical scenarios are based on fictitious changes in risk factors. With regard to the hypothetical scenarios a distinction is also made between economic scenarios that simulate a downturn in the macroeconomic environment and portfolio-specific scenarios that can represent a potential threat for the value of individual sub-portfolios of Hamburg Commercial Bank. The hypothetical scenarios are periodically reviewed and adjusted where necessary depending on changes in the market environment.

INSTRUMENTS FOR MANAGING MARKET RISK AS PART OF THE ACCOUNTING FOR HEDGING RELATIONSHIPS

The Treasury & Markets division also uses derivative financial instruments to manage market risk arising from loans and advances and liabilities as well as securities. Interest rate swaps and other interest rate or currency swaps are used to hedge the interest rate and foreign exchange risk arising from the underlying transactions. Market risks can be hedged at the micro, portfolio and macro level.

Changes in the value of derivatives are always recognised through profit or loss due to the FVPL classification. If underlying transactions classified as AC or FVOCIR are hedged by derivatives, this gives rise to a distortion in the income statement that is not consistent with the economic facts. One way of avoiding these distortions is to use fair value hedge accounting. In fair value hedge accounting, the changes in value of hedged items which are attributable to the hedged risk are recognised through profit or loss. In so doing, the Bank only takes account of hedges of the fair value against interest rate risk. Fixed-interest rate loans, issued instruments and securities positions are designated as underlying transactions (hedged items), while only external interest rate and interest rate currency swaps are designated as hedging instruments. Hamburg Commercial Bank recognises appropriate hedges of underlying transactions by external derivatives under portfolio fair value hedge accounting as well as micro hedge accounting in individual cases, insofar as the requirements of IFRS 9 are met.

Liquidity risk

Hamburg Commercial Bank's internal liquidity management represents a core component of the Internal Liquidity Adequacy Assessment Process (ILAAP) New ILAAP requirements were published as part of an ECB guide in November 2018. These have already been largely implemented as at 31 December 2018, final implementation will take place in 2019.

A distinction is made in the ILAAP between two approaches - the normative perspective and the economic perspective. The normative perspective is an assessment of the ability to fulfil all regulatory, supervisory and in part internal liquidity requirements and guidelines today and in the future and covers a multi-year assessment period. The objective is the forward-looking assessment of liquidity adequacy. In addition to a baseline scenario, adverse scenarios are also to be taken into account in forecasting the parameters.

Conversely, the economic perspective ensures that all material risks that may negatively affect solvency, are identified, quantified and covered by internal liquidity, so that the business strategy can be pursued continuously and the continuity of the institution is maintained at all times. The objective of the economic perspective is to manage economic risks and ensure liquidity adequacy through stress test programs. Only internal parameters (Pillar II ratios) are considered from today's perspective under the economic perspective, i.e. on the basis of the current balance sheet. Any structural events occurring at the Bank or in the environment are taken into account. A distinction is made between insolvency risk and liquidity transformation risk in the internal risk management process.

Insolvency risk refers to the risk that present or future payment obligations cannot be met in part or in full. The key driver of this liquidity risk is the cash flow structure in the liquidity development report, which is determined by the assets (maturity/currency structure) and liabilities (funding structure by maturity/currency/investor).

Liquidity maturity transformation risk refers to the risk that a loss will result from a mismatch in the contractual maturities of assets and liabilities, the so-called liquidity maturity transformation position, and from the change in the Bank's refinancing surcharge.

Organisation of liquidity risk management
Strategic liquidity management is the responsibility of the Bank Management division. The objective of liquidity management is to ensure the solvency of Hamburg Commercial Bank at all times, at all locations and in all currencies, to adhere to the regulatory liquidity ratios, to manage the marketability of the liquid assets of the liquidity buffer and to avoid concentration risks in the refinancing structure. The Treasury & Markets division is operationally responsible for funding and marketing.

The Group Risk Management division is responsible for the methods used to measure and limit liquidity risk within the Group and performs daily risk measurement and limit monitoring. Bank Management uses the risk measurement results to support it in managing liquidity for all maturity bands and enable it to counter possible risks at an early stage.

The OBM committee is the central committee responsible for managing the resource liquidity and is assisted by the Credit Committee in this task by means of an active portfolio management at the material individual transaction level.

Hamburg Commercial Bank has a liquidity contingency plan and regulated procedures and responsibilities in place in the event of a liquidity crisis. Institution-specific, risk-based and capital market-oriented early warning indicators are also taken into account as part of the contingency process in order to avert a liquidity emergency. The liquidity contingency plan is closely linked to the Recovery Plan as defined in SAG.

Liquidity risk management

MEASUREMENT AND LIMITATION OF LIQUIDITY RISK
The transactions in the Group impacting liquidity are presented as cash flows and the resultant inflows and outflows allocated to maturity bands (liquidity development report) for the purposes of measuring insolvency risk or funding requirements. The difference between inflows and outflows represents a liquidity surplus or deficit (gap) in the relevant maturity bands. The gaps are are shown on a cumulative basis from day one to twelve months in order to map future liquidity requirements. They are compared to the respective liquidity potential which is applied to close the cumulative gaps of the individual maturity bands and consequently represents the respective limit for insolvency risk. The net liquidity position, which shows the extent of the insolvency risk, is determined as the net amount from the gaps and the respective liquidity potential.

In addition to all on-balance sheet business, loan commitments already granted, guarantees, transactions with forward value dates and other off-balance sheet transactions are incorporated in the liquidity development report. Maturity scenarios are used for a number of positions to map economic maturities more effectively. In doing so any possible minimum levels of deposits as well as liquidation periods and realisation amounts of assets, for example, are modelled conservatively as a matter of principle. The modelling assumptions used are periodically reviewed, which is also required under MaRisk.

The liquidity potential available to close gaps is composed of a securities portfolio held as a precaution in the event of a crisis (liquidity buffer), other securities according to how liquid they are and industrial loans eligible for refinancing with central banks. Most of the portfolio of securities is invested in liquid markets and can be liquidated via the refinancing channels, namely central banks, Eurex repo market, bilateral repo market or the cash market.

The components of the liquidity potential – such as the liquidity buffer required under MaRisk for example – are monitored continuously and validated in accordance with internal and external minimum requirements.

The liquidity-value-at-risk (LVaR) as a reflection of liquidity maturity transformation risk is calculated monthly through historical simulation (confidence level of 99.9 %) of the liquidity spreads and their present value effects on transactions, which would be theoretically necessary to immediately close the current maturity transformation position. LVaR limits are set at Group level and are a part of the risk-bearing capacity concept.

LIQUIDITY MANAGEMENT
The short-term liquidity base and regulatory liquidity ratios are operationally managed by the Bank Management division based on general parameters specified by the Treasury & Markets division. In addition to the regulatory requirements the liquidity development report is relevant amongst other things for determining these general parameters. The definition of or change to individual parameters or the framework is decided by the OBM committee or the Management Board. This places Hamburg Commercial Bank in the position to react flexibly to market developments.

Hamburg Commercial Bank uses the so-called expected case liquidity development report and stress case forecast, which contain expected cash flows and are prepared for a period extending beyond the current financial year, as the basis for managing the medium-term liquidity base. This tool is used to forecast how the worst stress case and/or stress case liquidity development report develops over time.

Insolvency risk over more than one year is managed by means of the portfolio/liquidity development report. It shows the pure maturity mismatches in the base case.

The collateral pool of Hamburg Commercial Bank consisting of cash balances, securities and loan receivables that are eligible for funding is coordinated by Bank Management in order to be able to utilise the potential for secured funding in the best possible manner.

In the event that this causes a deterioration in the relevant MaSan indicators under the SRF, measures would have to be taken to strengthen the liquidity position after transition into the MaSan early warning phase in order to comply with the internally required parameters and thus the regulatory requirements (Pillar 2 requirement) at the Hamburg Commercial Bank Group level.

STRESS TESTS

The selection of our stress tests is the result of an analysis of historical events and hypothetical scenarios. The selection is reviewed at least on an annual basis and adapted to current developments where necessary.

Within the different stress modelling processes additional market-specific scenarios (e.g. rating downgrade of Hamburg Commercial Bank, capital market rumours) are assessed for insolvency risk on a monthly basis in addition to the daily calculation of the stress case liquidity development report. A stressed US dollar (gradual appreciation) is taken into account in the scenarios market liquidity crisis and severe economic downturn.

Within the framework of a stress test for the liquidity maturity transformation risk an analysis is carried out to determine how the LVaR changes on increasing liquidity spreads and stressed liquidity gaps.

Furthermore, events that could have a critical impact on Hamburg Commercial Bank's solvency were analysed in the reporting year within the framework of the periodic implementation of inverse stress tests.

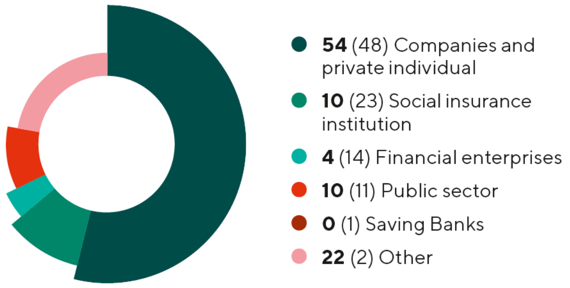
RISK CONCENTRATIONS

Hamburg Commercial Bank has established a monitoring system for managing concentrations of both asset and liability instruments. Special emphasis is placed on deposits that are analysed and reported on with regard to the depositor structure (investor, sectors), maturities (original and residual maturities). Depositor concentration was reduced significantly in 2018 compared to the previous year. The ten largest depositors account for around 17 % of total deposits. (31.12.2017: 29 %). The deposit structure by sector has also developed positively in 2018. The proportion of retail deposits increased to 19 % (31.12.2017: <2 %). The proportion of institutional investors was 3.6 % as at 31 December 2018 (31.12.2017: 85 % based on a broader definition). Based on the maturity structure the proportion of deposits payable on demand of 44.5 % is still high (31.12.2017: 44.3 %).

The following chart shows the structure of our deposits by sector:

Depositor structure as at 31 December 2018

(%, previous year figures in brackets)



In addition to the analysis of the depositor structure with regard to existing depositor concentrations, risk concentrations are examined with regard to the US dollar asset/liability position. For the purposes of analysing the dependency on the US dollar, a US dollar liquidity development report is additionally prepared and sensitivity analyses and a US dollar stress test are performed. The risk has decreased significantly compared to the previous year due the reduction in US dollar assets.

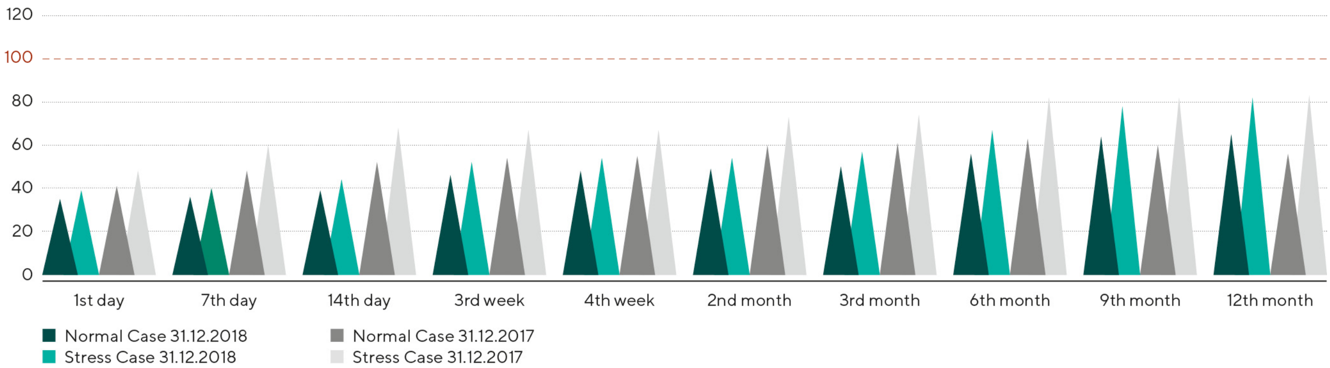
Quantification of liquidity risk

The following chart shows the relative utilisation levels of the liquidity potential for individual cumulative liquidity gaps in the normal case and stress case as at 31 December 2018 as well as at the end of 2017. Utilisation represents the ratio of the cumulative gap to the total liquidity potential, which also includes the liquidity buffer required under supervisory law.

During 2018 the liquidity buffer to be maintained under MaRisk was reduced from € 9.0 billion to € 6.0 billion due to the decrease in liquidity risks.

Limit on cumulative liquidity gaps

(Utilisation of liquidity potential in %)



Hamburg Commercial Bank's risk appetite with regard to liquidity risk is reflected, amongst other things, in the definition of a minimum survival period, which describes how long utilisation of a liquidity potential lower than 100 % is to be maintained under the normal and stress cases for insolvency risk.

The liquidity potential had a peak utilisation of 65 % in the twelfth month as at the reporting date in the normal case assessment, which is based on the assumption of business development in an ordinary market environment. All limits within the minimum survival period of twelve months defined by the Bank were thereby adhered to. The stress case liquidity development report (combined scenario – economic downturn and rating downgrade) shows that the liquidity potential was also not exceeded within the minimum survival period of one month established taking account of MaRisk and the minimum survival period of three months derived from the 2017 SREP decision; in fact, the limits as at the end of 2018 are even adhered to for a period of twelve months. Compared to the 2017 year end, utilisation levels have decreased in the normal case and stress case in virtually all maturity bands. The improvements result in particular from the disposal of loan and securities portfolios as well as from liquidity inflows arising from guarantee payments made by the former public shareholders of the Bank. Critical limit utilisation levels were not reported in the normal case nor in the stress case liquidity development report during the period under review.

The results of the market-specific and Bank-specific stress scenarios determined in addition to the stress case liquidity development report show that, as at December 2018, Hamburg Commercial Bank's liquidity requirement was covered by the liquidity potential over twelve months in all scenarios despite the worst- case assumptions. A minimum survival period of three months is thereby maintained in all scenarios. The results show that Hamburg Commercial Bank is prepared accordingly for the crisis scenarios assessed.

In the year under review, the LVaR as an expression of the liquidity maturity transformation risk increased to € 50 million (previous year: € 46 million).

REGULATORY LIQUIDITY RATIOS

The regulatory indicator for liquidity risks is the liquidity coverage ratio (LCR), the purpose of which is to ensure that liquidity is safeguarded in an acute stress period of 30 days. When calculating the LCR the amount of highly liquid assets is compared to the net outflows over the next 30 days. Their basis of calculation is laid down in the CRR and the CRR Delegated Regulation (EU) 2015/61. The minimum threshold of 110 % to be maintained by Hamburg Commercial Bank was maintained at all times in the reporting period. The LCR amounted to 225 % as at 31 December 2018 (previous year: 169 %).

Under the Amending Regulation with regard to the Liquidity Regulation Hamburg Commercial Bank AG has been excluded from its scope of application since 1 January 2018, so that the relevant ratio (LiqV) was calculated for the last time as at 31 December 2017.

The net stable funding ratio (NSFR), which must be adhered to from 2021 at the earliest, is calculated as the ratio of available stable funding resources across all maturities to the stable funding required and must also be at least 100 % after full implementation. As at 31 December 2018 the NSFR of the Bank amounted to 121 % under the QIS (Basel framework) (previous year: 114 %).

Since 31 March 2018 Hamburg Commercial Bank AG has also calculated the adjusted additional liquidity monitoring metrics (AMM) including the preparation of the stipulated liquidity development report on the C66 reporting form in accordance with Implementing Regulation 2016/313,

By means of the AMM the LCP (liquidity capacity period) is determined for the supervisory authorities. In so doing, inflows and outflows from a contractual point of view excluding any prolongation or new business assumptions are compared to the unencumbered liquid funds of the counterbalancing capacity (C 66) less any haircuts The LCP is no longer maintained from the date on which the cumulative cash flows give rise to a need for liquid funds, which exceeds the liquidity position. At this date the Bank's liquidity reserves are no longer sufficient from a purely contractual perspective to meet further payment obligations. The supervisory authorities has stipulated a minimum LCP period of four weeks for the Bank in 2019, which may not be undershot for a period of five banking days. This figure is determined by the Bank on a daily basis and was at least four months as at 31 December 2018.

REFINANCING SITUATION

Hamburg Commercial Bank successfully implemented its funding strategy in the 2018 financial year. In addition to the successful implementation of fundraising, there were inflows from the settlement of losses under the second loss guarantee in the 2018 financial year. Besides the issuing activities, deposits from corporates, institutional investors and retail customers contributed to the refinancing of the business. The regulatory requirements for the liquidity ratios were met at all times during the reporting period. The future refinancing and diversification of the funding structure continue to constitute major challenges. There is still no unrestricted access to the capital markets. In addition, institutional deposits have a comparatively low average duration, and there is a significant, albeit substantially reduced, level of counterparty concentration. Should access to the existing sources of refinancing deteriorate, this would severely limit the funding options and would adversely impact the Bank's rating.

Execution of funding measures in the market can also 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.

Should inclusion in the senior membership of the guarantee scheme of the Federal Association of German Banks not succeed as planned, this could lead to a significant outflow of deposits, triggering a significant increase in funding costs. Also as a result of the different manner in which the deposit guarantee funds work, i.e. institutional protection under the protection system of the German Savings Banks Finance Group versus protection of deposits, there is a risk of liquidity outflows associated with the change in the deposit guarantee fund. Furthermore, non-inclusion in the private guarantee scheme could put pressure on the meanwhile stable rating position.

Hamburg Commercial Bank'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.

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

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

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

Operational risk

Hamburg Commercial Bank defines operational risk (OpRisk) as the risk of direct or indirect losses caused by the inappropriateness or failure of the internal infrastructure, internal procedures or staff or as a result of external factors (risk categories). This definition includes the risk of loss resulting from legal risk and compliance risk.

For purposes of risk-bearing capacity management, operational risks are determined by applying a modified standardised approach, which also includes results from the scenario analyses. The corresponding economic capital required amounted to € 0.2 billion as at 31 December 2018 (previous year: € 0.2 billion).

Organisation of operational risk management

The management of operational risk at Hamburg Commercial Bank is organised in a decentralised manner. The risks are identified and managed directly in the individual organisational units of the Bank. Accordingly, the division heads are responsible for the management of operational risk and the quality of such management in their areas of responsibility. The operational implementation is supported by OpRisk officers in the individual divisions. The Group Risk Management Division is responsible for OpRisk Controlling.

As a Bank-wide steering committee for operational and other risks in the Group, the OpRisk Committee convenes every quarter and provides support to the Overall Management Board in the implementation of the OpRisk strategy under the chairmanship of the head of Group Risk Management. The objective of the interdisciplinary OpRisk Steering Committee is to promote dialogue between the persons involved at all hierarchy levels and to determine appropriate measures for reducing operational risk.

Operational risk management

The identification, analysis, evaluation and monitoring of operational risk and the promotion of a corresponding risk culture in the Group represents an important success factor for Hamburg Commercial Bank. Different procedures and instruments are used in this process as shown below.

Loss events arising from operational risk are consolidated into a central loss event database for Hamburg Commercial Bank and relevant subsidiaries. The loss events are recorded by the divisions concerned and forwarded to OpRisk Controlling.

In the reporting year 44 % (previous year: 53 %) of the operational loss events reported were incurred in the employee causes category. This risk category includes, for example, processing errors or unauthorised actions. The proportion of operational loss events reported under the Internal Processes risk category amounted to 16 % (previous year: 15 %). These include, for example, deficient or missing processes. The proportion of operational loss events reported under the External Influences category (e.g. criminal acts, regulatory and statutory requirements) amounted to 41 % (previous year: 28 %). The proportion of loss events reported under the Internal infrastructure category (e.g. system failures, functionality or security) amounted to 0 % (previous year: 4 %).

In a further procedure Hamburg Commercial Bank conducts an annual, group-wide risk inventory of operational risk based on defined scenarios. Information about the risk situation of the divisions gained from this inventory supplements the reporting and serves the purpose of preventive management and monitoring of operational risk.

Based on an analysis of the causes of significant loss events and the results of the risk inventory, suitable measures are established in order to avoid future losses as far as possible. The measures identified are to be appropriate under cost-benefit aspects. In doing this, the instruments of risk mitigation consist above all of a large number of organisational safeguarding and control measures which are also applied in the context of the internal control system. OpRisk Controlling monitors the actual implementation of the measures determined using the measures controlling procedures.

Risk indicators are collected on a quarterly basis and incorporated in the OpRisk reporting. The indicators are selected based on the estimated risk situation and are periodically reviewed to ensure that they are up-to-date. The aim is to identify risks at an early stage and prevent their causes by the use of ongoing and comparative analysis of loss events and risk indicators.

In addition to the methods mentioned above, specific procedures and responsibilities have been instituted within Hamburg Commercial Bank for the operational risk elements listed below.

Management of personnel risks

Personnel risk refers to the risk of losses that may occur as a result of the unplanned departure of key personnel of Hamburg Commercial Bank, shortage of skilled staff or poor motivation of employees. This risk could materialise particularly in light of the current reduction in staff. The Human Resources division is therefore focusing increasingly on measures to reduce personnel risk and actively supports the planned reduction in staff.

A large number of personnel management tools for employee retention are used to prevent the unscheduled departure of key personnel. In addition, succession planning is performed and regularly reviewed for relevant positions.

IT risk management

The IT division is responsible for IT risk management. In the IT strategy it has defined as the primary objective of IT risk management to identify IT risks at an early stage and assess them based on protection needs in order to avert or reduce particularly severe losses on the basis of clear responsibilities.

IT-specific risk tools are used by means of which risks concerning projects in the line functions and at outsourcing partners are actively managed and reduced by a monitored implementation of measures.

No significant losses were incurred in the past year in the area of responsibility of the IT division and the risk potential was again significantly reduced.

Business continuity management
Hamburg Commercial Bank is exposed to risks arising from unforeseen events, which may result in business interruption. Group Risk Management has established with the involvement of the relevant divisions processes to limit the risks arising from the fact that the information technology fails or service providers or employees are unavailable. The objective of the business continuity plans established and to be periodically reviewed is to ensure the functional capability of critical business processes and activities, also in the event of an emergency.

