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Financial Report 2009

HSH NORDBANK

FINANCIAL REPORT 2009 OF HSH NORDBANK AG

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UNDERLYING CONDITIONS

Global economy shows signs of recovery after historic downturn

2009 will go down in the history books as an extremely turbulent year for the global economy. At the beginning of the year, the historic slump experienced in many sectors of the economy stoked fear of a second Great Depression. Thanks to strong action taken by many governments and central banks, there were already clear signs of stabilisation in the economy by spring. Beginning in the summer of 2009, world trade began to rebound largely on the back of demand from emerging economies in Asia. As an export-dependent economy, Germany benefited more than others from the recovery. As severe as the economic downturn was in the first quarter, the recovery began to take hold relatively early. In spite of this, however, the economy contracted by -5%, the largest such decline in the post-war era. The fall in GDP in the euro zone was somewhat lower at -4% due to the relative stability of several countries, mainly France and to a lesser extent Spain, both of which tend to rely more on domestic demand.

As in the euro zone, the US did not begin to emerge from the recession until the third quarter. The recovery was largely driven by government stimulus programmes and changes in company inventory cycles. In addition, investment in residential construction ended 14 quarters of consecutive declines in the third quarter. Total economic output fell by -2.4%, lower than the decline reported in the euro zone.

Stabilisation of financial markets not without setbacks

While there was a trend towards risk aversion amongst financial market investors at the start of the year, risk appetite began to grow in spring. For instance, three-month unsecured interbank lending rates and risk premiums for corporate bonds fell significantly. There was also a pick up in the volume of securities issued. The yield on German federal ten-year bonds peaked in June, but by year-end it was back at just over 3% – more or less where it had started in January. In the US, yields rose faster from their low of around 2.2% in mid-January to over 3.6% by year's end.

The yields on two-year German government bonds fell sharply especially at the beginning of the year. This is because the European Central Bank (ECB), unlike the Fed which had already cut the Fed Funds rate to historically low levels in 2008, continued to make cuts until early May when rates reached 1%, where they have also remained since. At the end of the year, the yields on two-year government bonds in the US and in German were largely stable in the view of expectation that interest rates will remain at or near the low level seen in February for a considerable time. In addition to historically low prime rates, the key central banks also took measures to stimulate the economy through quantitative easing. The ECB, for instance, granted banks access to unlimited liquidity in the form of long-term repo facilities and began its purchase of covered bonds in the summer. The Fed and the Bank of England went so far as to purchase government bonds.

As investor confidence grew, the euro appreciated against the US dollar, which had previously benefited from its position as a safe haven, from lows of around 1.25 in early May to 1.50 in early December. This was in part driven by carry trades that pushed the US dollar lower on the back of extremely low US rates. In late November, negative reports on the state of Greek public finances however resulted in euro weakness.

The global equity markets also rose sharply over the course of the year. Boosted by hopes of an economic rebound, the DAX, DJ STOXX 50 and S&P 500 had all gained more than 60% from their lows at the beginning of March by the end of the year. While they had not recovered to the levels of late-2008 until mid-year, the performance of these markets from mid- to late-2009 reflects a return of more optimistic expectations. Pressure on many investors to get on board also provided support to the markets. Overall, the DAX and DJ STOXX 50 reported an annual rise of 24%, while the S&P 500 saws gains of 23.5%.

Further challenges for banks

Bank earnings continued to improve as the year progressed, especially for credit institutions with a strong capital market business. In addition to profits realised from low central bank interest rates, the recovery on the financial markets was the other main catalyst for higher earnings. A number of banks were able to repay the state aid they had received and once more raise unsecured funds on the capital markets. The charges reported by banks for impairment losses and defaults have been falling steadily every quarter since their peak at the end of 2008.

Improved conditions in the capital market business were met by a significant rise in loan loss provisions as a result of the economic downturn, which affected banks involved in the traditional lending business. In view of the ongoing pressure on banks to improve their capital strength, but also because of the lower demand caused by the recession, lending in the euro zone over the course of the year fell to below the level of the previous year.

BUSINESS OVERVIEW

Realignment of HSH Nordbank

HSH Nordbank began a wide-ranging strategic realignment in 2009. The aim is to exit the financial market and economic crisis with a sustainable business model in place, while ensuring a stable and profitable future for the Bank. To this end, a series of measures was implemented in 2009 to establish the necessary groundwork and put the Bank's capital base on a more solid footing.