Internal control system
Operational risk is closely linked to Hamburg Commercial Bank's internal control system (ICS). A major objective of the ICS is to optimise the internal bank processes in order to avoid losses that may arise as a result of, for example, processing errors. Detailed information on the ICS is set out in the Risk management system section.

Management of legal risk
Legal risk also falls under operational risk. Legal risks include economic risks arising as a result of non-compliance or incomplete compliance with regulations or with the framework defined by case law, in particular commercial law, tax law and company law. In case any of these risks materialises, this may lead to a higher financial burden than planned.

The Legal and Taxes division is responsible for managing these risks. In order to reduce, limit or prevent risk all divisions are given comprehensive legal advice by regularly trained staff and where appropriate by external consultants.

Hamburg Commercial Bank recognised provisions of € 250 million for litigation risks and costs as at the reporting date (previous year: € 98 million). In addition, there are also contingent liabilities arising from legal disputes. A major portion of the provisions for litigation risks relates to the legal proceedings mentioned below.

Since 2005 Hamburg Commercial Bank AG has been involved in legal proceedings with a Turkish shipping group and up to now had to pay a total amount of USD 54 million in the year 2013 due to final decisions made by Turkish courts. The plaintiffs asserted at a later date further claims in the Turkish courts under which damages are asserted based on loss of profit and third party liabilities in connection with measures taken to realise loan collateral provided to the Bank for a loan.

Furthermore, Hamburg Commercial Bank AG is being sued for payment by a former borrower. The claims were increased and filed by the plaintiff in the fourth quarter 2018. The plaintiff is asserting various claims, particularly claims for payment of compensation and for unjustified enrichment in connection with measures taken by the Bank in connection with a non-performing loan. Various lawsuits have already been conducted on key sub-aspects of the underlying facts of the claim.

Furthermore, individual and groups of investors in hybrid financial instruments have taken legal action against the Bank and, in addition to establishing that their cancellation is invalid, request that they be written up to their nominal value and are claiming compensation for missed interest payments.

As a component of legal risk, tax risks mainly result from the fact that the binding interpretation of rules that can be interpreted in specific cases may only be known after several years due to the long period between tax audits. Tax audits are currently being conducted for the years 2008–2011 and 2012–2015. Appropriate provisions have been recognised for the effects of the tax audits.

Hamburg Commercial Bank recognised provisions and liabilities (including interest) totalling € 14 million (previous year: € 44 million) for tax risks. Tax risks arising from tax audits account for a significant proportion of these provisions.

Management of compliance risk
Compliance risk arises as a result of non-compliance with legal regulations and requirements that may lead to sanctions being imposed by the legislator or supervisory authorities, financial losses or to a negative impact on the Bank's reputation.

The Compliance division is responsible for compliance risk management. Compliance with the different legal requirements is also ensured by the respective divisions concerned. Compliance monitors adherence to codes of conduct with respect to the topics of capital markets compliance, prevention of money laundering, terrorism financing and other criminal offences in accordance with Section 25h KWG as well as compliance with financial sanctions and embargoes. In addition, the division performs the compliance function as defined in AT 4.4.2 MaRisk and in this context strives to ensure that the essential legal regulations and standards are implemented at Hamburg Commercial Bank and complied with.

The Code of Conduct summarises the requirements of different legal sources and internal guidelines. It applies to all employees as well as the Management Board of Hamburg Commercial Bank AG and is a mandatory part of the overall Bank's objectives. The specific code of conduct requirements of the Compliance division are set out in detail in internal instructions.

The Bank's staff is regularly trained in compliance-relevant topics. The objective of the training is to firmly anchor compliance as part of the corporate culture, to disseminate relevant standards and changes thereto, and to enable new staff to quickly become familiar with corporate practices and to ensure compliance with such legal requirements in this way.

The Bank receives notification of suspicious cases of misconduct via internal reporting channels and the so-called "whistle-blowing office", and forwards these to the responsible bodies. The whistle-blowing office is staffed by independent ombudsmen from BDO Deutsche Warentreuhand Aktiengesellschaft Wirtschaftsprüfungsgesellschaft and enables anonymous reporting of suspicious cases both by employees of the Bank and external third parties.

Management of model risks

Models are vitally important for the Bank's management processes. The use of models involves of course a degree of uncertainty, which may cause financial losses as a result of inappropriate business decisions and give rise to regulatory risks as a result of the incorrect disclosure of capital, balance sheet and liquidity ratios and reputation risk.

The Bank's model risk management process includes careful development of models, independent validation of models and overarching model governance, which establishes and monitors the framework for dealing with models and model risk.

Other material risks

In addition to operational risk, business strategy risk and reputation risk are included in the other material risks of Hamburg Commercial Bank. In the reporting year Hamburg Commercial Bank adopted a non-financial risk framework in order to better address the diversity of the different risk types, which are commonly referred to as non-financial risks. This framework describes the relevant responsibilities in accordance with the 3 lines of defence method, whereby special attention is paid to so-called cross-cutting themes. In view of the increasing importance of these themes a "non-financial risk" unit reporting directly to the CRO will be created in 2019.

Business strategy risk

Business strategy risk refers to the risk of financial damage being incurred due to long-term strategic decisions based on incorrect assumptions. Should Hamburg Commercial Bank not be successful in identifying changes in markets relevant for it on a timely basis, this could have a negative impact on its competitiveness. Changes to laws and regulations or new regulatory requirements for instance could also jeopardise the implementation of Hamburg Commercial Bank's business model. This risk is managed via the annual review and updating of the business strategy and the closely related overall bank planning process established in the Bank. The Overall Management Board is responsible for the strategy of Hamburg Commercial Bank, whereby the Strategy & Management Board Office is responsible for the process for preparing the business strategy and the Bank Management division for strategy controlling. An action-oriented management dialogue, including on the strategic business objectives, is conducted during the year in the business review meeting.

Reputation risk

Reputation risk is the risk of a direct or indirect loss caused by damage to the reputation of the company. Damage to reputation means a public loss of confidence in Hamburg Commercial Bank or a loss of esteem of the Bank from the viewpoint of individual stakeholder groups (e.g. capital markets, clients, shareholders, investors, the general public, employees).

Hamburg Commercial Bank manages reputation risk particularly by means of preventive measures via the review of specific transactions, on the one hand, and via process-related rules, on the other, in order to prevent the occurrence of reputational damage if possible. The reputation risk strategy that is adopted every year defines the bank-wide principles for managing reputation risk as a supplement to the existing regulations and instructions, such as the Code of Conduct.

Summary of risk assessment and outlook

The 2018 financial year was characterised by the continuing winding down of high-risk, non-strategic lending and capital markets transactions held in the Non-Core Bank's portfolios as well as by the progress made in implementing the business model as the key strategic steps towards the successfully executed change in ownership.

Hamburg Commercial Bank's risk-bearing capacity was maintained at all times during the reporting year both under the new and old regulatory requirements.

Hamburg Commercial Bank is facing major challenges regarding its future development, which are described in detail in the Forecast, Opportunities and Risk Report.

The risk and bank management systems described in this report are aligned to take account of risk on a systematic basis. This also applies to our expectations regarding future market and business developments. We believe that we have appropriately presented the overall risk profile of the Hamburg Commercial Bank Group as well as the opportunities and risks inherent in the future development of our business activities in the Forecast, opportunities and risks report section and in this risk report in an appropriate and comprehensive manner.

Comment on the annual financial statements of Hamburg Commercial Bank AG in accordance with the German Commercial Code (HGB)

Report on earnings, net assets and financial position

Earnings situation

The earnings situation of Hamburg Commercial Bank AG was influenced to a particular degree by transformation effects in the year under review. Within this context, restructuring provi sions had a particular impact on net income. The composition and development of the statement of income can be seen in the following overview.

Statement of Income

(€ m)	2018	2017	Change in %
Net interest income	498	771	-35
Net commission income	-132	-88	-50
of which: Fees for the second loss guarantee	-165	-154	7
Net income from the trading portfolio	33	126	-74
Administrative expenses	-485	-521	-7
of which: Personnel expenses	-181	-202	-10
of which: Operating expenses	-305	-319	-4
Other operating income	-101	-90	-12
Operating result before loan loss provisions/valuation	**-187**	**198**	**>-100**
Loan loss provisions/valuation	-287	-1,166	-75
Operating result after loan loss provisions/valuation	**-474**	**-968**	**51**
Extraordinary result	-340	-69	>-100
Income tax expense	194	-2	>-100
Income from the assumption of losses	327	285	15
Result for the year	**-293**	**-754**	**-61**

Earnings hit hard by restructuring costs for transformation and loan loss provisions, in particular
The following developments in the individual income items were decisive to the Bank's earnings situation:

Net interest income amounted to € 498 million compared to € 771 million in the previous year. Overall, operating performance is satisfactory. Net operating interest income was moderately above expectations. New business activities are showing mixed development. In a highly competitive environment, Hamburg Commercial Bank selects new business based on strict risk and return requirements. The development of new business margins in the reporting period already points towards a noticeable success story thanks to the consistent focus on earnings, with new business profitability also in line with the current ambition level. The volume of new business, however, remains moderately below expectations. The reason for the decline in net interest income is the previous year's result from the sale of receivables from promissory note loans.

As a result, Hamburg Commercial Bank AG had realised unrealised gains in order to partially compensate for the considerable structural burdens resulting from loan loss provisions on non-performing legacy loans.

The **net commission income** of € -132 million (previous year: € -88 million) was hit, in particular, by the fees for the second loss guarantee in the amount of € -165 million (previous year: € -154 million). This includes non-recurring expenses of € 100 million for the early cancellation of the guarantee. The net commission income of € 33 million adjusted for expenses for government guarantees decreased sharply compared to the previous year (€ 66 million). The decline is mainly attributable to lower income from the lending business and higher expenses from the guarantee business.

Net income from the trading portfolio amounted to € 33 million (previous year: € 126 million). The higher net income in the previous year is attributable to above-average operating income from interest rate transactions. € 4 million was added during the reporting period to the fund for general banking risks in accordance with Section 340e from net income from the trading portfolio (previous year: € 14 million).

Last year **administrative expenses**, after taking the expenses for the bank levy and the deposit guarantee scheme in the amount of € -87 million (previous year: € -41 million) into account, amounted to € 485 million (previous year: € -521 million). The marked increase in the item relating to expenses for the deposit guarantee fund is due to provisions set up for expected one-off payments to be made to the Association of German Banks (*Bundesverband deutscher Banken*) due to the planned change in the guarantee scheme as at 1 January 2022.

Administrative expenses, on the other hand, will fall considerably. Hamburg Commercial Bank AG is continuing to successfully implement its cost-cutting programme, which has been ongoing since 2014 and counteracts the increasing pressure on earnings and margins in the highly competitive banking market and the increasing expenses for regulatory requirements, stringently and in line with its plans. During the reporting period, Hamburg Commercial Bank AG once again made the progress it planned to make in implementing measures for operating expenses. The ongoing cost reduction program will be consolidated with the measures forming part of the transformation project, which aim to reduce costs and increase efficiency, and will be implemented resolutely until an appropriate CIR of 40 % at the most has been achieved.

Personnel expenses, which fell from € -202 million to € -168 million, were mainly affected by a further reduction in the number of employees according to plan as part of the headcount reduction. At the end of the year, the number of employees had fallen by -180 to 1,510 (calculated in full-time equivalents, FTE).

Operating expenses amounted to € -305 million compared with € -319 million in the previous year. Savings were made in particular with regard to legal advice, fees and IT costs due to lower costs for external consultancy. The positive development of the cost-saving measures was partly offset by opposite effects affecting various individual items.

Other operating income amounted to € -101 million (previous year: € -90 million). In addition to income from cost allocations and reimbursement of expenses (€ 32 million) and legal costs paid in advance (€ -18 million), this mainly includes provisions.

Operating result before loan loss provisions/valuation

The operating result after loan loss provisions amounted to € -187 million compared to € 198 million in the previous year. The main reason for the significant change lies in effects resulting from the decline in net interest income.

Mounting geopolitical risks put pressure on loan loss provisions

On the one hand, the development in loan loss provisions as at the reporting date is due to specific loan loss provisions set up in the Shipping division, which are largely related to restructuring measures for a significant loan exposure. On the other hand, the increasing geopolitical and economic uncertainties are reflected in the general loan loss provisions that were set up. By setting up these provisions, Hamburg Commercial Bank is taking precautions in view of the increasing probability of downside scenarios due to the risk of a hard Brexit or the possible escalation of the trade conflict between the US and China, which could have a negative impact on developments in relevant sectors (in particular shipping).

Under "loan loss provisions", and taking into account the guarantee effect, Hamburg Commercial Bank AG reports a negative value of € -287 million (previous year: € -1,166 million). The burden from loan loss provisions after compensation fell significantly from € -1,256 million in the previous year to € -288 million as at the reporting date. In the previous year, significantly higher amounts allocated for legacy loan exposures, especially in the shipping portfolio of the Non-Core Bank, had a considerable negative impact on the net result. The loan loss provisions/valuation result in the securities business fell to € 18 million (previous year: € 44 million). The loan loss provisions/valuation result from equity holdings amounted to € -17 million (previous year: € 68 million).

Extraordinary result driven by restructuring and privatisation expenses

The extraordinary result increased to € -340 million compared to € -69 million in the previous year. Earnings were hit considerably by restructuring and privatisation expenses. Of this amount, € -235 million is attributable to restructuring expenses for personnel measures planned as part of the transformation project, € -44 million to material costs and € -67 million for privatisation (previous year: € -52 million).

High negative net result

Net income before taxes amounted to € -814 million (previous year: € -1,037 million). After taking account of income taxes of € 194 million (previous year: € -2 million) and income from the assumption of losses of € 327 million (previous year: € 285 million Hamburg Commercial Bank AG reports a negative net result of € -293 million (previous year: € -754 million). The net result is in line with expectations, although the earnings drivers were partly influenced by unplanned special factors, such as unplanned considerable loan loss provisions and high restructuring expenses. These burdens were partially offset by tax effects and the assumption of losses.

Income taxes mainly comprise income from the recognition of deferred tax assets on loss carryforwards and income from current taxes in previous years.

Distributions may not be made on silent participations in the event that a net loss for the year or an accumulated loss is determined. Furthermore, based on the corresponding contractual agreement, equity instruments must also share in the net loss for the year or an accumulated loss in the event of a net loss for the year or an accumulated loss. In the 2018 financial year, the silent participations shared in the loss reported by Hamburg Commercial Bank AG in the amount of € 327 million (previous year: € 285 million). Silent participations are placed in the international capital markets (€ 389 million) and with domestic/European institutional investors (€ 205 million). The hybrid capital instruments listed on the capital market participated in the group net loss (incl. group net loss carried forward from the 2017 annual financial statements). The carrying amounts of the hybrid instruments, which are listed on the capital markets, correspond to 22.9 % of the original nominal amount due to the attributed losses on the reporting date.

Net assets and financial position

Balance Sheet

(€ m)	2018	2017	Change in %
Assets			
Cash reserve, debt instruments issued by public authorities, bills eligible for rediscount	5,355	6,617	-19
Loans and advances to banks	2,277	2,770	-18
Loans and advances to customers	31,521	40,349	-22
Securities	10,508	15,035	-30
Trading portfolio	2,157	2,696	-20
Equity holdings in non-affiliated companies and interests in affiliated companies	654	631	4
Other assets	2,124	2,232	-5
Total assets	**54,596**	**70,330**	**-22**
Liabilities			
Liabilities to banks	6,012	8,891	-32
Liabilities to customers	28,427	36,822	-23
Securitised liabilities	10,399	14,086	-26
Trading portfolio	1,163	1,414	-18
Subordinated debt	1,055	1,048	1
Fund for general banking risks	2,366	2,362	0
Equity capital	2,641	3,250	-19
Other liabilities	2,533	2,457	3
Total assets	**54,596**	**70,330**	**-22**
Contingent liabilities	1,869	2,022	-8
Other obligations	7,646	6,724	14
Derivatives held in the banking book (credit equivalents)	449	616	-27
Total off balance sheet business	**9,964**	**9,362**	**6**
Business volume	**64,560**	**79,692**	**-19**

Decrease in total assets

The Group's total assets fell by around one-fifth in the 2018 financial year to € 54,596 million (31 December 2017: € 70,330 million). The following developments were decisive for the decline in total assets:

The cash reserve fell compared with the previous year-end to € 5,355 million (31 December 2017: € 6,617 million). Loans and advances to banks also decreased and amounted to € 2,277 million (31 December 2017: € 2,770 million). Hamburg Commercial Bank AG's active liquidity management, which aims, among other things, to gradually reduce the excess liquidity built up during the privatisation period, led in particular to a decline in balances at central banks.

Loans and advances to customers came to € 31,521 million (31 December 2017: € 40,349 million), also below the level seen in the previous year. The decline is mainly due to the closing of the portfolio transaction. In connection with the closing of the privatisation process, the portfolio transaction agreed to relieve Hamburg Commercial Bank AG of large parts of its non-performing legacy loans and the early termination of the second loss guarantee were implemented at the same time.

The volume of the securities portfolio also fell from € 15,035 million to € 10,508 million due to active liquidity management. Trading portfolio assets decreased to € 2,157 million (31 December 2017: € 2,696 million). Both debentures and other fixed-interest securities in the trading book and the positive fair values of derivative positions declined.

All material line items on the liability side of the balance sheet decreased. Liabilities to banks declined to € 6,012 million compared to € 8,891 million as at 31 December 2017. Call deposits held at other banks, time deposits and repurchase agreements declined due to lower refinancing requirements. In line with the gradual reduction in excess liquidity, liabilities to customers also declined significantly to € 28,427 million (31 December 2017: € 36,822 million).

Securitised liabilities stood at € 10,399 million (31 December 2017: € 14,086 million), also below the level seen in the previous year. Subordinated liabilities and profit participation capital remained at approximately the same level as in the previous year (31 December 2017: € 1,055 million, previous year: € 1,048 million).

At € 2,641 million as at 31 December 2018, reported equity was significantly lower than at the end of the previous year (31 December 2017: € 3,250 million). In addition to the group net loss for the 2018 financial year, this is due to the loss distribution attributable to the silent partners, which resulted in a lower carrying amount. With regard to the development of the regulatory capital ratios, reference is made to the Risk report in the combined management report of Hamburg Commercial Bank.

BUSINESS VOLUME ALSO DOWN

The business volume decreased in line with the decreasing total assets and amounted to € 64,560 million (31 December 2017: 79,692 million). Contingent liabilities, which essentially comprise guarantees and warranties, also fell to € 1,869 million (31 December 2017: € 2,022 million), whereas other commitments, which mainly consist of irrevocable loan commitments, increased slightly to € 7,646 million (31 December 2017: € 6,724 million).

Refinancing

Hamburg Commercial Bank AG successfully implemented its funding strategy in the year under review by using various funding sources. The regulatory requirements for the liquidity ratios were exceeded by far during the reporting period. Further details can be found in the combined management report of Hamburg Commercial Bank.

FINAL DECLARATION CONCERNING THE DEPENDANT COMPANY REPORT IN ACCORDANCE WITH SECTION 312 AKTG

In accordance with Section 312 of the German Securities Act (AktG), the Management Board of Hamburg Commercial Bank AG is obliged to submit a Dependent Company Report from 1 January to 28 November 2018.

The final declaration of the Management Board concerning the Dependent Company Report is as follows:

"With respect to the transactions listed in the Dependent Company Report HSH Nordbank AG has received adequate consideration for every transaction entered into under the circumstances known to us at the time the transactions were concluded. The company did not take nor fail to take any action at the instigation or in the interests of both controlling companies."

Controlling companies of Hamburg Commercial Bank AG are the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein, which coordinate their decision-making process via HSH Finanzfonds AöR – Gemeinsame Anstalt der Freie und Hansestadt Hamburg und des Landes Schleswig-Holstein (HSH Finanzfonds AöR) - incorporated with effect from 21 April 2009 as well as HSH Beteiligungs Management GmbH - incorporated with effect from 20 May 2016.

Hamburg/Kiel, 15 March 2019

Stefan Ermisch

Ulrik Lackschewitz

Dr. Nicolas Blanchard

Oliver Gatzke

Annual financial statements of Hamburg Commercial Bank AG

Balance sheet of Hamburg Commercial Bank AG

as at 31 December 2018

Assets

(€ k)	(Note)				31.12.2018	31.12.2017
1. Cash reserve						
a) Cash on hand				826		4,132
b) Balances at central banks				5,292,704		6,507,343
thereof:					**5,293,530**	**6,511,475**
with Deutsche Bundesbank		5,289,089				
		(previous year: 6,499,476)				
2. Debt instruments issued by public institutions and bills of exchange eligible for refinancing with central banks						
a) Treasury bills, discounted treasury notes and similar debt instruments issued by public-sector institutions				61,647		105,940
					61,647	**105,940**
3. Loans and advances to banks	(5, 6, 23-26)					
a) Payable on demand				409,149		363,425
b) Other receivables				1,867,690		2,406,826
					2,276,839	**2,770,251**
4. Loans and advances to customers	(5, 6, 23-26)				**31,521,343**	**40,348,844**
thereof:						
secured by mortgages		9,814,741				
		(previous year: 10,091,955)				
public-sector loans		3,810,967				
		(previous year: 4,054,771)				
secured by a maritime lien		3,754,336				
		(previous year: 5,692,150)				
5. Debentures and other fixed-interest securities	(8, 23-28, 31)					
a) Money market instruments						
aa) from other issuers			8,405			5,004
				8,405		
b) Bonds and debentures						
ba) from public-sector issuers			5,073,244			6,887,370
thereof:						
eligible as collateral at the Deutsche Bundesbank		5,000,869				
		(previous year: 6,816,402)				
bb) from other issuers			4,698,544			6,644,597
thereof:				9,771,788		
eligible as collateral at the Deutsche Bundesbank		4,493,945				
		(previous year: 6,118,453)				
c) Own debentures				718,572		1,446,671
Nominal value		706,717			**10,498,765**	**14,983,642**
		(previous year: 1,432,617)				
To be carried forward					**49,652,124**	**64,720,152**

Assets

(€ k)	(Note)			31.12.2018	31.12.2017
	To be carried forward			**49,652,124**	**64,720,152**
6. Shares and other non-fixed-interest securities	(8, 27, 28, 31)			**8,958**	**50,796**
6a Trading portfolio	(9, 29)			**2,156,581**	**2,696,443**
7. Equity holdings in non-affiliated companies	(15, 27, 31, 63)			**7,496**	**10,007**
thereof:					
in banks		3,734			
		(previous year: 4,907)			
8. Interests in affiliated companies	(15, 27, 31, 63)			**646,924**	**621,417**
thereof:					
in banks		82,590			
		(previous year: 82,590)			
9. Trust assets	(30)			**3,220**	**3,934**
thereof:					
trust loans		3,220			
		(previous year: 3,934)			
10. Intangible fixed assets	(16, 31)				
a) Industrial property rights acquired in-house and similar rights and assets			570		1,100
b) Licences, industrial property rights and assets as well as licenses to use such rights and assets purchased			6,597		6,988
				7,167	**8,088**
11. Tangible fixed assets	(17, 31)			**80,404**	**86,175**
12. Other assets	(32)			**1,325,128**	**1,525,184**
13. Prepaid expenses	(5, 19, 33)			**53,441**	**76,964**
14. Deferred tax assets	(18, 34)			**654,827**	**531,336**
Total assets				**54,596,270**	**70,330,496**

Liabilities

(€ k)	(Note)				31.12.2018	31.12.2017
1. Liabilities to banks	(19, 37–39)					
a) Payable on demand				266,179		488,662
b) With an agreed maturity or notice period				5,745,951		8,402,614
					6,012,130	**8,891,276**
2. Liabilities to customers	(19, 37–39)					
a) Savings deposits						
aa) with agreed notice period of three months			10,721			14,344
ab) with agreed notice period of more than three months			-			-
				10,721		14,344
b) Other liabilities						
ba) Payable on demand			7,933,858			10,997,724
bb) With an agreed maturity or notice period			20,482,580			25,809,905
				28,416,438		36,807,629
					28,427,159	**36,821,973**
3. Securitised liabilities	(19, 39, 67)					
a) Debentures issued				10,398,837		14,082,878
b) Other securitised liabilities				-		3,002
thereof:					**10,398,837**	**14,085,880**
Money market instruments		-				
		(previous year: 3,002)				
3a. Trading portfolio	(9, 40)				**1,162,845**	**1,414,071**
4. Trust liabilities	(41)				**3,220**	**3,934**
thereof:						
trust loans		3,220				
		(previous year: 3,934)				
5. Other liabilities	(42)				**815,757**	**971,622**
6. Deferred Income	(5, 19, 43)				**71,651**	**76,488**
6a. Deferred tax liabilities	(18, 44)				**14,609**	**69,144**
7. Provisions	(20)					
a) Provisions for pensions and similar obligations				840,189		814,812
b) Tax provisions				25,388		109,771
c) Other provisions	(45)			761,437		411,458
					1,627,014	**1,336,041**
8. Subordinated debt	(46)				**1,055,396**	**1,048,002**
9. Fund for general banking risks	(47)				**2,366,156**	**2,362,444**
of which special items under Section 340e (4) HGB		56,354				
		(previous year: 52,642)				
To be carried forward					**51,954,774**	**67,080,875**

Liabilities

(€ k)	(Note)			31.12.2018	31.12.2017
	To be carried forward			**51,954,774**	**67,080,875**
10. Equity capital	(48)				
a) Subscribed capital					
aa) Share capital		3,018,225			3,018,225
ab) Silent participations		594,017			908,773
			3,612,242		3,926,998
b) Capital reserve			76,535		76,535
c) Accumulated loss			-1,047,281		-753,912
				2,641,496	**3,249,621**
Total liabilities				**54,596,270**	**70,330,496**

1. Contingent liabilities	(60)				
a) Liabilities from guarantee and indemnity agreements				**1,869,321**	**2,022,220**
2. Other obligations	(60)				
a) Irrevocable loan commitments				**7,646,258**	**6,724,077**

Income statement of Hamburg Commercial Bank AG

for the period 1 January to 31 December 2018

(€ k)	(Note)			2018	2017
1. Interest income	(49, 50)				
a) lending and money market transactions		2,237,822			2,990,942
less negative interest resulting from loan and money market transactions		-141,406	2,096,416		-184,678
b) from fixed-interest securities and book-entry securities		211,968			305,610
less negative interest resulting from securities and book-entry securities		-	211,968		-
			2,308,384		**3,111,874**
2. Interest expenses	(50)				
from the banking business		1,928,000			2,505,967
less positive interest resulting from the banking business		-75,878			-107,529
			1,852,122		2,398,438
				456,262	**713,436**
3. Current income from	(49)				
a) Equities and other non-fixed-interest securities			296		2,241
b) Equity holdings in non-affiliated companies			9,479		12,569
c) Interests in affiliated companies			31,515		42,674
				41,290	**57,484**
4. Commission income	(49, 51)		82,975		**111,335**
5. Commission expenses	(51)		215,275		199,363
				-132,300	**-88,028**
6. Net income/Net expenses from the trading portfolio	(49)			**33,410**	**125,535**
7. Other operating income	(49, 52)			**171,068**	**179,331**
8. General administrative expenses					
a) Personnel expenses					
aa) Wages and salaries		153,804			166,621
ab) Compulsory social security contributions, expenses for retirement pensions and support		26,742			35,075
			180,546		201,696
thereof:					
for retirement pensions	3,857				
	(previous year: 9,836)				
b) Other general administrative expenses	(57)		297,003		310,549
				477,549	**512,245**
9. Depreciation, amortisation and impairments on intangible fixed assets and tangible fixed assets	(31)			**7,674**	**8,234**
10. Other operating expenses	(53)			**269,177**	**266,475**
11. Depreciation and impairments on loans and advances and certain securities and additions to provisions in the lending business				**328,056**	**1,294,525**
To be carried forward				**-512,726**	**-1,093,721**

(€ k)	(Note)		2018	2017
	To be carried forward		**-512,726**	**-1,093,721**
12. Income from additions to equity holdings in non-affiliated and interests in affiliated companies and securities treated as fixed assets			**57,653**	**141,645**
13. Expenses from the transfer of losses			**16,592**	**13,371**
14. Profit on ordinary activities			**-471,665**	**-965,447**
15. Extraordinary income	(54)	5,197		**8,680**
16. Extraordinary expenses	(54)	345,348		**77,487**
17. Extraordinary result	(54)		**-340,151**	**-68,807**
18. Income tax expenses	(55)	-193,859		**1,912**
19. Other taxes not shown under item 10		2,715		**2,870**
			-191,144	**4,782**
20. Income from loss-sharing	(56)		**327,303**	**285,124**
21. Annual net loss			**-293,369**	**-753,912**
22. Loss carried over from the previous year			**-753,912**	**-**
23. Accumulated loss			**-1,047,281**	**-753,912**

Notes for the 2018 Financial Year

General information and notes

1. Hamburg Commercial Bank AG and its shareholders

Hamburg Commercial Bank AG, formerly HSH Nordbank AG, with its registered offices in Hamburg and Kiel, was established by the merger of the Hamburgische Landesbank – Girozentrale –, Hamburg, and the Landesbank Schleswig-Holstein Girozentrale, Kiel, on 2 June 2003. For accounting and tax purposes, the merger took effect retroactively as of 1 January 2003. Since 28 November 2018, the Bank has had shareholders who are independent of each other: Cerberus Capital Management, L.P., J. C. Flowers & Co. LLC, GoldenTree Asset Management LP, Centaurus Capital LP and BAWAG P.S.K and/or funds initiated by these shareholders. Since 4 February 2019, the Bank has been operating under the name Hamburg Commercial Bank AG.

Hamburg Commercial Bank AG is entered in the Hamburg commercial register under HRB 87366 and in the Kiel commercial register under HRB 6127 KI.

Hamburg Commercial Bank AG prepares Group financial statements as the ultimate parent company.

The following overview shows Hamburg Commercial Bank AG and its shareholders with their respective direct and indirect holdings of voting capital as at 31 December 2018.

Ownership structure

Several funds initiated by **Cerberus Capital Management, L.P.**			One fund advised by **J.C. Flowers & Co. LLC**	One fund initiated by **GoldenTree Asset Management LP**	**Centaurus Capital LP**	**BAWAG P.S.K.** Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft
Promontoria Holding 221 B.V.	Promontoria Holding 231 B.V.	Promontoria Holding 233 B.V.	JCF IV Neptun Holdings S.à r.l.	GoldenTree Asset Management Lux S.à r.l.	Chi Centauri LLC	
9.89 %	13.88 %	18.73 %				
42.5 %			**35.0 %**	**12.5 %**	**7.5 %**	**2.5 %**

2. Provision of a guarantee facility

Second loss guarantee of HSH Finanzfonds AöR
The fundamental information on the hedging effect of the guarantee is presented in the 2017 HGB Financial Report of Hamburg Commercial Bank AG.

Privatisation of the Bank

As part of the privatisation of the Bank, an agreement was reached between Hamburg Commercial Bank AG, the guarantor HSH Finanzfonds AöR and HSH Beteiligungsmanagement GmbH on 28 February 2018 on the premature termination of the agreement on the provision of a guarantee facility. This means that, on the date on which the cancellation takes effect, Hamburg Commercial Bank AG will no longer be under any obligation to pay guarantee fees, and the guarantor will make a compensation payment to Hamburg Commercial Bank AG to compensate for the loss facility that has not yet been settled/disbursed. In addition, Hamburg Commercial Bank AG had to make a one-off payment of € 100 million to the guarantor to compensate for the monetary benefits associated with the early termination of the guarantee, as well as the premature liquidity effect, in particular state aid law advantages resulting from the fact that premium payments are no longer to be made. This put pressure on the income statement in 2018.

The cancellation of the guarantee, remuneration and compensation payment, i.e. the guarantee cancellation agreement, depended on the closing of the purchase agreement on the shares in Hamburg Commercial Bank AG (share purchase agreement), corresponding notification sent to the parties to the agreement on the sale of an extensive credit portfolio (portfolio transaction) on 28 February 2018 and, as a result, on the closing of the portfolio transaction.

Accounting impact of the second loss guarantee in the 2018 financial year

With the execution of the share purchase agreement - the "closing" of the privatisation process - on 28 November 2018, the guarantee was also cancelled with a compensation payment of € 5,711 million made by HSH Finanzfonds AöR. Together with the losses already paid in the 2018 financial year, the payments made by HSH Finanzfonds AöR in the 2018 financial year amount to € 6,203 million. The guarantee facility granted by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein via HSH Finanzfonds AöR which had a hedging effect for the first time as at 31 December 2010, no longer exists as at 31 December 2018 (previous year: € 6,203 million). Since the guarantee had already been utilised in full as at 31 December 2017, there is no effect on income in loan loss provisions in 2018 (previous year: € 88 million).

The guarantor made payments of € 10 billion over the entire term of the guarantee.

Since the 2009 reporting year the Bank has recorded premium expense totalling € 4,024 million for the provision of the second loss guarantee. Of this amount, € 1,235 million is attributable to one-off payments, including € 100 million from the early termination of the guarantee. This figure also includes payments made to HSH Beteiligungs Management GmbH in the amount of € 260 million.

(€ m)	2018	2017	2018	2017
	Balance sheet	Balance sheet	Income statement	Income statement
	Loan loss provisions	Loan loss provisions	Loan loss provisions	Loan loss provisions
Hedging effect before guarantee costs	–	6,203	-6,203	-1,857
Payments of HSH Finanzfonds AöR	–	–	6,203	1,945
Compensation under the second loss guarantee	**–**	**6,203**	**–**	**88**

3. Deposit guarantee fund, guarantee obligation (Gewährträgerhaftung) and maintenance obligation (Anstaltslast)

Hamburg Commercial Bank AG is a member of the support fund of the Landesbanks and is integrated into the guarantee system of the German Savings Banks Finance Group.

The German Savings Banks Finance Group has an institutional guarantee scheme: This has been recognised as a deposit guarantee scheme under the German Law on Deposit Insurance (*Einlagensicherungsgesetz* - EinSiG) since 3 July 2015.

The primary objective of the guarantee scheme is to protect the member institutions themselves and to avert imminent or existing financial difficulties at these institutions. This is intended to avoid triggering a deposit guarantee event and ensure that the business relationship with the customer is continued on a sustainable basis and without restrictions (voluntary institutional guarantee).

The institutional guarantee scheme of the German Savings Banks Finance Group also meets the statutory deposit guarantee requirements under the EinSiG by its official recognition as a deposit guarantee fund scheme. Under the statutory deposit guarantee, the customer has a claim against the guarantee scheme for the repayment of its deposits up to € 100,000.

The seamless transition of Hamburg Commercial Bank AG to the deposit protection fund for private banks is planned for 1 January 2022. This deposit guarantee fund consists of the Compensation Scheme of German Banks (EdB, statutory deposit guarantee fund) and the voluntary deposit protection fund of the Association of German Banks (ESF).

The transitional agreement reached in the understanding with the EU Commission dated 17 July 2001 on the expiration of the maintenance obligation (*Anstaltslast*) and guarantee obligation (*Gewährträgerhaftung*) mechanisms on 18 July 2005 also applies to Hamburg Commercial Bank AG pursuant to Section 2 of the treaty signed by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein on 4 February 2003 concerning the merger of the predecessor institutions. Liabilities entered into on or before 18 July 2001 are therefore covered by the guarantee obligation, regardless of their maturities.

As previous owner of Landesbank Schleswig-Holstein Girozentrale, Landesbank Baden-Württemberg, Stuttgart is liable within the scope of the guarantee obligation described above for the liabilities agreed upon prior to its withdrawal effective 23 May 2003 and transferred to Hamburg Commercial Bank AG by way of the merger. Westdeutsche Landesbank, Düsseldorf, and/or its legal successor are liable for liabilities entered into before the expiry of the guarantee obligation.

4. Accounting standards applied

We prepared the annual financial statements and the management report of Hamburg Commercial Bank AG as at 31 December 2017 in accordance with the provisions of the German Commercial Code (HGB), the German Stock Corporation Act (AktG), the German Bank Accounting Regulation (RechKredV) and the German Mortgage Bond Act (PfandBG). In addition, we complied with the applicable pronouncements of the Institute of Public Auditors in Germany, Incorporated Association - IDW.

Further explanatory information on selected items and scenarios is set out below.

ACCOUNTING AND VALUATION PRINCIPLES

Accounting and measurement are based on the assumption that the Bank is a going concern. The Bank's corporate planning forms the basis for the going concern assumption.

5. Loans and advances

We recognised loans and advances to banks and to customers (asset items 3 and 4) at their nominal value or at their cost of acquisition. Premiums or discounts are recorded under prepaid expenses or deferred income and amortised on a straight-line basis over the term of the loan or the fixed-interest period, whichever is shorter. Pro-rata interest is recognised on an accrual basis and disclosed in the corresponding loans and advances line items. We observe the strict lower-of-cost-or-market principle by rigorously applying our risk provisioning principles which are described below.

If, in the case of non-genuine securitisation transactions, loans and advances are not derecognised and the risk on such loans and advances remains fully with Hamburg Commercial Bank AG, any necessary valuation allowances are recognised solely on our original loans and advance amounts.

6. Valuation allowances and provisions in the lending business (loan loss provisions)

In order to provide for possible loan losses, we make valuation allowances in accordance with the following principles. These adjustments are set off against the corresponding items in the balance sheet. For off-balance sheet business this is achieved by means of provisions. In order to ensure that our loan loss provisions cover all identifiable counterparty default and country risks, risk is determined in three steps:

Our loan exposures are monitored on an ongoing basis. We make individual valuation allowances in the amount of the anticipated loss for all counterparty default risks identifiable when examined individually. We calculate the exposure at default from the carrying amount of loans and advances less the net present value of all payments still expected to be received. The expected incoming payments comprise in particular all expected interest and redemption payments as well as payments from the liquidation of collateral, with any liquidation costs taken into account.

In addition, we set up country-specific portfolio valuation allowances for exposures related to borrowers domiciled in countries rated as non-investment grade. The valuation allowance rates are scaled according to rating grades in 5 % steps. Transactions in countries with a default rating (16 – 18) are 100 % value-adjusted. In determining the basis for calculation, we take no account of any transactions of clients and banks in respect of which counterparty-related loan loss provisions have already been created. Similarly, other risk-mitigating factors (such as valuable collateral, for example) are taken into account.

Finally, we set up portfolio valuation allowances in accordance with the German commercial law for the remaining loan exposures not accounted for in the first two steps, but still involving latent risks. The portfolio valuation allowances are determined as of the reporting date on the basis of risk parameters derived from the determination of internal economic counterparty default risk. For the calculation the parameters exposure at default (EAD), probability of default over a 12-month horizon (PD), loss given default (LGD) and for off-balance sheet items the credit conversion factor (CCF) are used. We recognise portfolio valuation allowances for loans and advances, contingent liabilities and irrevocable loan commitments. Regular checks are also performed to see whether other scenarios have a material non-linear impact on the amount of loan loss provisions. Within the context of what are known as model overlays, risk factors relevant to valuation are taken into account if they were not already included in the calculation parameters used in the models. In this case, the loan loss provisions are corrected either directly or indirectly by altering the credit risk parameters to reflect these effects.

As part of the allocation to loan loss provisions for loans and advances to customers in accordance with the expected credit loss model, adjustments were also made as at 31 December 2018 in the form of model overlays. These relate to risk factors relevant to valuation that are not already included in the calculation parameters used in the expected loss models/the expert estimates. Particularly, these risk factors relate to the need for a stronger weighting of downside scenarios given the current economic uncertainties with a potential impact on the sectors relevant to the Bank (in particular shipping and real estate). Additionally, they relate to the impact, as estimated by Hamburg Commercial Bank AG, of the emission requirements for ships that will apply from 2020.

Assessments as to the need for loan loss provisions are frequently made on the basis of information which is partly provisional in nature (e.g. planned restructuring of borrowers, draft reorganisation reports) or are subject to increased volatility (e.g. collateral value of real estate and ships). This results in increased uncertainty regarding estimates of key parameters of loan loss provisions. In such cases the large degree of uncertainty is mainly due to the assessment of expected cash flows which are dependent on borrowers, industries, the assessment of the overall economy among other factors. The assumptions made are subject to a periodic review and are adapted to the changed underlying conditions where necessary.

These portfolio valuation allowances are determined for tax purposes in accordance with the bulletin of the Federal Ministry of Finance dated 10 January 1994.

Provided the credit risk no longer exists or is reduced, all three types of loan loss provisions mentioned above are reversed accordingly. We thereby comply with the obligation to reverse impairments in accordance with tax law and with the provisions of the German Commercial Code.

If the Bank determines that a receivable must be classified as unrecoverable (in whole or in part), its write-down is initiated.

7. Determining fair value

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. 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 respectively).

Fair value can 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. This is generally the case with regard to securities and derivatives traded on liquid markets.

The mark-to-matrix method is used to determine fair value where the fair value cannot be determined on the basis of market or transaction prices of an identical financial instrument. For this purpose, prices of comparable financial instruments or indices, which are representative for the financial instrument, are used as an alternative and adjusted where necessary.

Fair value is determined by the mark-to valuation using a suitable model (e.g. option price model, discounted cash flow method, collateralised debt obligation model) if a valuation cannot be derived either of adequate quality or at all. Trading assets and liabilities are measured using mid-market rates.

Where valuation techniques and models are concerned, a distinction can be drawn between procedures based exclusively on observable market data or parameters that are non-observable only to an insignificant extent on the one hand and those based to a significant extent on non-observable parameters on the other hand. 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). Valuation techniques and models based on non-observable market data or valuation parameters, and which therefore require assumptions to be made with regard to these parameters, are usually necessary for structured securities – or more generally for securities whose markets are illiquid - and for complex OTC derivatives. Examples of non-observable parameters are special correlations and volatilities. In these cases a significant number of judgements have to be made with regard to the selection of both the model and the parameter estimates. If the valuation technique or model used to determine the value of a derivative does not appropriately reflect modelling risks, parameter uncertainties, funding costs and benefits as well as credit or counterparty risk, the value is correspondingly adjusted by the Bank. The methods applied for this draw to some extent on non-observable market parameters in the form of estimates.

If the valuation of a financial instrument is based partly on non-observable parameters, the fair value determined is the best estimated value in accordance with a discretionary decision by the Bank. However, it remains subjective in that there may be alternative parameter selection options that cannot be refuted by observable market data.

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. The impact of the collateral provided is taken into account as part of measurement.

A substantial proportion of securities held in the trading portfolio is valued using liquid market prices. If a current price from a liquid market is not available, interest-bearing securities are valued using the discounted and sector-dependent yield curves derived from market data of fixed-income securities.

In a few cases, a fair value cannot be determined for securities disclosed under Shares and other non-fixed-interest securities on the assets side of the balance sheet (asset item 6). This applies to non-negotiable shares in public limited companies, which means that no direct market prices or observable market data are available for use in a valuation model. As with Equity holdings in non-affiliated companies and Interests in affiliated companies (asset items 7 and 8), these items are measured at amortised cost and regularly tested for permanent impairment.

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) are used for the valuation that are based on estimates of non-observable parameters to an insignificant extent at most.

8. Securities

For valuation purposes, we divide our securities (asset items 5 and 6) not assigned to the trading portfolio in accordance with the provisions under German commercial law into an investment portfolio and a liquidity reserve, depending on the respective purpose.

Given that securities held in the investment portfolio are intended for long-term investment, we value them at the moderate lower-of-cost-or-market value. When impairments are considered to be temporary we recognise the corresponding securities at acquisition cost. Impairments are considered to be temporary if they are not considered indications of future disruptions in the servicing of interest and capital payments. This is the case, for example, where impairments are caused by changes in interest rates. We thus avoid reporting performance volatility, which would not be economically justified based on the short-term nature of the value fluctuations. As part of the risk provisioning process for securities, we have defined comprehensive criteria ("trigger events") for identifying possible permanent impairments. These are identified on a quarterly basis. All securities under review including any cover assets/underlyings are subjected to an analysis and a two-stage risk assessment process. Depending on the security's asset class, this analysis includes additional indicators (e.g. external ratings, calculation of over-collateralisation for mezzanine tranches, cash flow analyses). As long as this analysis of an individual case does not confirm a trigger event in economic terms or no trigger event is identified, there is no permanent impairment. In the case of impairments expected to be permanent – usually caused by changes in the credit rating – we write down the security to the lower of the exchange price, market price or fair value.