Focusing the business

The realignment concept adopted at the beginning of 2009 calls for the Bank to focus on its strategic core areas while at the same time significantly reducing its total assets. The core business primarily includes regional commitments in the Corporate Clients, Private Banking, Savings Banks and Real Estate Clients divisions, together with international activities in the Shipping, Transportation and Renewable Energy sectors. The client-facing units are supported by the Bank's financial market activities. The Bank has furthermore identified non-strategic commitments and special risk positions in various business areas that will be wound down over the next few years in a way which will take account of income, liquidity and risk. The selected credit and capital market portfolios were pooled into the new Restructuring Unit, created on 1 December 2009, an organisational unit run separately from the core units and shown as a separate segment in the consolidated financial statement.

Good progress has already been made in winding down the portfolios in the 2009 reporting year. The credit investment business, for example, which in the previous year had generated heavy losses because of the crisis in the financial markets, was significantly reduced. Traditional credit portfolios, which had been transferred to the Restructuring Unit, were in some cases also significantly scaled down (for example, in the areas of commodity financing and leasing). HSH Nordbank's total assets decreased accordingly at the end of 2009 to EUR 185 billion (previous year: EUR 212 billion) partly as a result of efforts to wind down these portfolios. In addition, HSH Nordbank is reducing the size of its German and international branch network as well as the number of its holdings.

Capitalisation completed and risk shield in place

Following the adoption of the new business concept, the Free and Hanseatic City of Hamburg and the State of Schleswig-Holstein provided the Bank with a capital injection of EUR 3 billion. To conduct this capital increase Hamburg and Schleswig-Holstein established HSH Finanzfonds AöR, a special fund with the legal status of an institution under public law, which then subscribed for new ordinary shares. The fund is financed on equal part by Hamburg and Schleswig-Holstein.

In addition, Hamburg and Schleswig-Holstein will provide against future risks to the Bank via a second loss guarantee of up to EUR 10 billion. This results in a reduction in the bank's risk-weighted assets. The guarantee takes effect as soon as losses sustained in the defined portfolio exceed the Bank's agreed first-loss piece of EUR 3.2 billion. HSH Nordbank pays fair market fees for the provision of the guarantee. The Bank intends to reduce the amount guaranteed, accordingly, as risk decrease.

The capital increase and financial guarantee resulted in a rise in the Bank's regulatory capital ratio, which had previously declined due to losses sustained in 2008. As a result, the Bank was able to exceed its regulatory capital requirements after implementing a package of measures in 2009.

As at the beginning of 2010, the EU Commission has not yet granted final approval of the realignment concept (and the recapitalisation) (see section "EU state-aid proceedings" in this Management Report).

Utilisation of SoFFin guarantees

In order to secure refinancing that could not be readily obtained due to the financial crisis, the Bank has drawn on guarantees of EUR 17 billion in 2009 from the state-backed Special Fund for Financial Market Stabilisation (SoFFin) for the issue of bonds. This included EUR 9 billion in bonds issued to investors on the capital market. In addition we deposited short-dated debt instruments to a total volume of some EUR 8 billion with the European Central Bank (ECB) to increase the collateral pool for money market transactions. The guarantee facility from SoFFin totalling up to EUR 30 billion, which had been applied for in November 2008, was reduced to EUR 17 billion at the end of 2009. Independently of this, the SoFFin guarantee remains in place for issues of EUR 17 billion backed by this guarantee. Within this framework of this EUR 17 billion facility, HSH Nordbank may apply to extend guarantees set to expire in 2010 until 31 December 2010 at the latest.

Cost-cutting programme on track

One of the key components of the realignment is a cost-cutting initiative consisting of a variety of measures. Administrative expenses were reduced through these cost-saving measures by 3.4%. This is due to cutbacks in operating costs and progress made in reducing headcount. In this area, HSH Nordbank plans to cut roughly 1,100 full-time positions in Germany and abroad by 2012. As of 31 December 2009, the number of positions was down sharply to 3,610, a decline of 715 over last year's numbers.