We value the securities held in the liquidity reserve in accordance with the strict lower-of-cost-or-market principle. Accordingly, securities are stated at the lower of cost or exchange price, market price or fair value, irrespective of whether impairment is permanent.

For the balance sheet treatment and the presentation of hedging relationships, please refer to our remarks under Note 13.

Interest resulting from the Bank's own securities holdings is reported as interest income. In this connection, pro rata interest is recognised on an accrual basis. Valuation gains or losses and realised profits on securities held in the investment portfolio are allocated to Net income from financial investments (item 12 in the income statement); in the case of securities held in the liquidity reserve, they are allocated to Credit risk income/expense (item 11 in the income statement).

Dividends and other disbursements are reported under current income from shares and other non-fixed-income securities.

During the financial year there were no reclassifications between the trading portfolio, liquidity reserve and/or investment portfolio.

9. Financial instruments held in the trading portfolio

We include in the assets and liabilities held for trading (asset item 6a and liability item 3a) all financial instruments which we acquired or sold for purposes of realising a short-term proprietary trading profit. In addition to securities, these include in particular derivative financial instruments, but also certain receivables (such as promissory notes). Securities, receivables and derivatives with a positive fair value are disclosed under Trading portfolio (assets) (item 6a); derivatives with a negative fair value are disclosed under Trading portfolio (liabilities) (item 3a). The criteria for allocation to the Trading portfolio remained unchanged during the financial year. We value all financial instruments held in the trading portfolio at fair value less a risk discount. Where no stock market or market prices are available for financial instruments, fair value is calculated on the basis of generally accepted valuation models (cf. also Note 7). In order to account for counterparty risks from derivatives held in the trading portfolio we have created so-called credit valuation adjustments and have reduced the Trading portfolio (assets) accordingly. Furthermore, we have created debt valuation adjustments and have reduced the Trading portfolio (liabilities) accordingly.

Funding valuation adjustments are used to take account of the funding costs and advantages arising from the provision or receipt of cash collateral in connection with the hedging of an uncollateralised OTC derivative with a collateralised OTC derivative.

The risk discount represents a potential loss (value at risk) determined by mathematical methods and is based on all positions held in Hamburg Commercial Bank AG's trading portfolio. The value at risk (VaR) is calculated in such a way that a potential loss on items held for trading will not be exceeded within a holding period of ten days with a confidence level of 99 %. The observation period for the VaR is 250 trading days. The VaR discount is calculated taking into account correlations between the individual transactions in the Trading portfolio. In general, the risk discount is deducted from the assets held for trading. In those exceptional cases in which the liabilities held for trading are larger than the assets held for trading, a risk mark-up is instead disclosed under Trading portfolio (liabilities).

Income and expense (current income and expense, realised and unrealised valuation income and expense) from financial instruments held for trading are generally disclosed under Net trading income/ expense from the trading portfolio. Current income and expenses from securities and receivables are exempt from this. Consistent with Hamburg Commercial Bank AG's internal management, these are stated under Interest income, Interest expense respectively Current income from shares and other non-fixed-interest securities.

Each year that Hamburg Commercial Bank AG discloses net income in the trading portfolio, 10 % of this net income is allocated to the special item Fund for General Banking Risks (liability item 10). Reversals of this item are only possible in order to balance net expenses in the trading portfolio or as far as the item exceeds 50 % of the average of the past five years net income in the trading portfolio. Expenses from the addition to and income from the reversal of the item are stated respectively under the net income or net expense of the trading portfolio. € 4 million was added to the special item during the past financial year (previous year: € 14 million) from net income from the trading portfolio.

10. Balance sheet presentation on a net basis

We net the fair values of trading portfolio derivatives traded over the counter and cash collateral, for which measurement is performed and collateral provided on a daily basis under a master agreement with collateral agreement. The netting has no effect on the disclosure of net income from the trading portfolio. Cf. also Note 65.

11. Derivative financial instruments

Derivative financial instruments are recognised and valued in accordance with the general rules of commercial law. Internal transactions and their accounting are required to comply with uniformly determined conditions. In particular the terms must be in line with market conditions.

Income and expenses from option contracts held in the non-trading portfolio are disclosed under Other operating income or Other operating expenses in accordance with the disclosure requirements of IDW AcPS BFA 6. Income and expenses from interest rate cap agreements are disclosed under Interest income or Interest expenses. We recognise credit derivatives held in the non-trading portfolio in accordance with IDW AcPS BFA 1. The rules for loan collateral provided apply in principle to credit default swaps in which Hamburg Commercial Bank AG takes the position of a collateral provider and which are not allocated to a valuation unit within the meaning of Section 254 HGB. A provision is recognised in the amount of the negative fair value to take account of the default risk as at the reporting date

As at 31 December 2018, accounting for internal derivatives resulted in interest income in the amount of € 828 million (previous year: € 1,122 million), interest expense in the amount of € 743 million (previous year: € 986 million), Other operating income of € 4 million (previous year: € 19 million) and Other operating expense of € 2 million (previous year: € 9 million). Reverse effects are reported in the Net income from the trading portfolio.

Premiums paid or received on purchased or written options, which are not part of the Trading portfolio, are disclosed under Other assets or Other liabilities. If necessary, we conduct write-offs or create provisions to comply with the lower-of-cost-or-market or the recognition-of-loss principle (imparity principle).

To the extent a margin system is used in the case of financial instruments, the initial margin payments are recognised as assets or liabilities. Variation margin payments in the trading portfolio are recognised for income purposes directly in trading portfolio net income or loss. Variation margins outside of the trading portfolio are recognised as assets or liabilities. We disclose both initial margins and variation margins arising from OTC derivatives under Other assets (cf. Note 32) or Other liabilities (cf. Note 42).

The amount, the time and the certainty of future cash flows from derivatives, and thereby their fair values, are uncertain. Major influencing factors are:

- future developments with regard to interest rates, exchange rates, market prices, commodity prices, credit indices and other market prices;
- the future volatility of such prices;
- the default risk of the respective counterparty.

12. Structured products

We account for structured products in accordance with the IDW AcPS HFA 22 interpretation. Structured products valued at fair value or in accordance with the strict lower-of-cost-or-market principle are not subject to separate accounting. Structured assets that are valued in accordance with the moderate lower-of-cost-or-market principle are subject to separate accounting with regard to the derivative components and the host instrument. As a matter of principle, the separated derivative components are included in valuation units (cf. also Note 13). Derivative components of equity-linked structured products, however, are valued individually under the recognition-of-loss principle (imparity principle).

13. Hedge accounting via valuation units

We account for hedging relationships with regard to which the clear assignment of hedged items to hedging instruments is documented in a comprehensible manner in risk management as valuation units within the meaning of Section 254 of the German Commercial Code (HGB) in accordance with the IDW AcPS RS HFA 35, in cases where the requirements for the application of Section 254 HGB are met. Hedged items included in valuation units are assets and liabilities in the form of receivables, securities, liabilities as well as derivative financial instruments. Hedging instruments are derivative financial instruments. All types of market risks may be hedged. However, by far the largest share of valuation units has the purpose of hedging interest rate risk. The clear assignment of the hedged item to the related hedging instrument, the determination of the risk hedged as well as the risk management strategy, information as to the prospective effectiveness and to the methods for determining effectiveness are documented for balance sheet hedging relationships. In addition, the intention to retain or the period of time for which the hedging relationship is to remain in place is included in the documentation. In principle, the intention is to maintain all hedging relationships for the full residual maturity of the hedged transaction. In individual cases, hedging relationships are designated only for a certain term of hedged items and/or hedging instruments.

We present not only micro hedges but also portfolio hedges as valuation units.

A micro hedging relationship is present where a certain risk from a single hedged item is hedged by a single hedging instrument. A portfolio hedging relationship is present where a certain risk from a portfolio of hedged items of the same type is hedged with multiple hedges of the same type. In the case of micro valuation units, the combination into a related unit within the system is already required in the trading system upon the conclusion of the transaction. These are perfect hedging relationships where the value parameters are the same for the hedged portion of the hedged item and the hedging portion of the hedging instrument (e.g. currency, nominal amount, interest rate, interest due date, term). In the case the interest rate risk of a securities portfolio of the same type of fixed-interest securities is hedged by multiple interest swaps, this hedging relationship may be considered for purposes of forming a portfolio valuation unit. We create portfolio valuation units for the corresponding securities portfolios included in the liquidity reserve.

The depiction of hedging relationships accounted for as valuation units is made in two steps. In the first step, the changes in value to be attributed to the hedged risk from the hedged item and the hedging instruments are determined with regard to a valuation unit. We apply the so-called "net hedge presentation method". Changes in value are neither recognised in the carrying amount of the hedged items/hedging instruments on the face of the balance sheet nor in the income statement. Any unrealised loss arising on the netting of such changes in value is recognised in the income statement in accordance with the imparity principle as a provision for contingent losses, which is disclosed on the balance sheet under Other provisions. Additions to valuation allowances for liquidity reserve portfolios as well as additions to loss provisions in the lending business are disclosed in the income statement under Depreciation and impairments on loans (and advances) and certain securities and reversals of such provisions under Income from additions to loans and advances and certain securities as well as from the reversal of provisions in the lending business. Other holdings are disclosed under Other operating expenses. In the second step, the residual change in fair value of the hedged item and hedging instrument are determined on the basis of the individual transaction. This represents the change in fair value attributable to the non-hedged risks. This is separately accounted for in accordance with the imparity principle under general accounting standards. In the second step unrealised losses relating to the liquidity reserve are disclosed in the same manner as in the first step.

The prospective and retrospective effectiveness of a hedging relationship is substantiated and documented at least once a year at the time the annual financial statements are prepared. In the case of micro hedges, the prospective documentation of effectiveness is made on the basis of the critical-terms-match method. As part of this substantiation it needs to be shown that the value parameters of the hedged item and the hedging instruments to be allocated to the hedged risk match. If they match, it is to be presumed that changes in value attributable to the hedged risk will be offset over the entire residual maturity/the designated term of the transactions. In the case of portfolio hedges, prospective substantiation of effectiveness is accomplished by means of quantitative and maturity range-dependent sensitivity analyses in relation to the hedged risk. In the case of a corresponding offset of sensitivities of hedged items and hedging instruments in the relevant maturity ranges, it may be presumed that there will be a high degree of correlation between the changes in the value attributable to the hedged item and those attributable to the hedging instrument over the entire residual maturity of the transactions. The retrospective measurement of effectiveness is generally accomplished, not only for micro but also for portfolio hedges by mathematically determining the ratio of the cumulative changes in value on the part of the hedged item to be attributed to the hedged risk arising since the designation of the hedge to those of the hedging instruments.

AMOUNT OF HEDGED ITEMS AND HEDGING INSTRUMENTS INCLUDED IN VALUATION UNITS

The following table shows the carrying amount of assets and liabilities included in valuation units by balance sheet item.

Derivative financial instruments included in valuation units are disclosed under the items Positive market value derivatives/Negative market values derivatives at their respective fair values.

Hedged items

(€ k)	31.12.2018		31.12.2017	
	Micro valuation units	Portfolio valuation units	Micro valuation units	Portfolio valuation units
Assets				
Loans and advances to customers	861,102	–	861,330	–
Debentures and other fixed-interest securities	375,747	6,454,843	438,574	9,076,705
Liabilities				
Liabilities to banks	43,507	–	32,158	–
Liabilities to customers	935,490	–	983,299	–
Securitised liabilities	90,283	–	95,995	–
Positive market values of derivatives	22,894	–	40,629	–
Negative market values of derivatives	131,930	–	148,026	–

Hedging instruments

(€ k)	31.12.2018		31.12.2017	
	Micro valuation units	Portfolio valuation units	Micro valuation units	Portfolio valuation units
Positive market values of derivatives	373,233	340	425,412	5,434
Negative market values of derivatives	597,483	229,355	635,283	357,887

In relation to the underlying nominal values, interest rate risk is being hedged in approximately 93 % of the valuation units. The other risks largely involve currency risks.

AMOUNT OF THE RISKS HEDGED IN VALUATION UNITS
The following table shows the effective portion of the changes in value to be allocated to the hedged risks on a cumulative basis since the designation of the valuation unit.

Hedged items

(€ k)	31.12.2018				31.12.2017			
	Micro valuation units		Portfolio valuation units		Micro valuation units		Portfolio valuation units	
	Positive change in value	Negative change in value	Positive change in value	Negative change in value	Positive change in value	Negative change in value	Positive change in value	Negative change in value
Assets								
Loans and advances to customers	356,629	–	–	–	359,549	–	–	–
Debentures and other fixed-interest securities	165,585	–	140,309	–	176,273	–	200,986	–
Liabilities								
Liabilities to banks	–	2,929	–	–	–	2,674	–	–
Liabilities to customers	705	131,996	–	–	1,182	156,367	–	–
Securitised liabilities	–	3,139	–	–	–	3,797	–	–
Derivatives	11,677	23,282	–	–	24,796	29,916	–	–

Positive changes in value on the part of the hedged items are offset by corresponding negative changes in value on the part of the hedging instruments for which no provisions for contingent losses were created. Negative changes in value on the part of the hedged items are offset by corresponding positive changes in value on the part of the hedging transactions.

14. Accounting for interest-related financial instruments held in the banking book

We have performed the loss-free valuation of interest-related transactions in the banking book by means of a computation based on the present value approach in accordance with IDW AcPS BFA 3. We have included all balance sheet and off-balance sheet interest-related financial instruments that are not part of the trading book. The whole banking book was used as the net risk exposure for the purpose of the calculation – in line with the funding context. Within the framework of the calculation we have compared the carrying amount of balance sheet and off-balance sheet transactions in the banking book under commercial law with the interest-related net present values. We then deducted the risk costs and administrative costs determined on a present value basis from the amount of the net present values exceeding the carrying amounts.

If a negative balance arises on comparing the present values to the carrying amounts, this amount is recognised in the income statement as a provision for contingent losses, which is disclosed under Other provisions on the balance sheet. Based on the results of the calculation no provisions needed to be created as at 31 December 2018.

Derivative financial instruments not allocated to the trading book and that are neither included in a valuation unit nor in the net risk exposure of the loss-free valuation and do also not fall under the specific cover are valued individually under the recognition-of-loss principle.

15. Equity holdings in non-affiliated companies and interests in affiliated companies

We recognise equity holdings in non-affiliated companies and interests in affiliated companies at acquisition cost. In the case of impairments expected to be permanent – usually induced by changes in the credit rating – we write them down to the lower fair value.

16. Intangible fixed assets

We account for internally-developed and purchased software under Intangible fixed assets. Internally developed software is recognised in the amount of the production costs incurred in its development. Production costs include expenses directly attributable to the development of the software (so-called development costs). Expenses which cannot be directly allocated to the development of the software (so-called research costs) are not included in production costs but are expensed against income for the year incurred. During the financial year, software development costs in the amount of € 1 million (previous year: € 1 million) and no research costs were incurred, as in the previous year.

Purchased software is valued at acquisition cost.

Intangible fixed assets are subject to scheduled, straight-line depreciation, whereby we assume a useful life of five years for acquired standard software. The amortisation period for internally generated intangible assets is ten years insofar as the likely useful life cannot be reliably estimated. In the case impairments are expected to be permanent, we conduct exceptional write-downs. If the reasons for such write-downs no longer exist, we conduct reversals up to the maximum amount of the amortised acquisition or production cost.

17. Tangible fixed assets

Tangible fixed assets are recognised at acquisition cost. For depreciable assets, we calculate scheduled straight-line depreciation for the following periods of useful live:

Tangible fixed asset category	Useful life in years
Buildings	50
Leasehold improvements	The useful life is determined on the basis of the remaining period of the lease.
Other operating equipment	3–15
Leasing assets	Customary useful life
Low-value items (€ 250.00 to € 1,000.00)	5

In the case of tangible fixed assets we conduct extraordinary write-downs where it is likely that permanent impairment has occurred. If the reasons for the write-downs no longer exist, we conduct write-ups up to the maximum amount of the (amortised) acquisition or production costs.

Any acquisition cost subsequently incurred is capitalised and depreciated in line with the adjusted depreciation schedule. Expenses for the maintenance of tangible fixed assets are recognised as expenses in the appropriate accounting period.

Tangible fixed assets with a purchase price of up to € 250.00 are recognised as an expense in the year of acquisition in accordance with the applicable tax provisions.

18. Deferred taxes

Deferred taxes are calculated based on the different carrying amounts of assets and liabilities in the balance sheet drawn up for accounting and tax purposes. We recognise deferred taxes on differences that are expected to offset in future financial years and will thereby lead to future tax expenses or reductions. Deferred tax assets are additionally attributed to tax losses carried forward to the extent the realisation of the tax benefit from the losses carried forward is expected to occur within the next five years. The Overall Bank is subject to an overall tax rate of 31.97 %. Deferred taxes are not discounted in accordance with the regulations. Deferred tax assets and deferred tax liabilities are stated in the balance sheet on a gross basis (asset item 14 and liability item 6a).

At each reporting date Hamburg Commercial Bank AG makes an assessment as to whether the realisation of future tax benefits is sufficiently probable to recognise deferred tax assets. Amongst other things, this requires a management assessment of the tax benefits that arise from the existing tax strategies and future taxable income as well as the consideration of other positive and negative factors. The deferred tax assets disclosed could decrease, if the estimates of the planned taxable income and the tax benefits achievable under the existing tax strategies are revised downwards or if changes to current tax legislation restrict the timing and extent of the realisability of future tax benefits.

19. Liabilities

We recognise liabilities at the amount repayable. Premiums and discounts are shown as deferred income or prepaid expenses, respectively, and are reversed over the term on a straight-line basis. We treat pro-rata interest on an accrual basis and report it in the corresponding liabilities line item.

20. Provisions

We value provisions at the expected call on the provisions in accordance with reasonable commercial judgement. Provisions with a residual maturity of more than one year are generally discounted on the basis of the average market rate determined and published by the Deutsche Bundesbank in accordance with the Regulations on the Determination and Disclosure of Discount Rates for Provisions (RückAbzinsV) in the version applicable as at the reporting date which corresponds to the residual maturity. We disclose income and expenses from the discounting or compounding of provisions under Other operating income (see also Notes 52 and 53); including the income effect of changes in the discount rate applied.

Provisions for pensions and similar obligations are calculated by independent actuaries based on the projected-unit-credit method. For this purpose, the unmodified 2018 G mortality tables (previous year: 2005 G) from Professor Klaus Heubeck are employed as the biometrical basis. The following assumptions were made in determining the obligations:

	2018	2017
Salary growth	2.0 %	2.0 %
Personnel growth	0.5 %	0.5 %
Pension growth		
Employment contract 1/ old pension provision rules	individual	individual
New pension provision rules	2.0 %	2.0 %
Employment contract 4	2.0 %	2.0 %
Staff turnover		
Age up to 30	6.0 %	6.0 %
Age 30-55	Linear decline to zero	Linear decline to zero
Age above 56	0.0 %	0.0 %
Retirement age	pursuant to the 2007 AGAnpassG	pursuant to the 2007 AGAnpassG

Provisions for pensions and similar obligations are discounted, in accordance with Section 253 (2) sentence 2 HGB, at the average market interest rate for the past ten years based on an assumed duration of 15 years. The discount rate applied as at the balance sheet date was 3.21 % p.a. (previous year: 3.67 % p. a.). As at 31 December 2018, the non-distributable difference based on the average seven-year interest rate of 2.32 % p.a. (previous year: 2.80 % p.a.) in accordance with Section 253 (6) HGB amounts to € 116 million (previous year: € 105 million) (cf. Note 58). The use of the new 2018 G biometric mortality tables increases the provisions by € 8 million.

Assets, whose sole purpose is the fulfilment of pension obligations and to which no other creditors have access (fund assets) are recognised at their fair value of € 7 million (previous year: € 7 million), which is also equivalent to the amortised cost of the assets.Income from fund assets, which is offset against expenses, amounted to € 0.2 million in the period under review. Fund assets in the same amount have been offset against provisions for pensions and similar obligations. The amount required to meet the resultant liability was € 10 million as at 31 December 2018 (previous year: € 10 million).

21. Currency translation

Currency translation is performed pursuant to Section 256a HGB in conjunction with Section 340h HGB as well as IDW AcPS FS BFA 4 of the expert banking committee (BFA) of the IDW.

Currency translation with regard to financial instruments included in the trading portfolio is an implicit part of the valuation of such transactions (see comments under Note 9).

Remaining assets, liabilities and pending transactions – including financial instruments that are not classified as held for trading – are translated at the average spot rate prevailing as at the balance sheet date. As forward exchange transactions serve to hedge interest-bearing positions, we divided the agreed-upon forward exchange rate into spot exchange rate and swap positions, and allocate the swap positions over the term of the transaction. The corresponding expense and income are reported in Net interest income. Positive and negative spot exchange rate differences from pending transactions are netted within the same currency and reported under other assets or other liabilities.

To the extent the assets, liabilities and pending transactions are specifically hedged by other assets, liabilities or pending transactions, all expenses and income from currency translation are reported through profit and loss. All assets, liabilities and pending transactions in the same currency are in principle specifically hedged as the foreign exchange risk is managed via a currency position for each foreign currency, the individual currency items are transferred to the corresponding currency position and the amounts of positions or transactions in a foreign currency match. In addition, we also view matching foreign currency transactions which are not managed under a currency position as specifically hedged. If, in exceptional cases, there is no specific hedge (e.g. in case of assets with an acute default risk) and the residual term of the corresponding transactions is more than one year, valuation is made under the recognition-of-loss principle and unrealised income from the currency translation is only recognised to the extent the acquisition costs of assets are not exceeded or the settlement amount of liabilities is not undercut. In the case of residual terms of less than one year, we also recognise unrealised income in the case of corresponding transactions, if such income is not specifically hedged. Expenses and income from currency translation related to items not classified as held for trading are disclosed under Other operating income/Other operating expenses.

For financial statements of entities to be consolidated that have been prepared in a foreign currency, we translate the assets and liabilities at the corresponding mid-market rate of the ECB on the balance sheet date. Average rates for the reporting period are used to translate expenses and income.

22. Accounting treatment applied to the restructuring

Provisions for restructuring are recognised in accordance with the regulations of Section 249 (1) sentence 1 HGB in conjunction with Section 253 (1) sentence 2 and Section 253 (2) HGB, insofar as a restructuring programme has resulted in obligations or pending obligations from which the Bank cannot escape. The Bank discloses provisions for announced personnel measures as well as provisions for administrative cost measures under Other provisions. As soon as the obligation becomes sufficiently certain or can be quantified – e.g. through the signing of agreements – it is reclassified to other liabilities or provisions for pensions and similar obligations as a general rule.

In connection with its successful privatisation on 28 November 2018, Hamburg Commercial Bank approved an extensive restructuring programme, which includes the planned reduction in the number of employees and extensive projects to support the Bank's realignment.

The resultant income and expense is disclosed under the extraordinary income and expenses and is explained in detail there.

Notes on balance sheet assets

23. Affiliated companies

The following balance sheet items include loans and advances to affiliated companies in the following amounts:

(€ k)	31.12.2018	31.12.2017
Loans and advances to banks	493,334	488,447
Loans and advances to customers	341,056	423,396
Debentures and other fixed-interest securities		
Bonds and debentures	13,007	270,184

24. Non-affiliated companies

Loans and advances to non-affiliated companies are included in the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Loans and advances to banks	202	5,058
Loans and advances to customers	9,838	74,003

25. Subordinated assets

Assets must be reported as subordinated if they can only be honoured after the claims of other creditors in the event of the liquidation or insolvency of the debtor. We disclose subordinated assets under the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Loans and advances to banks		
Other receivables	61,112	102,838
Loans and advances to customers	60,164	54,017
Debentures and other fixed-interest securities		
Bonds and debentures	–	12,074
Shares and other non-fixed-interest securities	–	102

26. Residual maturities

The balance sheet items listed below are classified by their residual maturities as follows:

(€ k)	31.12.2018	31.12.2017
Loans and advances to banks		
Other receivables		
Up to 3 months	488,918	1,006,635
Between 3 months and 1 year	898,434	810,322
Between 1 year and 5 years	73,143	177,010
More than 5 years	407,195	412,859
Loans and advances to customers		
Up to 3 months	3,640,012	6,654,878
Between 3 months and 1 year	3,985,659	5,472,302
Between 1 year and 5 years	15,586,942	17,518,200
More than 5 years	8,299,836	10,703,464
With an indefinite term	8,894	–
Debentures and other fixed-interest securities		
Due in the following year	2,216,200	3,148,438

27. Negotiable securities

(€ k)	Listed		Unlisted		Total	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Debentures and other fixed-interest securities	9,545,246	13,898,696	953,518	1,084,946	10,498,764	14,983,642
Shares and other non-fixed-interest securities	8,052	5,164	772	10,047	8,824	15,211
Equity holdings	–	1,128	3,407	4,580	3,407	5,708
Interests in affiliated companies	–	–	46,890	46,890	46,890	46,890

28. Negotiable securities not valued using the lower-of-cost-or-market principle

(€ k)	31.12.2018	31.12.2017
Debentures and other fixed-interest securities		
Carrying amount of securities valued using the moderate lower-of-cost-or-market principle	624,593	1,334,450
Carrying amount of securities reported above their fair value	85,482	161,980
Market value of securities reported above their fair value	84,727	159,777
Unrealised losses	755	2,203
of which unrealised losses on securities which are not part of a valuation unit	755	2,126
Shares and other non-fixed-interest securities		
Carrying amount of securities valued using the moderate lower-of-cost-or-market principle	768	855
Carrying amount of securities reported above their fair value	–	–
Market value of securities reported above their fair value	–	–
Unrealised losses	–	–

The unrealised losses stated above result from the difference between the market value and carrying amount without taking the effects from the valuation units into account. Any collateral or guarantees are similarly not taken into account in calculating the unrealised losses.

Unrealised losses relating to securities held in valuation units, which are not to be allocated to the hedged risk (resulting for the most part from the creditworthiness of the issuer), amounted to € 49 million as at 31 December 2018 (previous year: € 15 million). The unhedged risk is not recorded as the valuation is based on the moderate lower-of-cost-or-market principle. These also include unrealised losses on securities relating to the unhedged risk, which would show an unrealised loss without taking the valuation unit into account.

If there is not a permanent, but rather only a temporary impairment of securities to be expected, which generally is not induced by changes in the credit rating, a write-down to fair value is not undertaken (cf. Note 8).

Unrealised losses on securities which show only a temporary impairment are comprised of the following - broken down by reason (the difference between the carrying amount and fair value is shown for each respective group):

(€ k)	Securities rating	31.12.2018	31.12.2017
No trigger events have occurred		**755**	**1,343**
	Rating investment grade or better	–	226
	Rating lower than investment grade	755	1,117
Trigger events have occurred		**–**	**860**
	Rating investment grade or better	–	–
	Rating lower than investment grade	–	860
Total		**755**	**2,203**

A review of instruments with existing trigger events and a rating lower than investment grade did not identify any requirement to recognise impairment losses.

29. Trading portfolio (assets)

The trading portfolio is comprised of the following:

(€ k)	31.12.2018	31.12.2017
Derivative financial instruments	1,255,840	1,536,676
Debentures and other fixed-interest securities	903,890	1,151,304
Shares and other non-fixed-interest securities	–	357
Other assets	242	12,623
Risk discount	-3,391	-4,517
Total	**2,156,581**	**2,696,443**

30. Trust assets

Trust assets are comprised of the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Loans and advances to customers	3,220	3,934
Total	**3,220**	**3,934**

31. Statement of changes in fixed assets

Development in fixed assets

(€ k)	1.1.2018	2018				31.12.2018	31.12.2018	31.12.2018	31.12.2017
	Historical cost of acquisition	Additions	Disposals	Transfers	Exchange rate differences	Historical cost of acquisition	Accumu-lated depreciation	Carrying amount	Carrying amount
Securities	1,434,246	49,480	825,008	–	2,480	661,198	3,916	657,282	1,370,681
Equity holdings	112,709	–	26,880	–	–	85,829	78,333	7,496	10,007
Interests in affiliated companies	1,278,333	–	6,621	–	25,507	1,297,219	650,295	646,924	621,417
Land and buildings	83,083	–	–	–	–	83,083	11,310	71,773	73,388
Plant and equipment	59,039	1,248	5,980	420	–	54,727	48,488	6,239	11,360
Assets under construction	1,427	1,385	–	-420	–	2,392	–	2,392	1,427
Leasing assets	–	–	–	–	–	–	–	–	–
Intangible fixed assets	173,509	2,569	14,018	–	–	162,060	154,892	7,168	8,089
Total	**3,142,346**	**54,682**	**878,507**	**–**	**27,987**	**2,346,508**	**947,234**	**1,399,274**	**2,096,369**

Development in depreciation/amortisation

(€ k)	01/01/2018	2018						31.12.2018
	Accumu-lated depreciation	Deprecia-tion in the financial year	Write-ups in the financial year	Change in total depreciation in connec-tion with additions	Change in total depreciation in connec-tion with disposals	Change in total depreciation in connec-tion with transfers	Exchange rate differences	Accumu-lated depreciation
Securities	63,565	–	–	–	59,649	–	–	3,916
Equity holdings	102,702	1,370	501	–	25,238	–	–	78,333
Interests in affiliated companies	656,916	–	–	–	6,621	–	–	650,295
Land and buildings	9,695	1,615	–	–	–	–	–	11,310
Plant and equipment	47,679	2,572	–	–	1,763	–	–	48,488
Assets under construction	–	–	–	–	–	–	–	–
Leasing assets	–	–	–	–	–	–	–	–
Intangible fixed assets	165,420	3,487	–	–	14,015	–	–	154,892
Total	**1,045,977**	**9,044**	**501**	**–**	**107,286**	**–**	**–**	**947,234**

Real estate includes land and buildings used for the Bank's own business activities at a carrying amount of € 72 million (previous year: € 73 million).

32. Other assets

The major components of other assets are:

(€ k)	31.12.2018	31.12.2017
Initial and variation margins from OTC derivatives (cf. Note 11)	1,185,426	1,399,614
Tenant loans	40,601	36,863
Receivables on fiscal authorities	34,640	20,120
Adjustment item for currency translation	23,934	9,399
Premiums paid from options trading and from interest limitation agreements	8,047	6,837
Receivables from profit and loss transfer agreements and from dividends	7,922	16,919
Swap deferrals under forward exchange transactions	1,622	10,471

33. Prepaid expenses

The major items disclosed here are:

(€ k)	31.12.2018	31.12.2017
Discount accruals from issuing business	22,375	36,816
Premium accruals from claims	4,875	8,538
Prepaid expenses from derivatives	8,885	11,855
Discount accruals from liabilities	2,215	3,149

34. Deferred tax assets

Deferred tax assets reported for the financial year result from the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Assets		
Loans and advances to customers	266,019	356,114
Debentures and other fixed-interest securities	26,955	18,710
Equity holdings	3,673	4,683
Interests in affiliated companies	1,588	1,860
Intangible fixed assets	61	36
Tangible fixed assets	10,670	6,406
Other assets	2,200	1,379
Prepaid expenses	1,010	661
Liabilities		
Other liabilities	291	126
Deferred income	–	829
Provisions	173,580	93,536
Losses carried forward	168,780	46,996
Total	**654,827**	**531,336**

The deferred tax assets increased by € 123 million in the financial year.

Deferred tax assets on losses carried forward in the amount of approximately € 159 million are attributable to the head office, while € 10 million is attributable to losses carried forward for the Singapore branch.

Within the context of deferred tax asset impairment, there was no impairment on temporary valuation differences at the end of the financial year (previous year: € 330 million).

35. Genuine repurchase agreements

As a borrower under genuine repurchase agreements, we have sold assets with a carrying amount of € 152 million (previous year: € 1,807 million) and simultaneously contracted to repurchase the same assets. The assets continue to be carried on our balance sheet; the consideration received in return for the assets is disclosed under the corresponding liability items.

36. Assets transferred as collateral

In addition to assets sold under repurchase agreements (cf. Note 35)) and the receivables serving as the cover pool for bonds issued (cf. Note 67), we have transferred further assets as collateral. These are mainly securities lodged with central banks and Eurex as collateral for participation in stock exchanges and clearing organisations and for funding as well as loan notes and loan receivables assigned as collateral for borrowings at central banks and other banks.

(€ k)	31.12.2018	31.12.2017
Assets transferred as collateral	7,916,628	7,432,399
thereof for		
Liabilities to banks	6,425,381	5,944,126
Liabilities to customers	305,821	88,659
Trading portfolio (liabilities)	1,185,426	1,399,614

Notes on balance sheet liabilities

37. Affiliated companies

Liabilities to affiliated companies are included in the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Liabilities to banks	699,610	686,471
Liabilities to customers	615,829	884,106

38. Non-affiliated companies

Liabilities to non-affiliated companies are included in the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Liabilities to banks	1,518	19
Liabilities to customers	14,291	68,952

39. Residual maturities

The balance sheet items listed below are classified by their residual maturities as follows:

(€ k)	31.12.2018	31.12.2017
Liabilities to banks		
With an agreed maturity or notice period		
Up to 3 months	820,180	2,911,775
Between 3 months and 1 year	880,720	1,302,512
Between 1 year and 5 years	2,246,099	2,392,046
More than 5 years	1,798,952	1,796,281
Liabilities to customers		
Other liabilities with an agreed maturity or notice period		
Up to 3 months	6,788,548	10,901,013
Between 3 months and 1 year	6,024,292	4,483,022
Between 1 year and 5 years	4,184,303	6,248,114
More than 5 years	3,485,437	4,177,756
Securitised liabilities		
Debentures issued		
Due in the following year	2,966,452	4,525,739
Other securitised liabilities		
Up to 3 months	–	2
Between 3 months and 1 year	–	3,000

40. Trading portfolio (liabilities)

The trading portfolio is comprised of the following:

(€ k)	31.12.2018	31.12.2017
Derivative financial instruments	1,162,570	1,412,670
Liabilities	275	1,401
Total	**1,162,845**	**1,414,071**

41. Trust liabilities

Trust liabilities are reported under the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Liabilities to banks	38	48
Liabilities to customers	3,182	3,886
Total	**3,220**	**3,934**

42. Other liabilities

The major components of this balance sheet item are the following:

(€ k)	31.12.2018	31.12.2017
Security deposits for assumption of debt	423,181	519,528
Variation margin from OTC derivatives	239,343	234,014
Pro rata interest on subordinated debt, profit participation rights and Silent participations	84,202	80,453
Adjustment item for currency valuation	29,420	33,175
Liabilities from profit and loss transfer agreements and from dividends	15,878	3,426
Tax liabilities	4,303	6,320
Outstanding payments for the second loss guarantee	-	34,706

43. Deferred income

The major components of deferred income are the following:

(€ k)	31.12.2018	31.12.2017
Deferrals from advance loan fees	50,993	52,665
Deferred income from derivatives	8,327	8,571
Discount deferrals from receivables	1,658	2,442
Premium deferrals from issuing business	6,065	9,444

44. Deferred tax liabilities

Deferred tax liabilities reported for the financial year result from the following balance sheet items:

(€ k)	31.12.2018	31.12.2017
Assets		
Loans and advances to customers	–	25,832
Interests in affiliated companies	497	93
Intangible fixed assets	169	352
Tangible fixed assets	10,723	10,456
Other assets	127	–
Liabilities		
Other liabilities	–	–
Deferred income	371	–
Provisions	2,722	32,411
Fund for general banking risks	–	–
Total	**14,609**	**69,144**

The deferred tax liabilities fell by € 55 million in the financial year.

45. Other provisions

Other provisions primarily relate to the following items:

(€ k)	31.12.2018	31.12.2017
Restructuring measures	280,952	43,190
Litigation risks and costs	242,441	111,787
Lending business	50,886	66,961
Regulatory expenses	46,712	-
Outstanding invoices	42,935	36,286
Securities transactions and financial derivatives	38,777	49,662
Personnel expenses	33,774	28,990
Archiving costs	4,542	4,338
Processing fees for commercial loans	4,452	1,600
Expenses in connection with the privatisation	3,680	8,721
Interest on corporate tax and trade tax	915	23,730
Expected back payment from tax audit	-	13,615
Assumption of costs of associated companies and discretionary benefits in the customer business	-	1,800

€ 246 million (previous year: € 23 million) of the provisions for restructuring measures relate to personnel expenses and € 35 million (previous year: € 20 million) to operating expenses. The provisions were set up primarily in connection with the extensive restructuring programme resulting from the privatisation of Hamburg Commercial Bank.

As at the balance sheet date, the Bank had set up provisions for litigation risks and costs to the extent it deemed necessary. These provisions also took account of the fact that individual or groups of investors in hybrid financial instruments have filed lawsuits against the Bank in court and, in addition to seeking a decision rendering the termination invalid, are demanding, among other things, that the instruments be written up to the nominal value or that compensation be paid for lost interest payments.

In allocating funds to the provision for litigation risks, significant assumptions and results from the bank planning process, which are associated with estimation uncertainty, were taken into account.

46. Subordinated debt

Subordinated debt was issued in the form of promissory notes, registered or bearer bonds and is denominated in EUR and USD. The original maturities range from under ten years to 40 years and the interest rates payable are between 0 % p.a. and 6.51 % p.a.

Individual items exceeding 10 % of total subordinated debt:

(€ m)	Currency	Interest rate	Maturity	Termination rights
125	USD	3.19 %	21/03/2031	None

In principle, subordinated debt meets the requirements of Article 63 of the Capital Requirements Regulation (CRR) for recognition as Tier 2 capital. Profit participation capital in the amount of € 100 million (previous year: 0million) will mature in less than two years. For the 2018 financial year, interest expense on subordinated debt amounted to € 15 million (previous year: € 17 million).

47. Fund for general banking risks

Amounts from net income from the trading portfolio totalling € 4 million (previous year: € 14 million) and no other amounts were allocated in the reporting period to the fund for general banking risks in accordance with Section 340g HGB (previous year: € 0 million).

48. Equity

Pursuant to Section 25 (1) of the German Bank Accounting Regulation (RechKredV), Subscribed capital consists of the share capital of Hamburg Commercial Bank AG and Silent participations.

The share capital of Hamburg Commercial Bank AG amounts to € 3,018 million and is divided into 301,822,453 registered shares with a notional par value of € 10.00 per share. All the issued shares have been fully paid up.

As at 31 December 2018, several funds launched by Cerberus Capital Management L.P., New York, indirectly held a total of 42.50 % of the voting rights via three acquisition companies (Promontoria Holding 221 B.V. 9.89 %, Promontoria Holding 231 B.V. 13.88 % and Promontoria Holding 233 B.V. 18.73 %). Funds advised by J.C. Flowers & Co LLC, New York, indirectly hold a 35.00 % stake through JCF IV Neptun Holdings S.à r.l. as an acquisition company. In addition, a fund launched by Golden Tree Asset Management LP, New York, indirectly holds a share of 12.50 % in Hamburg Commercial Bank AG via GoldenTree Asset Management Lux S.à r.l. as an acquisition company, while Centaurus Capital LP, Houston, indirectly holds a share of 7.50 % via Chi Centauri LLC as an acquisition company. The remaining 2.5 % stake is held by BAWAG P.S.K. Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft, Vienna.

In the previous year, HSH Beteiligungs Management GmbH, Hamburg, was the largest shareholder with 94.90 % of the voting rights. HSH Finanzfonds AöR – Gemeinsame Anstalt der Freien und Hansestadt Hamburg und des Landes Schleswig-Holstein – held an interest of 68.03 %, the Free and Hanseatic City of Hamburg, incl. the interest held indirectly via HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH held an interest of 11.30 %, the Federal State of Schleswig-Holstein held an interest of 10.02 % and Sparkassen- und Giroverband für Schleswig-Holstein held an interest of 5.55 % in Hamburg Commercial Bank AG, with all of these interests being held indirectly via HSH Beteiligungs Management GmbH. As at 31 December 2017, the nine groups of investors advised by J.C. Flowers & Co LLC held 5.10 % of the voting rights.

JCF IV Neptun Holdings S.à r.l., Luxembourg, informed us in November 2018 that it directly owned more than one quarter of the shares of Hamburg Commercial Bank AG pursuant to Section 20 (1) of the German Stock Corporation Act (AktG). In addition, the following companies and natural persons notified us in November 2018 that they indirectly owned more than one quarter of the shares of Hamburg Commercial Bank AG pursuant to Section 20 (1) sentence 1, sentence 2 in conjunction with Section 16 (4) AktG.

- JCF IV Europe S.à r.l.
- J.C. Flowers IV L.P.
- JCF Associates IV L.P.
- JCF Associates IV Ltd.
- Mr. James Christopher Flowers
- Mr. Stephen A. Feinberg

Neither Hamburg Commercial Bank AG itself nor any affiliated or majority-owned company hold treasury stock of Hamburg Commercial Bank AG. There are no cross-shareholdings as defined by Section 19 AktG.

As part of the regulatory restructuring of the capital structure, all Silent participations of the Bank and, as a result, all Silent participations subject to the regulatory phase-out provisions for additional Tier 1 capital pursuant to Art. 486 CRR were terminated in the year under review with a notice period of two years, i.e. with effect from 31 December 2020. As a result, the remaining regulatory recognition of hybrid instruments as AT1/T2 capital for the regulatory capital ratios under the CRR and SREP requirements no longer applies at the end of the 2018 financial year.

The terms and conditions for Silent participations fulfil the requirements of Article 484 (4) CRR in conjunction with Article 486 (3) and (5) CRR in conjunction with Section 31 of the German Solvency Regulation (SolvV) and can therefore be counted as additional Tier 1 capital during the transition periods up to the upper limits stated there. Furthermore, some of the Silent participations fulfil the requirements of Article 63 CRR for recognition as Tier 2 capital. Among other things, the terms and conditions provide for the Silent participations to be subordinate to other liabilities.

If a net loss is incurred for the current financial year, no distributions related to the Silent participations can be made. In addition, these equity instruments must participate in the net loss for the year. For the 2018 financial year, the Silent participations shared in the Bank's loss to the amount of € 327 million (previous year: € 285 million). The carrying amounts of the hybrid instruments, which are listed on the capital markets, correspond to 22.9 % of the original nominal amount due to the attributed losses.

Notes on the income statement

49. Breakdown of income items by geographical markets

(€ k)	2018			2017		
	Germany	Rest of Europe	Asia	Germany	Rest of Europe	Asia
Interest income	2,197,289	87,252	23,843	2,990,991	84,769	36,114
Current income from shares and other non-fixed-interest securities, equity holdings in non-affiliated companies and interests in affiliated companies	41,028	262	–	43,629	13,855	–
Commission income	79,930	2,521	524	106,511	4,294	530
Net income from the trading portfolio	32,379	–	1,031	122,898	–	2,637
Other operating income	164,820	5,631	617	166,402	11,895	1,034

50. Net interest income

Net interest income includes one-time expenses from the disposal of receivables in the amount of € 55 million (previous year: € 298 million).

51. Net commission income

Net commission income is comprised of the following:

(€ k)	2018	2017
Lending business	32,580	53,943
Payment transactions and foreign business, documentary business	18,137	18,778
Securities business	871	1,263
Guarantee business	-180,473	-170,753
Other	-3,415	8,741
Total	**-132,300**	**-88,028**

Net commission income for the year ended 31 December 2018 includes expenses for the guarantee from HSH Finanzfonds AöR in the amount of € 165 million (previous year: € 154 million). Of this amount, € 100 million relates to the cancellation fee.

The premium expense resulting from a synthetic securitisation transaction (see Note 3.II of the 2017 Financial Report) in the amount of € 25 million (previous year: € 26 million) was also reported under net commission income.