Optimisation of processes and structures

In view of the important role of efficient processes and structures play in the success of the Bank, the Bank launched a programme in 2009 to improve core cross-bank processes and tasks. This primarily focused on optimising accounting, loan approval and risk management procedures, with a special focus in the area of control systems. Major progress was already seen by the end of 2009. The Bank also took steps to strengthen the internal auditing and compliance functions. Other individual measures not yet implemented will for the most part be completed in 2010.

New Supervisory Board convened

The first meeting of the Bank's newly constituted Supervisory Board was held in July 2009. The committee consists of a number of independent experts from the fields of business and finance. New shareholder representatives include former board members at companies operating in economic sectors relevant to the Bank. Hilmar Kopper, former spokesperson of the Management Board at Deutsche Bank and a recognised banking expert, was appointed chairman of the Supervisory Board.

Changes to the Management Board

The Bank's management was reinforced with the appointment of two new members to the Management Board. We succeeded in attracting the expert on risk management, Constantin von Oesterreich, to the Board: he was appointed for three years with effect from 1 November 2009 with responsibility for overseeing risk. Also with effect from 1 November 2009, Martin van Gemmeren was appointed for three years to the Management Board as Head of the Restructuring Unit. Dr Martin van Gemmeren has been at HSH Nordbank since October 2006, taking responsibility for a number of areas including work-out management, and has for several months been in charge of the project to establish the Restructuring Unit. With effect from 1 December 2009, the Bank's Management Board has appointed Ulrich Voss as General Agent (Generalbevollmächtigter). He is responsible in his capacity of Chief Operating Officer for the Transaction Services and IT/Organisation divisions. Ulrich Voss is an expert in transaction banking, bank IT and restructuring. The Bank has also removed three board members in the year under review.

New remuneration system/corporate governance

HSH Nordbank has adopted a new remuneration system for the members of the Bank's Management board. These are based on new legal requirements. It also took account of the recommendations of the Corporate Governance Code. Particular attention was paid to compliance with the guarantee contract with the federal states.

The new contracts concluded in 2009 and all future contracts will be based on the following principles: a long-term calculation period, no legal entitlement to variable remuneration until the Bank is in a position to pay dividends, payouts to be staggered over several years, provisions to claw back payments not yet made and limits on payments on departure. By implementing the new remuneration system, the Bank is in compliance with requirements to limit the pay of board members and link variable payments to the long-term performance of the Bank. At the same time the system creates the conditions necessary to gain the services of top-quality experts for the Bank.

Detailed information on the remuneration of board members in 2009 can be found in the notes to the financial statements (section 64). In addition, each member of the Supervisory Board and of the committees formed by the Supervisory Board are listed in the notes (section 66). The Supervisory Board report contains information on the work of the board and its committees in 2009.

As a non-listed company, HSH Nordbank voluntarily accepted the German Corporate Governance Code. HSH Nordbank's Declaration of Conformity as per section 161 of the German Stock Corporation Act (AktG) is included in the corporate governance report of the annual report. An account of deviations to individual items of the Code shall be provided in the report.

Business developments

Overview of business performance in 2009

HSH Nordbank significantly improved its business situation in a challenging 2009. Operating loss after risk provisions/evaluation was halved to EUR -1,618 million (previous year: EUR -3,179 million) due to a 50% decline in write-downs from risk provisions/evaluation. Total assets fell sharply to EUR 185.0 billion (previous year: EUR 212.5 billion) as a result of the reduction of non-strategic assets. The capitalisation measures in mid-2009 raised the core capital ratio to 9.0%.

EARNINGS SITUATION

Income statement in € million	1/1/-12/31/2009	1/1/-12/31/2008	Change absolute	Change in %
Net interest income	1,624	1,912	-288	-15.1
Net commission income	-277	293	-570	>-100
Expenses for second loss guarantee	-364	0	-364	-
Expenses for SoFFin-guarantee	-118	0	-118	-
Net trading income	-55	-252	197	78.2
Administrative expenses	-796	-824	28	-3.4
Personnel expenses	-377	-380	3	-0.8
Other operating expenses	-419	-444	25	-5.6
Other operating income	75	16	59	>+100
Operating result before risk provision/valuation	571	1,145	-574	-50.1
Risk provisions/valuation	-2,189	-4,324	2,135	-49.4
Loans	-1,997	-2,473	476	-19.2
Securities	205	-1,276	1,481	>+100
Equity holdings	-397	-575	178	-31.0
Operating result after risk provisions/valuation	-1,618	-3,179	1,561	49.1
Extraordinary result	-121	-164	43	26.2
Income tax expense	364	-101	465	>+100
Partial profit transfers	0	0	0	-
Income from transfer of losses	559	351	208	59.3
Net loss for the year	-816	-3,093	2,277	73.6