52. Other operating income

In principal the following items are recognised as Other operating income in the course of the financial year:

(€ k)	2018	2017
Income on exchange from transactions not specifically hedged	60,190	–
Income from the reversal of other provisions	35,084	44,456
Cost allocations and reimbursement of expenses	31,599	40,882
Interest income from claims against tax authorities	7,044	608
Income from legal disputes	5,329	4,558
Income from the reversal of provisions for contingent losses from valuation units (cf. Note 13)	5,040	19,420
Income from option premiums received as well as compensation payments received for options held in the non-trading portfolio	4,445	36,333

53. Other operating expenses

Other operating expenses primarily include the following items:

(€ k)	2018	2017
Expenses from additions to provisions for litigation risks	138,002	61,475
Expenses for the compounding of provisions outside the lending business	80,350	66,297
Expenses paid in advance for transaction fees, legal fees, servicing	24,973	–
Expenses from additions to other provisions	5,207	26,431
Expenses from additions to provisions for contingent losses from valuation units (cf. Note 13)	1,290	2,846
Interest expenses pursuant to Section 233 AO	650	7,215

The expenses for the compounding of provisions includes not only the expense resulting from the change in the ten-year mean interest rate in the amount of € 51 million (previous year: € 36 million), but also the interest expense from discounting in the amount of € 29 million (previous year: € 30 million). Please refer to Note 45 for information on the increase in provisions for litigation risks.

54. Extraordinary result

The Extraordinary result includes restructuring expenses connected to the strategic realignment of the Bank in the amount of € 345 million (previous year: € 77 million). € 67 million of this amount (previous year: € 52 million) relates to expenses for the privatisation of the Bank. These were offset by income arising from the reversal of provisions from previous restructuring programmes. Please refer to Note 22 for information concerning the accounting treatment applied to the restructuring.

55. Income tax expense

Income tax expense comprises the following:

(€ k)	2018	2017
Deferred income taxes	178,027	-27,428
on temporary differences	26,689	-75,437
on loss carryforwards	151,338	48,009
Current income taxes	15,832	29,340
Total	**193,859**	**1,912**

Deferred tax income in the year under review was mainly influenced by the increase in deferred tax assets on loss carryforwards. This is due to the deferred tax assets set up at head office and to the reduction in deferred tax assets for the Singapore branch. Despite the significant reduction in asset differences, there is deferred tax income in this regard in the financial year under review due to the fact that temporary valuation differences amounting to € 1,030 million were not measured with deferred taxes in the previous year.

Current income tax expense of € 16 million relates largely to tax income for previous years.

56. Income from loss-sharing

The income from the assumption of losses relates to the participation in losses attributable to Silent participations in the amount of € 327 million (previous year: € 285 million).

57. Fees and activities of the auditor

AUDITOR'S ACTIVITIES

PricewaterhouseCoopers GmbH Wirtschaftsprüfungsgesellschaft audited the annual financial statements and Group financial statements of Hamburg Commercial Bank as at 31 December 2018 and conducted various audits of annual financial statements at subsidiaries. In addition, the review of the half-year financial report as at 30 June 2018 and, to a lesser extent, certain services relating confirmations for guarantee schemes were performed. In addition, tax consultancy services and services in the form of opinions on technical issues and agreed investigations were provided.

AUDITORS' FEES WITHIN THE MEANING OF IDW ACPS HFA 36 (NEW VERSION)

As parent company, Hamburg Commercial Bank AG is included in the consolidated financial statements of Hamburg Commercial Bank AG. Accordingly, in accordance with Section 285 No. 17 of the German Commercial Code (HGB), the total fee paid to the statutory auditor is not disclosed here. Please refer to the corresponding notes in the consolidated financial statements.

58. Non-distributable amounts

A total of € 757 million (previous year: € 522 million) of the reserves available for distribution are barred from being distributed. Of this amount, less than € 1 million (previous year: € 1 million) relates to the recognition of internally generated intangible fixed assets less the Deferred tax liabilities created in relation thereto. € 640 million (previous year: € 462 million) represents the amount by which the Deferred tax assets recognised on the balance sheet exceed the other Deferred tax liabilities. € 116 million (previous year: € 105 million) relates to the difference in accordance with Section 253 (6) HGB in connection with the discount rate for pension provisions.

Other disclosures

59. Leasing business

Assets related to the leasing business include € 73 million (previous year: € 76 million) shown under Loans and advances to customers. Liabilities from the leasing business amount to € 18 million (previous year: € 18 million) and are disclosed under Liabilities to customers.

60. Contingent liabilities and other commitments

Contractually agreed obligations, the realisation of which is unlikely as at the reporting date, constitute contingent liabilities. This item mainly contains financial guarantees provided in the course of our lending business which contain a legally possible call right and it is unlikely that they will be drawn upon. Irrevocable loan commitments are reported under Other commitments. Credit guarantees and irrevocable loan commitments are subject to the Bank's loan loss provisions process (cf. Note 6). As part of this process, the relevant commitments are continually monitored on the basis of certain criteria with respect to exposure to any acute default risk. In the event there are indications that the borrower's financial situation makes the full repayment of the loan unlikely and there is a threat of a call on the guarantee, the default risk is covered by the recognition of a provision. Provisions are additionally recognised for irrevocable credit commitments where a drawdown is likely and the borrower is not expected to repay the agreed loan amount, in full or in part, due to financial difficulties. Provisions are disclosed on the liability side of the balance sheet. Contingent liabilities or other commitments are reduced accordingly. To this extent, there is no acute credit risk for the Bank with regard to the contingent liabilities and other commitments disclosed on the balance sheet as at the reporting date.

Contingent liabilities do not include any material liabilities.

Irrevocable credit commitments mainly relate to domestic clients in the amount of € 5,827 million (previous year: € 5,134 million) and to foreign clients in the amount of € 1,587 million (previous year: € 1,590 million).

As was the case in the previous year, there were no placement or underwriting commitments as at 31 December 2018.

61. Letters of comfort

Except in the case of political risk, Hamburg Commercial Bank AG ensures that its affiliated company HSH Nordbank Securities S.A., Luxembourg, is able to meet its obligations.

In addition, Hamburg Commercial Bank AG has undertaken – except in the case of political risk – to provide HSH N Residual Value Ltd., Hamilton, with sufficient funds to allow it to meet when due the obligations it entered into during the period when Hamburg Commercial Bank AG held an equity interest in HSH N Residual Value Ltd.

62. Other financial obligations

The transactions listed below include payment obligations under pending contracts or continuing obligations that cannot be recognised in the balance sheet as well as other financial obligations that could have a material effect on the future financial position of Hamburg Commercial Bank AG.

Under the German Deposit Protection Act (EinSiG), the guarantee scheme of the German Savings Banks Finance Group is required to meet a statutory target volume by 3 July 2024. For this purpose, the guarantee scheme of the German Savings Banks Finance Group calculates the proportionate target volume allocated to the individual member institution every year, by 31 May of the current year, on the basis of data as at 31 December of the previous year, and arrives at the annual premium per member institution based on this data. The premium is collected before 30 September of each year. In previous years, Hamburg Commercial Bank AG had contributed a portion of its premium obligations as irrevocable payment obligations (total € 6 million, previous year: € 2 million).

Special or additional contributions over and above the annual membership fees referred to above may be levied, for instance, as part of a compensation case where support is provided. This means that, until it leaves the guarantee scheme of the German Savings Banks Finance Group at the end of 2021 and until the planned subsequent seamless transition of Hamburg Commercial Bank AG to the deposit guarantee fund for private banks, the Bank is obliged to pay any special or additional contributions potentially levied by the guarantee scheme of the German Savings Banks Finance Group, and these represent a risk with regard to the financial position of Hamburg Commercial Bank AG.

With the transposition of the Bank Recovery and Resolution Directive (BRRD) into German law a new legal basis for determining the bank levy came into force as at 1 January 2015. The target amount of the EU-wide Single Resolution Fund (SRF) is to be achieved by 1 January 2024 through contributions paid by European banks. The current levy is determined by the supervisory authorities as at 31 May of each year and is payable by 30 June. Subsequent payments are not provided for.

Further obligations in the amount of € 36 million (previous year: € 42 million) result from long-term leases for land and buildings used for business purposes. Additional obligations amounting to € 77 million (previous year: € 105 million) result from leasing agreements for IT services.

Long-term rental agreements for office space result in annual obligations of approximately € 1 million (previous year: € 1 million).

Under a sale of an equity holding the Bank has undertaken to purchase fund units at the market price up to a nominal amount of € 8 million (previous year: € 8 million).

The estimated payments made to BVV Versorgungskasse des Bankgewerbes e.V. amount to € 1 million (previous year: € 2 million). These include the additional contributions to compensate for the reduction in pension payments to employees applied by BVV Versicherungsverein des Bankgewerbes a.G. and BVV Versorgungskasse des Bankgewerbes e.V. in order to maintain the original benefit amount based on the individual pension commitments for these employees and prevent any pension gaps.

There is a payment obligation amounting to a maximum of € 3 million vis-à-vis two affiliated companies under cost assumption agreements (previous year: € 7 million).

As part of its former guarantor function the Bank also has a general liability towards Deka Bank Deutsche Girozentrale together with other former shareholders. It applies to liabilities entered into until 18 July 2001 regardless of their term.

There are no material other financial obligations apart from those listed above.

63. Notes on shareholdings

The following list contains information on the companies in which Hamburg Commercial Bank AG holds either a direct or indirect interest:

Affiliated companies – foreign banks

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
1	HSH Nordbank Securities S.A., Luxembourg, Luxembourg	100.00	100.00	EUR	207,855,834.61	9,355,834.61

Affiliated companies – other domestic companies

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
2	BINNENALSTER-Beteiligungsgesellschaft mbH, Hamburg	100.00	100.00	EUR	253,496.50	-8,313.52
3	Bu Wi Beteiligungsholding GmbH, Hamburg	100.00	100.00	EUR	21,202.86	2,222.82
4	CAPCELLENCE Dritte Fondsbeteiligung GmbH, Hamburg[1]	100.00	100.00	EUR	2,204,177.23	3,880,617.08
5	CAPCELLENCE Erste Fondsbeteiligung GmbH, Hamburg[1]	100.00	100.00	EUR	1,067,999.66	306,958.62
6	CAPCELLENCE Holding GmbH & Co. KG, Hamburg[1]	100.00	100.00	EUR	113,201,642.08	4,542,670.57
7	Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG, Hamburg[1]	83.33	99.91	EUR	161,281.85	121,488.33
8	Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG, Hamburg[1]	90.91	99.99	EUR	799,359.07	-23,083.57
9	CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG, Hamburg[1]	83.33	99.99	EUR	4,389,660.12	2,673,987.59
10	CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG, Hamburg[1]	90.91	99.47	EUR	-30,681.12	1,250,457.70
11	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG, Hamburg[1]	83.33	99.99	EUR	14,548,105.44	-126,600.24
12	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH, Hamburg[1]	100.00	100.00	EUR	4,116.35	-253,492.58
13	CAPCELLENCE Zweite Fondsbeteiligung GmbH, Hamburg[1]	100.00	100.00	EUR	5,015,613.44	2,620,376.55
14	GmbH Altstadt Grundstücksgesellschaft, Mainz[1] [10]	50.00	50.00	EUR	-239,917.11	279,088.35
15	HGA New Office Campus-Kronberg GmbH & Co. KG, Hamburg	56.44	56.44	EUR	10,674,163.21	-448,692.74
16	HSH Auffang- und Holdinggesellschaft mbH & Co. KG, Hamburg	100.00	100.00	EUR	2,321,685.25	359,521.34
17	HSH Care+Clean GmbH, Hamburg[1] [3]	51.00	51.00	EUR	25,000.00	41,793.68
18	HSH Facility Management GmbH, Hamburg[2]	100.00	100.00	EUR	205,600.00	-31,809.41
19	HSH Gastro+Event GmbH, Hamburg[1] [3]	100.00	100.00	EUR	25,000.00	51,876.22
20	HSH Move+More GmbH, Kiel[1] [3]	51.00	51.00	EUR	25,000.00	303,163.90
21	HSH Private Equity GmbH, Hamburg[2]	100.00	100.00	EUR	550,000.00	-2,404,337.61
22	Lyceum Capital Fund 2000 (Number Five) GmbH & Co. KG, Stuttgart[1] [5]	80.00	0.00	EUR	-240,902.29	–
23	PERIMEDES GmbH, Hamburg	100.00	100.00	EUR	31,190.81	2,707.20

Affiliated companies – other foreign companies

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
24	Asian Capital Investment Opportunities Limited, Hong Kong, Hong Kong[1)]	51.00	51.00	USD	114.00	-1.00
25	Avia Management S.à r.l., Luxembourg, Luxembourg	100.00	100.00	EUR	–5,646.42	10,944.73
26	Aviation Leasing OpCo France III, Paris, France[1)]	100.00	100.00	EUR	-387,581.00	–48,816.00
27	Aviation Leasing OpCo France IV, Paris, France[1)]	100.00	100.00	EUR	–92,893.00	-31,076.00
28	European Capital Investment Opportunities Limited, St. Helier, Jersey[1)]	51.00	51.00	EUR	225.00	-103.00
29	HSH N Finance (Guernsey) Limited, St. Peter Port, Guernsey	100.00	100.00	EUR	346,164.00	-140,303.00
30	HSH N Funding II, George Town, Cayman Islands	56.33	100.00	USD	654,305,988.00	36,276,800.00
31	HSH N Residual Value Ltd., Hamilton, Bermuda	100.00	100.00	USD	3,928,126.00	16,324.00
32	HSH N Structured Situations Limited, St. Helier, Jersey[7)]	100.00	100.00	USD	346,449.00	-68.00
33	Neptune Finance Partner II S.à.r.l., Luxembourg, Luxembourg[9)]	100.00	100.00	USD	62,763.63	–
34	Neptune Finance Partner S.à.r.l., Luxembourg, Luxembourg	100.00	100.00	USD	73,894.70	–
35	Next Generation Aircraft Finance 2 S.à.r.l., Findel, Luxembourg[1) 10)]	49.00	49.00	EUR	–5,648,667.00	3,785,444.00
36	Next Generation Aircraft Finance 3 S.à.r.l., Findel, Luxembourg[1) 10)]	49.00	49.00	EUR	–6,742,994.00	3,929,202.00
37	NORDIC BLUE CONTAINER V LIMITED, Majuro, Marshall Islands	100.00	100.00		[4)]	[4)]
38	RESPARCS Funding Limited Partnership I, Hong Kong, Hong Kong[1)]	0.01	100.00	USD	-1,442,877.00	7,092,061.00
39	RESPARCS Funding II Limited Partnership, St. Helier, Jersey[1)]	0.01	100.00	EUR	-125,899,585.00	405,671.00

Equity holdings

Serial. no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
40	4Wheels Management GmbH, Düsseldorf[1) 8)]	68.75	40.00	EUR	5,222,630.31	-981,266.48
41	AGV Irish Equipment Leasing No. 7 Limited, Dublin, Ireland[1)]	49.00	49.00	USD	20,674.00	-21,122.00
42	AKA Ausfuhrkredit-Gesellschaft mbH, Frankfurt am Main	1.33	1.33	EUR	238,732,103.15	11,080,000.00
43	Amentum Aircraft Leasing No. Ten Limited, Dublin, Ireland[1) 6)]	49.00	49.00	USD	2,377.00	10,253,806.00
44	CapVis Equity III L.P., St. Helier, Jersey[1)]	2.50	0.00	EUR	266,051,522.00	59,349,078.00
45	CVC European Equity Partners V (A) L.P., St. Helier, Jersey[1)]	0.45	0.00	EUR	1,546,534,316.00	301,837,946.00
46	Deutsche WertpapierService Bank AG, Frankfurt am Main	2.51	2.51	EUR	193,702,296.19	22,114,512.74
47	EDD AG, Düsseldorf	0.89	0.89	EUR	27,792,319.98	-3,009,362.33
48	EURO Kartensysteme GmbH, Frankfurt am Main	2.82	2.82	EUR	11,834,836.14	199,431.92
49	FSP CAPCELLENCE Beteiligungs GmbH, Hamburg[1)]	100.00	40.00	EUR	14,987,330.84	-47,178.34
50	GB Deutschland Fund GmbH & Co. KG, Hamburg[1)]	4.69	0.00	EUR	24,277,672.21	10,691,119.74
51	GLB GmbH & Co. OHG, Frankfurt am Main	15.77	15.77	EUR	5,658,173.91	453,351.20
52	GLB-Verwaltungs-GmbH, Frankfurt am Main	15.80	15.80	EUR	53,707.83	1,964.86
53	Global Format GmbH & Co. KG, Munich	28.57	28.57	EUR	1,948,092.72	41,614.87
54	Hamburgische Grundbesitz und Anlage GmbH & Co. Objekte Hamburg und Potsdam KG, Hamburg	5.15	5.16	EUR	10,946,020.84	1,103,626.68
55	HGA Objekt München GmbH & Co. KG, Hamburg	5.23	5.23	EUR	18,064,553.83	1,567,288.53
56	HGA Objekt Stuttgart GmbH & Co. KG, Hamburg	7.25	7.26	EUR	9,578,657.45	203,510.18
57	HGA Objekte Hamburg und Hannover GmbH & Co. KG, Hamburg	5.10	5.09	EUR	7,825,607.71	303,498.39
58	Hines European Development Fund Limited Partnership, Wilmington, USA[1)]	9.90	9.90	EUR	61,892,000.00	-747,000.00
59	Next Commerce Accelerator Beteiligungsgesellschaft mbH & Co. KG, Hamburg	16.39	16.39	EUR	1,999,231.89	-20,768.11
60	Next Commerce Accelerator GmbH, Hamburg	16.67	16.67	EUR	37,309.08	-42,690.92
61	RSU Rating Service Unit GmbH & Co KG, Munich	13.60	13.60	EUR	14,030,218.77	909,363.72
62	Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T. SCRL), La Hulpe, Belgium	0.04	0.04	EUR	469,330,000.00	45,119,000.00
63	True Sale International GmbH, Frankfurt am Main	7.69	7.69	EUR	4,928,143.76	119,247.90
64	Vofü-Fonds I Hamburgische Grundbesitz und Anlage GmbH & Co. KG, Hamburg	5.10	5.09	EUR	106,513.06	1,542,002.50

1) Indirect holding.
2) A profit transfer agreement with the company is in place.
3) There is a profit transfer agreement with HSH Facility Management GmbH.
4) No data available.
5) Only data as at 29 February 2016 is available.
6) Only data as at 30 June 2016 is available.
7) Only data as at 31 December 2016 is available.
8) Only data as at 31 July 2017 is available.
9) Only data as at 09 December 2017 is available.
10) Based on the contractual arrangement this is an affiliated company, although Hamburg Commercial Bank AG does not hold the majority of the voting rights.

Foreign exchange rates for € 1 as at 31 December 2018

USA	USD	1.145

Hamburg Commercial Bank AG is the general partner of GLB GmbH & Co. OHG, Frankfurt am Main.

There are no equity holdings exceeding five per cent of the voting rights in large corporations.

64. Notes on foreign currencies

The amounts of assets and liabilities denominated in foreign currencies as at the reporting date are as follows:

(€ k)	31.12.2018	31.12.2017
Assets	6,471,228	14,210,162
Liabilities	4,910,327	6,216,659

65. Information on the net balance sheet presentation

The netting of the fair values of trading portfolio derivatives traded over the counter against the cash collateral provided and received had the following impact with regard to the transactions included in the netting process:

(€ k)	31.12.2018			31.12.2017		
	Value before netting	Netting	Value after netting	Value before netting	Netting	Value after netting
Trading portfolio (assets)						
of which: derivative financial instruments	2,318,207	2,264,014	54,193	2,568,324	2,563,289	5,035
Other assets	1,660,708	630,437	1,030,271	1,860,670	597,409	1,263,261
Total assets	**3,978,915**	**2,894,451**	**1,084,464**	**4,428,994**	**3,160,698**	**1,268,296**
Trading portfolio (liabilities)						
of which: derivative financial instruments	2,536,341	2,494,924	41,417	2,803,100	2,779,394	23,706
Other liabilities	620,802	399,527	221,275	612,278	381,304	230,974
Total liabilities	**3,157,143**	**2,894,451**	**262,692**	**3,415,378**	**3,160,698**	**254,680**

66. Derivatives business

The following section presents the business conducted by Hamburg Commercial Bank AG in the area of derivative financial instruments (forward transactions within the meaning of Section 36 RechKredV) as at the reporting date.

Transactions held in the non-trading portfolio serve mainly to hedge interest, currency exchange rate or market price fluctuations. The following overview of the non-trading portfolio does not include derivatives that are a component of accounting valuation units (the nominal volume of these derivatives amounted to € 3,491 million as at 31 December 2018 (previous year: € 10 million)).

The following tables show, in addition to the nominal amounts of the contracts with counterparties outside of Hamburg Commercial Bank AG, the term structure and counterparty classification, broken down into interest rate risk, interest rate and foreign exchange risks, foreign exchange risks and other price risks. In addition, the following tables contain information on non-concluded foreign-currency-related, interest-dependent and other forward transactions as defined under Section 36 RechKredV.

I. Presentation of volumes and market values

Trading portfolio

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Interest rate swaps	126,848	141,616	3,190	3,625	2,347	2,625
FRA	937	–	–	–	–	–
Swaptions						
Long positions	2,358	2,053	61	72	16	15
Short positions	3,460	2,660	8	7	117	113
Caps, floors	13,146	10,941	24	28	45	43
Exchange-traded contracts	238	274	–	–	–	–
Other forward interest rate transactions	136	179	14	15	19	31
Interest rate risks	**147,123**	**157,723**	**3,297**	**3,747**	**2,544**	**2,827**
Interest rate/currency swaps	6,511	10,429	58	146	42	83
Interest rate and foreign exchange risks	**6,511**	**10,429**	**58**	**146**	**42**	**83**
Forward exchange transactions	1,503	1,937	38	24	28	26
Currency options						
Long positions	178	235	7	14	–	–
Short positions	128	213	–	–	2	6
Foreign exchange risks	**1,809**	**2,385**	**45**	**38**	**30**	**32**
Equity options						
Long positions	–	97	–	44	–	–
Short positions	–	96	–	–	–	43
Exchange-traded contracts	10	23	–	–	–	–
Equity and other price risks	**10**	**216**	**–**	**44**	**–**	**43**
Collateral taker	54	54	13	11	–	–
Credit derivatives	**54**	**54**	**13**	**11**	**–**	**–**
Structured products	**1,728**	**1,651**	**105**	**113**	**199**	**209**
Total	**157,235**	**172,458**	**3,518**	**4,099**	**2,815**	**3,194**

Non-trading portfolio

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Interest rate swaps	2,921	3,167	119	148	511	677
Swaptions						
Long positions	900	–	1	–	–	–
Short positions	650	–	1	–	–	–
Caps, floors	6	7	–	–	–	–
Exchange-traded contracts	526	–	–	–	–	–
Other forward interest rate transactions	12	–	–	–	–	–
Interest rate risks	**5,015**	**3,174**	**121**	**148**	**511**	**677**
Interest rate/currency swaps	64	64	–	–	30	27
Interest rate and foreign exchange risks	**64**	**64**	**–**	**–**	**30**	**27**
Forward exchange transactions	1,945	5,297	27	34	3	28
Foreign exchange risks	**1,945**	**5,297**	**27**	**34**	**3**	**28**
Equity options						
Long positions	5	16	–	–	–	–
Equity/index-based swaps	54	80	10	13	–	–
Equity and other price risks	**59**	**96**	**10**	**13**	**–**	**–**
Collateral provider	13	13	–	–	–	–
Collateral taker	–	380	–	–	–	–
Credit derivatives	**13**	**393**	**–**	**–**	**–**	**–**
Structured products	**609**	**647**	**21**	**28**	**122**	**126**
Total	**7,705**	**9,671**	**179**	**223**	**666**	**858**

II. Breakdown by counterparty

Trading and non-trading portfolio

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
OECD banks	65,894	78,615	1,396	1,720	2,184	2,704
Non-OECD banks	56	96	1	2	–	1
Non-banks (incl. stock exchanges)	94,767	98,415	2,068	2,366	1,048	1,070
Public authorities	4,223	5,003	232	234	249	277
Total	**164,940**	**182,129**	**3,697**	**4,322**	**3,481**	**4,052**

III. Breakdown by maturity

Trading and non-trading portfolio nominal values

(€ m)	Interest rate risks		Credit risks		Foreign exchange risks		Equity and other price risks		Structured products	
	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017
Residual maturity										
Up to 3 months	11,881	15,995	–	–	2,986	6,601	12	223	251	39
Up to 1 year	26,459	27,599	13	–	743	1,008	21	18	172	57
Up to 5 years	75,574	79,091	–	13	25	73	36	66	129	568
Over 5 years	44,799	48,705	54	434	–	–	–	5	1,785	1,634
Total	**158,713**	**171,390**	**67**	**447**	**3,754**	**7,682**	**69**	**312**	**2,337**	**2,298**

IV. Carrying amounts of derivative financial instruments held in the non-trading portfolio

Derivatives held in the non-trading portfolio are in principle not recognised as they are pending transactions. There are exceptions in cases where Hamburg Commercial Bank AG has paid option premiums as a purchaser or has received option premiums as the seller. These are capitalised under Other assets/are expensed under Other liabilities. In addition, the recognition of provisions for contingent losses may be necessary where the individual valuation of derivatives results in negative market values. Furthermore, reconciliation items are recorded for currency transactions. As of 31 December 2018, the net amount of reconciliation items shown under Other assets amounted to € 24 million (previous year: € 9 million) and the reconciliation items shown under Other liabilities amounted to € 29 million (previous year: € 33 million).

(€ m)	Option premiums paid		Option premiums received	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Interest rate contracts	1	–	1	–
Currency contracts	–	–	–	–
Equity and other contracts	7	7	–	–
Total	**8**	**7**	**1**	**–**

We have created provisions for contingent losses in the amount of € 17 million (previous year: € 25 million) for derivative financial instruments outside of the trading portfolio with regard to which an effective hedging relationship could not be shown.

67. Information in accordance with Section 28 of the Mortgage Bond Act (Pfandbriefgesetz)

The total amount of mortgage bonds, public-sector bonds and ship mortgage bonds in circulation, and the corresponding cover funds, stated in terms of the nominal value, net present value and risk-adjusted present value in accordance with PfandBarwertV[1] are as follows:

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Mortgage bonds	4,786	4,380	4,920	4,537	4,920	4,537
Cover funds	5,203	4,798	5,575	5,155	5,567	5,144
of which: Derivatives	–	–	–	–	–	–
Surplus coverage	**417**	**418**	**655**	**618**	**647**	**607**

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Public-sector mortgage bonds	2,996	3,784	3,452	4,359	3,316	4,176
Cover funds	3,213	4,115	3,817	4,861	3,548	4,513
of which: Derivatives	–	–	–	–	–	–
Surplus coverage	**217**	**331**	**365**	**502**	**232**	**337**

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2018	31.12.2017	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Ship mortgage bonds	119	1,163	124	1,178	122	1,174
Cover funds	1,789	2,176	1,916	2,312	1,723	2,124
of which: Derivatives	–	–	–	–	–	–
Surplus coverage	**1,670**	**1,013**	**1,792**	**1,134**	**1,601**	**950**

Composition of the additional cover assets

(€ m)		Receivables within the meaning of Section 19 (1) No. 2 PfandBG			Mortgage bonds
Registered receivables 2018	Equa-lisation claims	Total	there of covered debentures	Receivables within the meaning of Section 19 (1) No. 3 PfandBG	Total
Germany	–	15	–	571	586
Total	**–**	**15**	**–**	**571**	**586**

[1] Statutory Order on the Provision of Collateral for the Current Coverage of Mortgage Bonds, Public-sector Mortgage Bonds and Ship Mortgage Bonds according to Net Present Value and its Calculation at Mortgage Credit Banks dated 14 July 2005.

(€ m)	Receivables within the meaning of Section 20 (2) No. 2 PfandBG				Mortgage bonds
Registered receivables 2017	Equa-lisation claims	Total	there of covered debentures	Receivables within the meaning of Section 19 (1) No. 3 PfandBG	Total
Germany	–	20	–	145	165
Total	**–**	**20**	**–**	**145**	**165**

As in the previous year, there were no receivables that exceeded the limits set out in Section 19 (1) of the German Mortgage Bonds Act (Pfandbriefgesetz - PfandBG).

(€ m)	Receivables within the meaning of Section 20 (2) No. 2 PfandBG			Public-sector mortgage bonds
Registered receivables 2018	Equa-lisation claims	Total	there of covered debentures	Total
Germany	–	–	–	–
Total	**–**	**–**	**–**	**–**

(€ m)	Receivables within the meaning of Section 20 (2) No. 2 PfandBG			Public-sector mortgage bonds
Registered receivables 2017	Equa-lisation claims	Total	there of covered debentures	Total
Germany	–	2	–	2
Total	**–**	**2**	**–**	**2**

As in the previous year, there were no receivables that exceeded the limits set out in Section 20 (2) of the German Mortgage Bonds Act (Pfandbriefgesetz - PfandBG).

(€ m)	Receivables within the meaning of Section 26 (1) No. 3 PfandBG				Ship mortgage bonds
Registered receivables 2018	Equa-lisation claims	Total	there of covered debentures	Receivables within the meaning of Section 26 (1) No. 4 PfandBG	Total
Germany	–	–	–	30	30
Total	**–**	**–**	**–**	**30**	**30**

(€ m)	Receivables within the meaning of Section 26 (1) No. 3 PfandBG				Ship mortgage bonds
Registered receivables 2017	Equa-lisation claims	Total	there of covered debentures	Receivables within the meaning of Section 26 (1) No. 4 PfandBG	Total
Germany	–	–	–	493	493
Total	**–**	**–**	**–**	**493**	**493**

As in the previous year, there were no receivables that exceeded the limits set out in Section 26 (1) of the German Mortgage Bonds Act (Pfandbriefgesetz - PfandBG).

The mortgage bonds, public-sector mortgage bonds and ship mortgage bonds in circulation, and the corresponding cover assets, have the following maturity structure:

(€ m)	Mortgage bonds		Cover funds	
Nominal value	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Up to 6 months	257	9	329	201
Between 6 and 12 months	641	585	240	277
Between 12 and 18 months	163	257	190	204
Between 18 months and 2 years	554	641	577	140
Between 2 years and 3 years	646	716	513	709
Between 3 years and 4 years	1,090	646	748	749
Between 4 years and 5 years	1,425	590	733	575
Between 5 years and 10 years	10	936	1,847	1,914
More than 10 years	–	–	26	29
Total	**4,786**	**4,380**	**5,203**	**4,798**

(€ m)	Public-sector mortgage bonds		Cover funds	
Nominal value	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Up to 6 months	302	109	178	77
Between 6 and 12 months	9	624	266	188
Between 12 and 18 months	168	294	34	168
Between 18 months and 2 years	551	9	218	285
Between 2 years and 3 years	602	719	289	354
Between 3 years and 4 years	325	602	270	421
Between 4 years and 5 years	30	325	254	304
Between 5 years and 10 years	624	624	712	1,205
More than 10 years	385	478	992	1,113
Total	**2,996**	**3,784**	**3,213**	**4,115**

(€ m)	Ship mortgage bonds		Cover funds	
Nominal value	31.12.2018	31.12.2017	31.12.2018	31.12.2017
Up to 6 months	20	515	223	335
Between 6 and 12 months	15	540	185	171
Between 12 and 18 months	15	20	264	186
Between 18 months and 2 years	10	15	228	161
Between 2 years and 3 years	30	15	340	404
Between 3 years and 4 years	5	30	231	352
Between 4 years and 5 years	23	5	232	237
Between 5 years and 10 years	–	23	86	330
More than 10 years	–	–	–	–
Total	**118**	**1,163**	**1,789**	**2,176**

The proportion of fixed-interest-bearing cover assets in the corresponding cover funds and the ratios of fixed-interest-bearing bonds to the liabilities to be covered are as follows:

	Mortgage bonds	
(in %)	31.12.2018	31.12.2017
Proportion of fixed interest-bearing cover funds	47	40
Ratio of fixed interest-bearing bonds	98	97

	Public-sector mortgage bonds	
(in %)	31.12.2018	31.12.2017
Proportion of fixed interest-bearing cover funds	91	93
Ratio of fixed interest-bearing bonds	96	97

	Ship mortgage bonds	
(in %)	31.12.2018	31.12.2017
Proportion of fixed interest-bearing cover funds	3	11
Ratio of fixed interest-bearing bonds	62	52

The following tables show the net present value for each foreign currency:

(€ m)	Mortgage bonds	
Foreign currency	31.12.2018	31.12.2017
CHF	1	8
GBP	81	82
SEK	9	14

(€ m)	Public-sector mortgage bonds	
Foreign currency	31.12.2018	31.12.2017
CHF	-122	-123
JPY	25	23

(€ m)	Ship mortgage bonds	
Foreign currency	31.12.2018	31.12.2017
CHF	–	9
JPY	8	–
USD	1,744	1,626

The loans and advances used to cover mortgage bonds, public-sector bonds and ship mortgage bonds are broken down by size as follows:

(A) Mortgage bond register

(€ m)	Covering mortgages	
Nominal value	31.12.2018	31.12.2017
Up to € 300,000	18	22
Between € 300,000 and € 1 million	81	100
Between € 1 million and € 10 million	1,351	1,399
Over € 10 million	3,167	3,112
Total	**4,617**	**4,633**

(B) Public-sector mortgage bond

(€ m)	Covering mortgages	
Nominal value	31.12.2018	31.12.2017
Up to € 10 million	140	155
Between € 10 million and € 100 million	1,272	1,294
Over € 100 million	1,801	2,664
Total	**3,213**	**4,113**

(C) Ship register

(€ m)	Covering mortgages	
Nominal value	31.12.2018	31.12.2017
Up to € 500,000	1	1
Between € 500,000 and € 5 million	250	297
Over € 5 million	1,508	1,385
Total	**1,759**	**1,683**

The breakdown of loans and advances used to provide ordinary cover for mortgage bonds by the country in which the mortgaged property is located, as well as the use to which the property is put, is as follows:

(€ m)	31.12.2018	31.12.2017
Used for residential purposes	881	852
Used for commercial purposes	3,736	3,781

(€ m) 2018	Apartments	Single and semi-detached dwellings	Multiple dwellings	Office buildings	Retail properties	Industrial premises	Other Commercial properties	Unfinished new-buildings	Building plots	Total
Germany	–	4	846	1,308	1,277	3	743	318	21	4,520
Great Britain / Northern Ireland / Brit. Channel Islands	–	–	–	80	–	–	–	–	–	80
Netherlands	–	–	–	8	–	–	–	–	–	8
Sweden	–	–	–	–	9	–	–	–	–	9
Total	**–**	**4**	**846**	**1,396**	**1,286**	**3**	**743**	**318**	**21**	**4,617**

(€ m) 2017	Apartments	Single and semi-detached dwellings	Multiple dwellings	Office buildings	Retail properties	Industrial premises	Other Commercial properties	Unfinished new-buildings	Building plots	Total
Germany	–	1	833	1,274	1,157	1	780	190	38	4,274
France	–	–	–	245	–	–	–	–	–	245
Great Britain / Northern Ireland / Brit. Channel Islands	–	–	–	81	–	–	–	–	–	81
Netherlands	–	–	–	21	–	–	–	–	–	21
Sweden	–	–	–	–	12	–	–	–	–	12
Total	**–**	**1**	**833**	**1,621**	**1,169**	**1**	**780**	**190**	**38**	**4,633**

(€ m)	31.12.2018	31.12.2017
Total of payments at least 90 days in arrears	–	–
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	–	–

Other key figures relating to the regular cover assets of the mortgage bonds:

		31.12.2018	31.12.2017
Total amount of receivables that exceed the limits set out in Section 13 (1) PfandBG	€ m	–	–
Volume-weighted average age of the receivable	in years	4	4
Average weighted loan-to-value ratio	in %	57	57

The following tables show the breakdown of the total amount of loans and advances used to cover public sector mortgage bonds based on borrowers and the countries in which the borrowers are domiciled.

€ m	Country		Regional public authority		Local public authority		Other		Total	thereof guarantees received for export promotion reasons
2018	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed		
Germany	70	12	1,511	327	486	62	150	123	2,741	153
Belgium	250	–	–	8	–	–	–	–	258	–
Italy	–	–	8	–	–	–	–	–	8	–
Poland	24	–	–	–	–	–	–	–	24	–
Switzerland	–	–	93	–	–	–	–	–	93	–
Austria	–	44	–	–	–	–	–	–	44	–
EU institutions	–	–	–	–	–	–	45	–	45	–
Total	**344**	**56**	**1,612**	**335**	**486**	**62**	**195**	**123**	**3,213**	**153**

€ m	Country		Regional public authority		Local public authority		Other		Total	thereof guarantees received for export promotion reasons
2017	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed		
Germany	105	13	2,102	39	514	63	191	500	3,527	127
Belgium	250	–	–	10	–	–	–	–	260	–
Great Britain / Northern Ireland / Brit. Channel Islands	–	–	–	–	–	–	10	–	10	–
Italy	–	–	12	–	–	–	–	–	12	–
Luxembourg	–	–	–	–	–	–	48	–	48	–
Poland	22	–	–	–	–	–	–	–	22	–
Switzerland	–	–	90	–	–	–	–	–	90	–
Austria	–	144	–	–	–	–	–	–	144	–
Total	**377**	**157**	**2,204**	**49**	**514**	**63**	**249**	**500**	**4,113**	**127**

The following amounts are in arrears concerning these loans and advances:

(€ m) 2018	Country	Regional public authority	Local public authority	Other	Total
Total of payments at least 90 days in arrears	–	–	–	1	1
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	–	–	–	9	9

(€ m) 2017	Country	Regional public authority	Local public authority	Other	Total
Total of payments at least 90 days in arrears	–	–	–	–	–
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	–	–	–	–	–

The following table shows the breakdown of loans and advances used to cover ship mortgage bonds by the country in which the ships pledged are registered:

(€ m)	31.12.2018		31.12.2017	
	Ocean-going vessels	Inland water vessels	Ocean-going vessels	Inland water vessels
Bahamas	45	–	49	–
Germany	448	–	418	–
Greece	92	–	101	–
Hong Kong	55	–	55	–
Liberia	432	–	340	–
Malta	134	–	139	–
Marshall Islands	264	–	296	–
Panama	112	–	112	–
Sweden	20	–	21	–
Singapore	37	–	50	–
Cyprus	120	–	102	–
Total	**1,759**	**–**	**1,683**	**–**

The following amounts are in arrears concerning these loans and advances:

(€ m)	31.12.2018	31.12.2017
Marshall Islands	–	1
Liberia	–	1
Total of payments at least 90 days in arrears	**–**	**2**
Germany	–	2
Marshall Islands	–	1
Liberia	–	1
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	**–**	**4**

The following table shows the number of foreclosures, judicially enforced receiverships and land and ships acquired to prevent losses in relation to the loans and advances used for coverage:

(Number) 2018	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Pending foreclosures and judicially enforced receiverships	–	–	–	–	–
Foreclosures completed	–	–	–	–	–
Land and ships acquired to prevent losses	–	–	–	–	–

(Number) 2017	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Pending foreclosures and judicially enforced receiverships	–	–	–	–	–
Foreclosures completed	–	–	–	–	–
Land and ships acquired to prevent losses	–	–	–	–	–

The following table shows total arrears on the interest due from mortgage debtors and repayments made during the financial year:

(€ m) 2018	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Total amount of arrears on interest to be paid	–	–	–	–	–

(€ m) 2017	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Total amount of arrears on interest to be paid	–	–	–	–	–

Of loans and advances to banks, the amount of € 163 million (previous year: € 198 million) and € 11,042 million of loans and advances to customers (previous year: € 11,859 million) are used to cover debentures issued.

68. Average number of employees

The average number of employees as of the reporting date is calculated based on quarterly levels and on a per capita basis:

	2018			2017		
	Male	Female	Total	Male	Female	Total
Full-time employees	893	324	1,217	1,001	381	1,382
Part-time employees	87	370	457	109	429	538
Total	**980**	**694**	**1,674**	**1,110**	**810**	**1,920**
Apprentices/trainees	15	14	29	18	16	34

69. Corporate governance

Hamburg Commercial Bank AG supports the aims of the German Corporate Governance Code and has recognised the Code's rules on a voluntary basis as an unlisted company. The Management Board and Supervisory Board of Hamburg Commercial Bank AG have given a declaration of conformity pursuant to Section 161 AktG and have made it available to the shareholders. The Declaration of Conformity is published on the website of Hamburg Commercial Bank AG. The Declaration of Conformity does not form part of these explanatory notes.

70. Remuneration paid to members of the Management Board and Supervisory Board

Up until the successful closing of the privatisation on 28 November 2018, the remuneration of each member of the Management Board of Hamburg Commercial Bank AG (formerly HSH Nordbank AG) was limited to € 500,000 per year (total fixed salary) in accordance with the guarantee agreement for as long as Hamburg Commercial Bank AG was not capable of making dividend distributions. Remuneration payable for secondary employment undertaken by the Management Board at the request of the Supervisory Board was set off against the remuneration entitlement set out in the employment contract.

Any additional variable remuneration was excluded under the terms of the guarantee agreement. The Management Board has opted not to collect a premium for a successful privatisation that would have been possible in line with the EU decision of 2 May 2016.

The Bank did not offer additional long-term incentives such as equity option schemes.

Following its privatisation on 28 November 2018, Hamburg Commercial Bank AG concluded new employment contracts with the current members of the Management Board. The remuneration system was also adjusted.

In addition to their fixed salary, each member of the Management Board receives a pension contribution corresponding to 20 % of their fixed annual salary and appropriate remuneration in kind.

Long-term variable compensation programme, including share-based payment

The new employment contracts of the Management Board include performance-related variable remuneration. Within this context, Management Board members receive 50 % of their annual bonus for the performance years leading up to 31 December 2021 in cash (cash bonus) and 50 % in the form of shares (share bonus) in Hamburg Commercial Bank AG.

40 % of the payment of the cash bonus and the transfer of the shares will be made in the year following the performance period in question, with 60 % subject to a deferral period of up to seven years.

The Bank's Supervisory Board uses an independent valuation for each performance year to determine the price at which the share bonus earned in euros is converted into shares in the Bank.

The variable remuneration was recognised in administrative expenses (personnel expenses) as at 31 December 2018.

The following table shows the remuneration of active and former members of executive bodies. The total remuneration paid to the members of the Management Board includes short-term benefits, payments into pension funds and remuneration from share-based payments. Remuneration of the Supervisory Board consists of additions to provisions for the activities of the Supervisory Board carried out during the financial year excluding value-added tax. See below for further details.

Remuneration of executive bodies

(€ k)	2018	2017
Total remuneration of active members of executive bodies		
Management Board	3,166	2,548
Supervisory Board	840	468
Total	**4,006**	**3,016**
Total remuneration of former members of executive bodies and their surviving dependants		
Management Board	2,989	2,787

As at 31 December 2018, a total of €k 46,712 (previous year: €k 44,647) was added to provisions for pension obligations relating to former members of the Management Board and their surviving dependants.

As was the case in the previous year, there were no advances, loans and other liabilities to members of the Management Board as at 31 December 2018. For members of the Supervisory Board they amounted to € 0 (previous year: €k 54) . In the 2018 reporting year no new loans were granted to members of the Supervisory Board. Repayments of loans by members of the Supervisory Board totalled €k 54 in total in 2018 (previous year: €k 96) .

The members of the Supervisory Board receive remuneration for their service during a financial year in an amount determined by the Annual General Meeting of the following year. The remuneration for the Supervisory Board for the 2017 financial year was therefore paid in the 2018 reporting period. Appropriate provisions have been recognised in the 2018 Annual Accounts for the 2018 reporting year.

The remuneration system that applied up until 28 November 2018 was based on the requirements of the German Corporate Governance Code and was organised as follows after the resolution of the Annual General Meeting of HSH Nordbank AG on 23 May 2014 and applied to the term of office of the Supervisory Board that has started on 23 May 2014:

(€) Executive body	Function	Fixed component	Attendance fee
Supervisory Board	Chair	25,000	250
	Deputy Chair	18,000	250
	Member	11,000	250
Risk Committee	Chair	15,000	250
	Member	7,000	250
Executive Committee	Chair	15,000	250
	Member	7,000	250
Audit Committee	Chair	15,000	250
	Member	7,000	250
Remuneration Monitoring Committee	Chair	12,000	250
	Member	5,000	250

The Mediation Committee to be formed under the German Co-determination Act of 1976 (*Mitbestimmungsgesetz*) did not receive any separate remuneration. Members of the Supervisory Board were also reimbursed for any value-added tax payable and for their expenses.

A new Supervisory Board has been in office since 28 November 2018, for which a new remuneration system is expected to be defined with retroactive effect from 28 November 2018. The new remuneration system will be approved at an extraordinary general meeting in mid-March 2019. The amount set up as provisions for the reporting period already includes the expected change.