Earnings depressed by commissions for government guarantees

Earnings totalled EUR 1,367 million, a decline of EUR 602 million over 2008 (EUR 1,969 million). This is largely attributable to lower net commission income (EUR -570 million over previous year) as a result of expenses related to government guarantees (EUR 482 million in total). Earnings are broken down as follows:

At EUR 1,624 million, the largest single income position of the Bank – **net interest income** – came in far below last year's figure of EUR 1,912 million, representing a drop of EUR 288 million. This decline can be attributed to lower earnings from profit-sharing agreements with subsidiaries, early repayment penalties as well as the loss of earnings from arbitrage trading. This comes against higher interest margins from lower volumes of existing business and positive effects on results from liquidity management.

Net commission income fell by EUR 570 million to EUR -277 million, representing the first time this figure is negative.This was attributable to expenses for government guarantees totalling EUR -482 million. In 2008 the expense for SoFFin guarantees amounted to only EUR -5 million and was shown under interest expense. In addition, the bank earned less on processing fees due to a sharp decline in new loans. The elimination of commission expenses for transactions carried out at the end of 2007 to reduce risk-weighted assets, which also resulted in charges in the first months of the previous year, had a positive effect on net commission income.

Net trading income amounted to EUR -55 million, an increase of EUR 197 million over the previous year's level. The improved results were primarily the result of lower risk discounts in the valuation of trading portfolios on the back of a recovery in the financial markets and market-driven adjustments to valuation parameters in derivatives trading. In addition, there were no charges related to arbitrage trading in 2009, which had depressed profits in 2008.

Costs continue to fall

At EUR -377 million, **personnel expenses** remained roughly the same as in 2008 (EUR -380 million). Progress in the area of staff reductions resulted in lower costs here. **Operating expenses** fell sharply to EUR 419 million, a decline of EUR 25 million over 2008. This was primarily achieved through strict cost management with clearly defined objectives that was launched in conjunction with the restructuring process.

Operating profit before risk provisions/evaluation stood at EUR 571 million, roughly half of the previous year's figure (EUR 1,145 million).

Loan loss provisions reduced by nearly half

The **risk provisions/evaluation** item was down EUR 2,135 million to EUR -2,189 million, roughly 50% lower compared to the previous year (EUR -4,324 million). This can be mainly attributed to much higher income from its securities business (EUR +205 million; previous year: EUR -1,276 million) and lower loan loss provisions (EUR -1,997 million; previous year: EUR -2,473 million).

One of the primary reasons for the drop in loan loss provisions in the lending business was HSH Nordbank's cancellation of EUR 400 million in debts of the HSH Nordbank Securities subsidiary and its credit investment business in the previous year, which was not required in the year under review. As a consequence of negative developments in the financial situation of debtors, loan loss provisions in the divisions remained high in the year under review.

The bank reported a profit of EUR +205 million in its securities business in the year under review. This came on the back of write-ups and gains on disposals which can be attributed to decreased volatility on the financial markets. Loan loss provisions in 2008 stood at EUR -1,276 million due primarily to write-downs in the credit investment portfolio.

Loan loss provisions in the Equity Holdings unit fell to EUR -397 million (previous year: EUR -575 million). As in 2008, the main factors behind the loan loss provisions in the year under review were write-offs on equity holdings and the assumption of losses sustained by the Bank's HSH Real Estate subsidiary.

Operating loss after risk provisions/evaluation was approximately halved to EUR -1,618 million (previous year: EUR 3,179 million) due to a 50% decline in write-downs from risk provisions/evaluation.

Restructuring costs related to the bank's realignment stood at EUR -121 million (previous year: EUR -164 million). This related largely to costs for the planned reduction in personnel as well as operating expenses such as legal and consulting fees.

Income tax expense, which benefited from deferred tax assets, stood at EUR +364 million. The previous year saw a tax expense of EUR -101 million.

As a result of a net loss for the year and corresponding balance sheet loss sustained by the Bank, it did not service profit-participation certificates and silent capital contributions in 2009.

In addition, the profit-participation certificates and silent capital contributions participated in the Bank's net loss for the year and balance statement loss. As a consequence, the Bank receives compensation for losses amounting to EUR 559 million (previous year: EUR 351 million).

NET ASSETS AND FINANCIAL POSITION

Balance sheet in € million	12/31/2009	12/31/2008	Change absolute	Change in %
Assets				
Cash reserve, debt intruments issued by public institutions, bills of exchange egible for refinancing with central banks	1,268	1,412	-144	-10.2
Loans and advances to banks	20,796	37,070	-16,274	-43.9
Loans and advances to customers	110,820	119,020	-8,200	-6.9
Securities (total)	46,209	46,407	-198	-0.4
Equity holdings and shares in affiliated companies	2,364	2,726	-362	-13.3
Trust assets	367	364	3	0.8
Other assets	3,147	5,477	-2,330	-42.5
Balance sheet total	184,971	212,476	-27,505	-12,9
Liabilities				
Liabilities to banks	46,627	70,615	-23,988	-34.0
Liabilities to customers	55,538	57,587	-2,049	-3.6
Securitised liabilities	63,966	66,720	-2,754	-4.1
Trust liabilities	367	364	3	0.8
Subordinated liabilities	5,216	5,303	-87	-1.6
Profit participation capital	439	966	-527	-54.6
Funds for general banking risks	1,052	1,052	0	0
Equity capital	6,572	5,024	1,548	30.8
Other liabilities	5,194	4,845	349	7.2
Balance sheet total	184,971	212,476	-27,505	-12.9
Contingent liabilities	9,209	12,163	-2,954	-24.3
Other obligations	15,280	24,163	-8,883	-36.8
Derivatives (credit risk equivalents)	19,059	25,648	-6,589	-25.7
	43,548	61,974	-18,426	-29.7
Business volume	228,519	274,450	-45,931	-16.7
Lending volume	211,541	256,971	-45,430	-17.7

Restructuring benefits a major feature of change in the balance sheet

The HSH Nordbank AG's **total assets** as at 31 December 2009 had fallen significantly against the figure reported at the end of 2008, namely by 12.9% to EUR 184,971 million (31 December 2008: EUR 212,476 million). This change was driven mainly by the consistent implementation of the restructuring measures, which are aimed at significantly reducing total assets.

The decrease in balance sheet assets can be primarily attributed to a sharp drop in loans and advances to banks and customers as well as major reduction in other assets.

Loans and advances to banks fell EUR 16,274 million, or roughly 44%, to EUR 20,796 million (31 December 2008: EUR 30,070 million). This represents the largest decline among assets and contributed more than half of the reduction in total assets**. Loans and advances to customers**, which were affected by the limited volume of new business and moves in exchange rates, fell remarkably by EUR 8,200 million, or -6.9%, to EUR 110,820 million (previous year: EUR 119,020 million).

The restriction on new lending and the reduction in portfolios were correspondingly reflected in the liabilities side of the balance sheet in particular by falls in liabilities to banks, liabilities to customers and securitised liabilities.

Liabilities to banks were down due to a drop in funding requirements significantly by EUR -23,988 million, or -34%, from EUR 70,615 million to EUR 46,627 million, and represented the primary factor behind the drop in total assets. **Liabilities to customers** and **securitised liabilities** experienced a slight -4% fall to EUR 55,538 million (31 December 2008: EUR 57,587 million) and

EUR 63,966 million (31 December 2008: EUR 66,720 million), respectively.

Increase in capital base

As part of the capital increase transacted in the second quarter of 2009, EUR 3 billion was added to HSH Nordbank's **equity** by the HSH Finanzfonds AöR. By contrast, the net loss for the year and the pro rata loss participation of silent partners had a negative effect on equity capital. Overall, reported equity stood at EUR 6,572 million (31 December 2008: EUR 5,024 million).

Reduction in business volume

Corresponding to the fall in total assets, there was an overall 16.7 % drop in the volume of business as at 31 December 2009 to EUR 228,519 million. At the same time the total volume of off-balance sheet liabilities fell significantly by EUR 18,426 million to EUR 43,548 million (previous year: EUR 61,974 million). Besides contingent liabilities (EUR -2,954 million) and credit derivatives (EUR -6,589 million), this mainly involved loan commitments (EUR -8,883 million) falling sharply.