€k 554 of the amount provided for in the 2017 financial year (€k 557, thereof VAT: €k 89) was paid to the members of the Supervisory Board in the reporting period. This includes €k 86 of value-added tax.

€k 1,000 has been set up in provisions for activities of the Supervisory Board in the reporting year (thereof VAT: €k 160) and will be disbursed after the Annual General Meeting provided a corresponding resolution is passed by the 2019 Annual General Meeting. The expected remuneration (excluding value-added tax) is distributed as follows among the Supervisory Board members who were in office up until 28 November 2018/31 December 2018 (employee representatives):

(€)	Fixed remuneration		Attendance fee		Total	
Members of the Supervisory Board	2018	2017	2018	2017	2018	2017
Dr Thomas Mirow, Chair	53,666	59,000	5,250	6,000	58,916	65,000
Olaf Behm, Deputy Chair	43,548	44,000	7,000	6,500	50,548	50,500
Stefanie Arp[1]	–	15,682	–	3,000	–	18,682
Peter Axmann	18,000	18,000	2,750	3,250	20,750	21,250
Simone Graf	29,367	30,000	5,750	5,250	35,117	35,250
Silke Grimm	15,005	16,000	1,250	2,250	16,255	18,250
Cornelia Hintz	11,000	11,000	2,250	2,500	13,250	13,500
Stefan Jütte	23,649	26,000	3,000	3,500	26,649	29,500
Dr Rainer Klemmt-Nissen	27,288	30,000	5,250	5,750	32,538	35,750
Rieka Meetz-Schawaller	17,367	18,000	3,500	3,500	20,867	21,500
Bert Michels[2]	18,000	2,049	3,250	250	21,250	2,299
Dr David Morgan[3]	16,373	18,000	2,500	1,750	18,873	19,750
Dr Philipp Nimmermann	33,655	37,000	5,000	5,500	38,655	42,500
Stefan Schlatermund	18,000	18,000	3,000	3,750	21,000	21,750
Klaus-Dieter Schwettscher	11,000	11,000	2,250	2,500	13,250	13,500
Elke Weber-Braun	23,649	26,000	2,250	3,500	25,899	29,500
Jörg Wohlers	22,740	25,000	4,250	4,500	26,990	29,500
Total	**382,307**	**404,731**	**58,500**	**63,250**	**440,807**	**467,981**

[1] until 14 November 2017
[2] from 15 November 2017
[3] Amounts before deduction of Supervisory Council tax and solidarity surcharge

The members of the Supervisory Board have again not provided any advisory or brokerage services or any other personal services to the Bank in the year 2018. Accordingly no additional remunerations were granted.

71. Seats on supervisory bodies

On the reporting date, the following seats were held on statutorily required supervisory bodies of large corporations or financial institutions:

(a) Members of the Management Board

ULRIK LACKSCHEWITZ
HSH Nordbank Securities S.A., Luxembourg
Chair of the Supervisory Board

(b) Employees

JUTTA ARLT
AKA Ausfuhrkredit-Gesellschaft mbH, Frankfurt am Main
Member of the Supervisory Board

PETER AXMANN
Sprinkenhof GmbH, Hamburg
Member of the Supervisory Board
HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

OLAF BEHM
HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

SIMONE GRAF
HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

BJÖRN KLIMM
HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

JAN LÜHRS-BEHNKE
HSH Nordbank Securities S.A., Luxembourg
Member of the Supervisory Board

YORAM MATALON
AKA Ausfuhrkredit-Gesellschaft mbH, Frankfurt am Main
Member of the Supervisory Board

PATRICK MILJES
Buss Investment GmbH, Hamburg
Member of the Supervisory Board

THOMAS RABEHL
HSH Nordbank Securities S.A., Luxembourg
Member of the Supervisory Board

KATRIN WÄCHTER
Technosis AG, Hamburg
Member of the Supervisory Board

72. The Supervisory Board of Hamburg Commercial Bank AG

JUAN RODRÍGUEZ INCIARTE, MADRID
Chair
CEO of Sareema Inversiones S.A.
(from 28 November 2018)

DR THOMAS MIROW, HAMBURG
Chair
Former President of the European Bank for Reconstruction and Development, London
(until 28 November 2018)

OLAF BEHM, HAMBURG
Deputy Chair
Employee of Hamburg Commercial Bank AG

GEOFFREY ADAMSON, NEW YORK
Partner GoldenTree Asset Management
(from 28 November 2018)

PETER AXMANN, HAMBURG
Employee of Hamburg Commercial Bank AG

MICHAEL CHRISTNER, ANDORRA
Managing Director J.C. Flowers & Co. UK LLP
(from 28 November 2018)

JAMES CHRISTOPHER FLOWERS, NEW YORK
Founder and Managing Director of J.C. Flowers & Co. LLC
(from 28 November 2018)

ALLEN GIBSON, COLUMBUS
Chief Investment Officer Centaurus Capital LP
(from 28 November 2018)

MANUEL GONZÁLEZ CID, MADRID
Senior Advisor Cerberus Global Investment Advisors, LLC
(from 28 November 2018)

SIMONE GRAF, ALTENHOLZ
Employee of Hamburg Commercial Bank AG

SILKE GRIMM, REINBEK
Member of the Board of Euler Hermes Deutschland AG
(until 28 November 2018)

CORNELIA HINTZ, DORTMUND
Federal state secretary ver.di district North Rhine-Westphalia

STEFAN JÜTTE, BONN
Former Chair of the Management Board of Deutsche Postbank AG
(until 28 November 2018)

DR RAINER KLEMMT-NISSEN, HAMBURG
Managing Director, HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH
(until 28 November 2018)

CHAD LEAT, NEW YORK
Financial Advisor
(from 28 November 2018)

RIEKA MEETZ-SCHAWALLER, KIEL
Employee of Hamburg Commercial Bank AG

BERT MICHELS, HAMBURG
Employee of Hamburg Commercial Bank AG

DR DAVID MORGAN, LONDON
Managing Director J.C. Flowers & Co UK LLP
(until 28 November 2018)

MARK NEPORENT, ARMONK
Chief Operating Officer, Senior Legal Officer and
Senior Managing Director Cerberus Capital Management, L.P.
(from 28 November 2018)

DR PHILIPP NIMMERMANN, KIEL
Secretary of State at the Schleswig-Holstein Ministry of Finance
(until 28 November 2018)

STEFAN SCHLATERMUND, HAMBURG
Employee of Hamburg Commercial Bank AG

KLAUS-DIETER SCHWETTSCHER, REINBEK
Representative of ver.di's federal management board

ELKE WEBER-BRAUN, HAMBURG
Independent chartered accountant
(until 28 November 2018)

MARK WERNER, NEW YORK
Financial Advisor
(from 28 November 2018)

PAULUS DE WILT, BREUKELEN
Chief Executive Officer NIBC Bank NV
(from 28 November 2018)

JÖRG WOHLERS, RELLINGEN
Former Member of the Board of Hamburger Sparkasse AG and HASPA Finanzholding
(until 28 November 2018)

(a) Members of the Risk Committee

CHAD LEAT
Chair
(from 28 November 2018)

STEFAN JÜTTE
Chair
(until 28 November 2018)

GEOFF ADAMSON
(from 28 November 2018)

OLAF BEHM

MICHAEL CHRISTNER
(from 28 November 2018)

ALLEN GIBSON
(from 28 November 2018)

SIMONE GRAF

DR RAINER KLEMMT-NISSEN
(until 28 November 2018)

RIEKA MEETZ-SCHAWALLER
(until 28 November 2018)

DR THOMAS MIROW
(until 28 November 2018)

DR PHILIPP NIMMERMANN
(until 28 November 2018)

STEFAN SCHLATERMUND

MARK WERNER
(from 28 November 2018)

(b) Members of the Audit Committee

PAULUS DE WILT
Chair
(from 28 November 2018)

ELKE WEBER-BRAUN
Chair
(until 28 November 2018)

PETER AXMANN

OLAF BEHM

MANUEL GONZÁLEZ CID
(from 28 November 2018)

BERT MICHELS

DR PHILIPP NIMMERMANN
(until 28 November 2018)

MARK WERNER
(from 28 November 2018)

JÖRG WOHLERS
(until 28 November 2018)

(c) Members of the Executive/ Nominating Committee

JUAN RODRÍGUEZ INCIARTE
Chair
(from 28 November 2018)

DR THOMAS MIROW
Chair
(until 28 November 2018)

OLAF BEHM

MICHAEL CHRISTNER
(from 28 November 2018)

MANUEL GONZÁLEZ CID
(from 28 November 2018)

SIMONE GRAF
(until 28 November 2018)

DR RAINER KLEMMT-NISSEN
(until 28 November 2018)

DR DAVID MORGAN
(until 28 November 2018)

DR PHILIPP NIMMERMANN
(until 28 November 2018)

JÖRG WOHLERS
(until 28 November 2018)

(d) Members of the Remuneration Monitoring Committee

JUAN RODRÍGUEZ INCIARTE
Chair
(from 28 November 2018)

DR THOMAS MIROW
Chair
(until 28 November 2018)

OLAF BEHM
(until 28 November 2018)

MICHAEL CHRISTNER
(from 28 November 2018)

ALLEN GIBSON
(from 28 November 2018)

SIMONE GRAF

SILKE GRIMM
(until 28 November 2018)

DR RAINER KLEMMT-NISSEN
(until 28 November 2018)

DR PHILIPP NIMMERMANN
(until 28 November 2018)

(e) Members of the Mediation Committee

JUAN RODRÍGUEZ INCIARTE
Chair
(from 28 November 2018)

DR THOMAS MIROW
Chair
(until 28 November 2018)

OLAF BEHM

MICHAEL CHRISTNER
(from 28 November 2018)

DR RAINER KLEMMT-NISSEN
(until 28 November 2018)

RIEKA MEETZ-SCHAWALLER

73. The Management Board of Hamburg Commercial Bank AG

STEFAN ERMISCH
Born in 1966
Chief Executive Officer (CEO)

ULRIK LACKSCHEWITZ
Born in 1968
Chief Risk Officer (CRO) and Deputy CEO since 10 December 2018

DR NICOLAS BLANCHARD
Born in 1968
Chief Clients and Products Officer (CCO) (since 10 December 2018)

OLIVER GATZKE
Born in 1968
Chief Financial Officer (CFO)

TORSTEN TEMP
Born in 1960
Management Board member responsible for the Market divisions (until 31 December 2018)

Hamburg/Kiel, 15 March 2019

Stefan Ermisch Ulrik Lackschewitz

Dr Nicolas Blanchard Oliver Gatzke

INDEPENDENT AUDITOR'S REPORT

To Hamburg Commercial Bank AG, Hamburg/Kiel

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT

AUDIT OPINIONS

We have audited the annual financial statements of Hamburg Commercial Bank AG, Hamburg/Kiel (formerly HSH Nordbank AG, Hamburg/Kiel), which comprise the balance sheet as at 31 December 2018, and the statement of profit and loss for the financial year from 1 January to 31 December 2018 and notes to the financial statements, including the presentation of the recognition and measurement policies. In addition, we have audited the management report of Hamburg Commercial Bank AG, which is combined with the group management report, for the financial year from 1 January to 31 December 2018. In accordance with the German legal requirements, we have not audited the content of the statement on corporate governance pursuant to § [Article] 289f HGB [Handels-gesetzbuch: German Commercial Code] and § 315d HGB.

In our opinion, on the basis of the knowledge obtained in the audit,

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law and give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2018 and of its financial performance for the financial year from 1 January to 31 December 2018 in compliance with German Legally Required Accounting Principles, and
- the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our audit opinion on the management report does not cover the content of the statement on corporate governance referred to above.

Pursuant to § 322 Abs. [paragraph] 3 Satz [sentence] 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

BASIS FOR THE AUDIT OPINIONS

We conducted our audit of the annual financial statements and of the management report in accordance with § 317 HGB and the EU Audit Regulation (No. 537/2014, referred to subsequently as "EU Audit Regulation") in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions on the annual financial statements and on the management report.

KEY AUDIT MATTERS IN THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from 1 January to 31 December 2018. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our audit opinion thereon; we do not provide a separate audit opinion on these matters.

In our view, the matters of most significance in our audit were as follows:

❶ Provisions for restructuring in the context of the "Reset & Go" strategic program

❷ Presentation of legal disputes in the context of hybrid capital

❸ Loan loss provisions in the customer lending business

❹ Deferred taxes

Our presentation of these key audit matters has been structured in each case as follows:

① Matter and issue

② Audit approach and findings

③ Reference to further information

Hereinafter we present the key audit matters:

❶ **Provisions for restructuring in the context of the "Reset & Go" strategic program**

① At the beginning of financial year 2018, Hamburg Commercial Bank AG announced its "Reset & Go" strategic program. As part of the new strategy, the Company is focussing on future customer requirements, structuring overarching business models at the bank and using new IT solutions. In the context of the closing in connection with the privatization on 28 November 2018, the outcomes of “Reset & Go” were used as a basis for developing a transformation agenda in 2018 which sets the overriding goal of increasing the Bank's profitability. To that end, a target operating model on a reduced cost basis was defined which calls for significant staff cuts, among other measures. In December 2018, employees were notified and negotiations with the employee representative bodies were initiated. The Company recognized an expense for a restructuring provision amounting to EUR 257 million in 2018 in connection with the planned transformation measures. In our view, this matter was of particular significance for our audit, as the measurement of the restructuring provisions is significant in terms of its amount, and is based on estimates and assumptions made by the executive directors.

② In accordance with § 249 Abs. 1 Satz 1 HGB, provisions must be recognized for uncertain liabilities. For this, there must be an external obligation which was caused legally or economically during the financial year, and a claim must be a seriously expected. In the context of our audit, we assessed whether the individual recognition criteria were met and whether the measurement of the restructuring provision was appropriate. For that purpose, we obtained and evaluated relevant evidence from the executive directors of the Company. We were able to satisfy ourselves that the matter as well as the estimates and assumptions made by the executive directors in connection with the recognition and measurement of a restructuring provision were sufficiently documented and substantiated. The measurement occurred within ranges considered by us to be reasonable.

③ The Company's disclosures relating to provisions are contained in the notes to the annual financial statements in section 22 "Accounting treatment applied to the restructuring".

❷ **Presentation of legal disputes in the context of hybrid capital**

① Hamburg Commercial Bank AG is party to several agreements concerning the establishment of silent partnerships, through which investors participate in the bank's commercial activities as silent partners ("hybrid capital investors"). These are hybrid capital instruments that are either entered into bilaterally with institutional investors or placed on the capital market. As a measure to restructure and optimize capital (so-called “liability management exercise”), the bank terminated all existing silent contributions during the financial year with effect from 31 December 2020. As a result of this, these silent contributions will be repaid by no later than financial year 2021 in accordance with the contractual terms and conditions. The bank has pointed out that the amounts to be repaid are likely to be significantly lower than the nominal amounts. In this connection, claims are being asserted against the Company in and out of the courts, calling for the instruments to be recovered, profit participations to be paid in arrears and the terminations to be invalid, among other things. The bank has recalculated the risk provisions for these legal disputes within other provisions in the annual financial statements. In our view, this matter was of particular significance in the context of our audit since the recognition and measurement of provisions to cover these risks are to a large extent based on assumptions and judgement of the executive directors.

② As part of our audit, we, among other things, assessed the process established by the Company for the recording, risk assessment and reporting of legal disputes in the financial statements. This assessment also included a substantive review of the material legal risks, including the legal disputes in connection with the hybrid investors. Our assessment took into account the knowledge gained in the course of our regular meetings with the bank's legal department as well as from the assessments provided to us in writing on the outcomes of the respective proceedings. In addition, we have obtained confirmations from external lawyers. In our opinion, the provisions for legal disputes fall within a reasonable range.

③ The measurement of the provisions is discussed in the notes to the financial statements in note 45 "Other Provisions".

❸ Loan loss provisions in the customer lending business

① In the Company's annual financial statements loan receivables amounting to EUR 31,521 million are reported under the "Loans to customers" balance sheet item. As at 31 December 2018, risk provisions for the loan portfolio consisting of individual and general valuation allowances are reported in the balance sheet. The measurement of the risk provisions for the customer lending business is determined in particular by the executive directors' estimates with respect to future loan defaults, the structure and quality of the loan portfolios and general economic factors. The amount of the individual valuation allowances for customer loans reflects the difference between the outstanding amount of the loan and the lower val-ue assigned to it as at the balance sheet date. Existing collaterals are taken into account. The calculation of general valuation allowances also takes into account valuation-relevant risk factors in the context of model overlays. The amounts of the valuation allowances in the customer lending business are highly significant for the assets, liabilities and financial performance of the Company and they involve considerable judgment on the part of the executive directors. Furthermore, the measurement parameters applied, which are subject to material uncertainties, have a significant impact on the recognition and the amount of any valuation allowances required. Against this background, this matter was of particular significance during our audit.

② As part of our audit, we initially assessed the appropriateness of the design of the controls in the Company's relevant internal control systems and tested the controls' effectiveness. In doing so, we considered the business organization, the IT systems and the relevant measurement models. Moreover, we evaluated the measurement of the customer loans, including the appropriateness of estimated values, on the basis of sample testing of loan engagements. For this purpose, we assessed, among other things, the available documentation of the Company with respect to the economic circumstances as well as the recoverability of the related collaterals. For real estate as collateral, we obtained an understanding of and critically assessed the source data, measurement parameters applied and assumptions made on which the expert valuations provided to us by the Company were based and evaluated whether they lay within an acceptable range. In addition, for the purpose of assessing the individual and general valuation allowances applied, we evaluated the calculation methodology applied by the Company together with the underlying assumptions and parameters. We assessed the appropriateness of the inclusion of additional valuation-relevant risk factors based on the current economic uncertainties. Based on our audit procedures, we were able to satisfy ourselves that overall the assumptions made by the executive directors for the purpose of testing the recoverability of the loan portfolio are appropriate, and that the processes implemented by the Company are appropriate and effective.

③ The Company's disclosures regarding Loans and advances to customers are contained in the notes of the financial statement in note 6 "Valuation allowances and provisions in the lending business (loan loss provisions)".

❹ Deferred taxes

① In the Company's annual financial statements deferred tax assets amounting to EUR 654.8 million and deferred tax liabilities of EUR 14.6 million are reported. The resulting surplus of deferred tax assets amounting to EUR 640.2 million is reported in accordance with the recognition option pursuant to § 274 Abs. 1 Satz 2 HGB. Deferred tax assets are recognized in accordance with the principle of prudence to the extent that the executive directors consider it probable that taxable profit will be available in the foreseeable future which will enable the deductible temporary differences and unused tax losses to be realized. For this purpose, insofar as sufficient deferred tax liabilities arising from taxable temporary differences are not available, future taxable profits are projected on the basis of the medium-term business plan prepared by the executive directors, whereby material tax differences are carried forward due to planning assumptions. Tax loss carryforwards are only recognized – in the absence of sufficient deferred tax liabilities – if they can be expected with sufficient certainty on the basis of the projections to be realized within the following five years.

From our point of view, the accounting treatment of deferred taxes was of particular significance in the context of our audit, as it depends to a large extent on the estimates and assumptions made by the executive directors and is therefore subject to uncertainties.

② As part of our audit, we assessed, among other things, the internal processes and controls for recording tax matters as well as the methodology used for the determination, accounting treatment and measurement of deferred taxes. We also assessed the recoverability of the deferred tax assets relating to deductible temporary differences and unused tax losses on the basis of the Company's internal forecasts of its future earnings situation, and the appropriateness of the underlying estimates and assumptions.

Based on our audit procedures, we were able to satisfy ourselves that the estimates and assumptions made by the executive directors are substantiated and sufficiently documented.

③ The Company's disclosures relating to deferred tax assets and liabilities are contained in the notes of the financial statement in note 18 "deferred taxes".

OTHER INFORMATION

The executive directors are responsible for the other information. The other information comprises the statement on corporate governance pursuant to § 289f HGB and § 315d HGB.

The other information comprises further the remaining parts of the financial report – excluding cross-references to external information – with the exception of the audited annual financial statements, the audited management report and our auditor’s report, and the separate non-financial report pursuant to § 289b Abs. 3 HGB and § 315b Abs. 3 HGB.

Our audit opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an audit opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the audit, or
- otherwise appears to be materially misstated.

RESPONSIBILITIES OF THE EXECUTIVE DIRECTORS AND THE SUPERVISORY BOARD FOR THE ANNUAL FINANCIAL STATEMENTS AND THE MANAGEMENT REPORT

The executive directors are responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, the executive directors are responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, the executive directors are responsible for assessing the Company’s ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, the executive directors are responsible for the preparation of the management report that as a whole provides an appropriate view of the Company’s position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, the executive directors are responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in ac-cordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Company’s financial reporting process for the preparation of the annual financial statements and of the management report.

AUDITOR'S RESPONSIBILITIES FOR THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT
Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our audit opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with § 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our audit opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an audit opinion on the effectiveness of these systems of the Company.
- Evaluate the appropriateness of accounting policies used by the executive directors and the reasonableness of estimates made by the executive directors and related disclosures.
- Conclude on the appropriateness of the executive directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective audit opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.
- Evaluate the consistency of the management report with the annual financial statements, its conformity with German law, and the view of the Company's position it provides.
- Perform audit procedures on the prospective information presented by the executive directors in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by the executive directors as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate audit opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as auditor by the annual general meeting on 21 November 2017. We were engaged by the supervisory board on 23 January 2018. We have been the auditor of the Hamburg Commercial Bank AG, Hamburg/Kiel without interruption since the financial year 2018.

We declare that the audit opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Lothar Schreiber.

Hamburg, 15 March 2019
PricewaterhouseCoopers GmbH
Wirtschaftsprüfungsgesellschaft

Lothar Schreiber	ppa. Tim Brücken
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

Responsibility statement by the Management Board

We hereby affirm that to the best of our knowledge the annual 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 Hamburg Commercial Bank AG and that the management report presents the course of business, including the results of the business and Hamburg Commercial Bank AG's situation, in such a manner that it gives a true and fair view and describes the main opportunities and risks for Hamburg Commercial Bank AG's foreseeable performance.

Hamburg/Kiel, 15 March 2019

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