Share capital and shareholders

The share capital of HSH Nordbank AG is divided into 246,017,368 registered shares with a notional par value of EUR 10 each. The shares are not traded on an organised market. The ownership structure as of 31 December 2009 is as follows: the capital increase in June 2009 raised the joint direct and indirect shareholdings of the Free and Hanseatic City of Hamburg and the State of Schleswig-Holstein from 59.5% to 85.5%, of which 64.18% is held by HSH Finanzfonds AöR, jointly held by the two federal states, 10.89% by Hamburg and 10.43% by Schleswig-Holstein. The shareholding of the Savings Bank Association for Schleswig-Holstein was reduced to 5.31%, while the groups of investors advised by J.C. Flowers held 9.19% of the equity as at 31 December 2009.

Tier 1 capital ratio at 9.0%*

Total Tier 1 capital as of 21 December 2009 stood at EUR 8.5 billion (31 December 2008: EUR 8.6 billion). The Tier 1 capital ratio increased to 9.0% (incl. market risk position) on the back of the capital increase carried out in the 2nd quarter and more importantly to the financial guarantee provided by the states of Hamburg and Schleswig-Holstein, which results in a reduction in the bank's risk-weighted assets. As at 31 December 2008 the Tier 1 capital ratio still stood at 7.7%.

The regulatory capital ratio also rose noticeably to 13.7% (31 December 2008: 11.9%). Total regulatory capital as at the end of the 2009 climbed to EUR 13.0 billion (31 December 2008: EUR 13.2 billion).

Regulatory figures

%	12/31/2009	12/31/2008
Equity ratio (solvency ratio)	**14.2**	**12.7**
Total ratio/Regulatory capital ratio	**13.7**	**11.9**
Tier 1 capital ratio	**9.5**	**8.5**
Tier 1 capital ratio (including market risk items)	**9.0**	**7.7**

* Figures in text and tables before adoption of financial statements

Refinancing plan 2009 completed ahead of schedule

Funding conditions continuously improved over the course of the year under review following considerable uncertainty and caution on the part of investors which characterised the start of the year. In addition to positive signals from the banking sector and an improvement in early economic indicators, the stabilisation measures taken by governments and central banks played a key role in bringing about an improvement in market sentiment and lay the foundation for a strong revival in issues of non-state guaranteed bonds. By facilitating secured, short-term refinancing, the European Central Bank (ECB) helped improve the functioning of the capital market. In the second half of the year, liquidity in the interbank market began to increase once again.

To cover its funding requirements, HSH Nordbank placed three bonds guaranteed by SoFFin with a total volume EUR 9 billion and maturities of two to three years on the capital market. Additional guaranteed debt instruments with a total volume of around EUR 8 billion and maturities not exceeding one year were lodged with the ECB to enlarge our collateral pool for money-market transactions.

The financial crisis and the Bank's financial situation made raising funds extremely difficult in the financial year under review. In May 2009 the Standard & Poor's rating agency downgraded the long-term and short-term ratings of HSH Nordbank, each crucial in raising funds. This downgrade of our short-term rating resulted in investors who are only permitted to invest in bonds of a certain rating not renewing time deposits at the Bank once these expired.

The stabilisation of the bank, in particular the capital increase carried out in June, renewed investor interest for non-guaranteed issues launched by the Bank. This allowed the bank to place increased amount of unsecured debt instruments and Pfandbriefe, mainly with institutional and private investors in Germany. The refinancing plan for 2009 as a whole was therefore already met in October. The overall liquidity situation has stabilised and the Bank was able to raise more funds than anticipated. At the end of 2009, the volume of privately placed debt instruments amounted to EUR 3.8 billion for longer term unsecured and EUR 1.6 billion for secured bonds (Pfandbriefe). Spreads on the Bank's debt instruments fell considerable in the second half of the year to levels comparable to similar competitors.

To further raise potential funding via repo facilities, the Bank has lodged corporate loans and securities from structured portfolios with central banks around the world. These measures led to significant growth in the freely available collateral pool at the ECB and elsewhere, which provided an additional boost to short-term liquidity. The volume of deposits has furthermore stabilised since mid-year, which enabled the bank to significantly reduce the amount of central bank repo facilities it had to draw on. Further measures to ease refinancing included the systematic management of new business and the reduction of assets under the terms of the Bank’s realignment plan.

More extensive information on the liquidity and risk situation may be found in the Risk Report.

EMPLOYEES

Progress in reducing headcount

As one of the key components of its realignment, the Bank launched a cost-cutting programme that includes staff reductions. The decision was made to reduce the number of full-time employees at HSH Nordbank in a socially acceptable and transparent manner. The plan calls for cuts of 1,100, of which 760 will take place in Germany and 340 at its international operations by 2012. At the end of 2009, job cuts were ahead of schedule. The number of full-time staff was reduced by 715 to 3,610. As of 31 December 2009, the number of permanent employees at the bank (HSH Nordbank AG) fell year-on-year from 3,694 to 4,105.

In early April, the Management Board and Works Council signed a works agreement that cleared the way for voluntary redundancies. This was expanded in September 2009 to include arrangements on balancing interests and establishing a social compensation plan. These agreements regulate the concerns of the employees and compensatory measures. As per agreement, there will be no layoffs for operational reasons until October 2012. The parties agreed to severance agreements, early retirement plans and partial retirement programmes as methods available to reduce the headcount.

In view of the required restructuring of many processes at the Bank, the setup of the new Restructuring Unit and the closing of individual branches, major restructuring was necessary in 2009. This in some cases resulted in transfers to other units and employees being assigned new duties. The Bank implemented a range of personnel-related measures to limit the potential risks associated with the restructuring and a periodic rise in staff turnover in the year under review. These included employee and executive training. A further focus was on recruiting external specialists as a means of strengthening key areas within the Bank.

Headcount

	12/31/2009	12/31/2008
Total employees in Group[1]), of whom:	4,188	5,070
Women	1,905	2,240
Men	2,283	2,830
Employees in Germany	3,490	4,087
Employees abroad	698	983
Permanent Group employees[2]) , of whom:	4,094	4,750
HSH Nordbank AG	3,694	4,105
Full-time employees (FTE)	3,610	4,325
Key figures:		
Maternity and parental leave[3])	174	175
Pensioners and surviving dependents/early retired	1,733	1,743
Part-time employees (%)	14.7	17.2
Turnover rate[3]) (%)	8.8	4.8
Sickness rate[3]) (%)	4.1	3.4
Average age[3]) (years)	40	39
New employees [3])	40	309

1) Headcount

2) Total number of employees excluding trainees, temporary staff and interns.

3) Head office only; does not include branches or subsidiaries.

Business management improved

HSH Nordbank employs an internal indicator system to manage its business. This is designed to measure the performance of the business areas, as well as individual businesses and products on a risk basis. Key internal management indicators here include RaRoC (risk-adjusted return on capital) and value added (gross income less liquidity, administrative, risk and capital costs). In addition, key figures, e.g. new business margin and cross-selling income, are used to quantify success.

In conjunction with the realignment of the Bank, efforts are currently underway to upgrade the indicator and reporting system in order to meet expanded management requirements stemming from the financial market and economic crises. These focus primarily on growing the business in a way that preserves liquidity, on limiting risk-weighted assets and on the efficient use of venture capital.

As part of efforts to scale back the international branch network, the post of regional head (previously in charge of operational management at the Bank's individual international offices) was abolished. The global heads therefore now have exclusive and direct responsibility for the management and coordination of business activities at the international offices.

The business activities bundled in the Restructuring Unit will be wound down in a way to minimise risk while protecting profitability. To help achieve this goal, new management reports with special key financial ratios were developed with the aim of ensuring an efficient wind-down of portfolios.

A special report was also established related to the portfolio secured via a second loss guarantee from the states as a means of effectively monitoring the protective effect using the relevant key financial ratios.

Outlook

The following sections should be read in conjunction with the other chapters in this Management Report. These forward-looking statements at this time are based on our beliefs and assumptions made using information currently available to us. The statements rely on a number of assumptions concerning future events and are subject to uncertainties, risks, and other factors, many of which are outside of our control, that could cause actual results to differ materially from such statements. Therefore actual results may differ from the following future-looking statements.

ANTICIPATED UNDERLYING CONDITIONS

Sluggish recovery for global economy

The global economy looks set to continue its recovery, with global output expected to return to growth following the slump in 2009. The strongest force driving the recovery will once again be the Asian emerging markets, with Central and Eastern Europe economies not far behind. Moderate growth in Latin America is also expected.

In our view, the US and the euro zone economies will experience a slowdown in their respective recoveries in 2010. Though exports should continue to grow, the boost to growth from the inventory cycle and the impact of fiscal programmes will gradually fade. High unemployment on both side of the Atlantic will hurt consumer demand. The ongoing problem of relatively low capacity utilisation rates as well as uncertain sales prospects will furthermore dampen the appetite of companies to invest. There is also the risk that the pressure to consolidate in the banking sector will limit companies' access to credit. Towards the end of the year, the recovery should gradually become self-sustaining. In view of long-term pressures related primarily to the need to reduce public debt which rose sharply during the crisis, growth in these economic regions should remain depressed into 2011.

2010 will be also a challenging year for banks. In the euro zone alone, the ECB forecasts additional write-downs of EUR 187 billion, with the lending business strongly hit here. At the same time banks will seek to maintain or improve their capital base in view of stricter regulations in this area. In addition, the European Commission has called on several state-backed banks in the euro zone to reduce their total assets. This should result in further consolidation in the banking sector.

In view of the sluggish economic recovery and low inflation at this time, the main central banks are expected to be extremely cautious in rolling back their highly expansionary policies. Both the Fed and the ECB have announced that they will allow several liquidity-boosting measures currently in place to expire in the first quarter. The expectation of rate hikes by investors could raise the yields on two-year government bonds. We also expect a major increase in yields on ten-year government bonds. Yields on US treasuries should experience a strong rise in yields, as extremely high supply, lower demand from the Fed, uncertainty surrounding the future impact of high public debt, as well as the risk of inflation and exchange rate volatility act to restrain demand. The euro may continue to weaken in the months to come on the back of the debate on the poor state of public finances in several euro zone member states. Thereafter, the euro may well strengthen against the US dollar because of the major structural adjustments that the USA still faces.

On the equity markets the dynamic recovery and now very optimistic expectations of corporate profits increase the probability that the markets will experience more muted growth. But, in view of the lack of alternatives, this is offset to a certain extent by the pressure to invest.

ANTICIPATED BUSINESS SITUATION

Core areas of HSH Nordbank strengthened for the future

Key changes were made to help create a sustainable structure for the Bank in the year under review. The Bank's restructuring concept was drafted and individual measures were implemented in close coordination with the Free and Hanseatic City of Hamburg and the State of Schleswig-Holstein as the guarantor as well as the EU

Commission. Although the EU Commission has made no final decision in the matter (see below "EU state-aid proceedings"), much progress has been made in restructuring HSH Nordbank as of the beginning of 2010 and we will continue to rigorously pursue this plan in 2010.

One of the main goals of the Bank is to continue to wind down of non-strategic portfolios and risk positions at the internal Restructuring Unit set up at the end of 2009. This will be accompanying by a further major reduction in total assets. The spin-off and bundling of portfolios will significantly relieve the remaining strategic business areas at the Core Bank. In connection with vast improvements made to the lending and risk processes, the focus on core activities will create a strong basis for it to increasingly concentrate on the profitable client business in 2010 and 2011. In addition to existing business which produced higher income in 2009, new business will once again play a key role on the back of a rise in the demand for credit in 2010. The Bank will take a risk-sensitive approach and maintain business volume at the Core Bank at a steady rate. The tighter meshing of the client-facing unit with the Financial Markets divisions should provide a significant boost to the Bank's cross-selling business. The income base of HSH Nordbank (incl. the Restructuring Unit) will decrease in size over the coming years as total business volume falls.

Although the outlook in many industries and sectors has improved over recent months, conditions for lending remain difficult as a result of the impact of the economic downturn and continued sluggish economic growth. This may mean that income will be lower than expected and that default risks will remain high for banks. We continue to see longer-term challenges in shipping, which is a key business area for the Bank. We therefore also expect high loan loss provisions in 2010. However, these should remain significantly below last year's levels should the macroeconomic indicators continue to stabilise. A large portion of expected value adjustments relate to wind-down portfolios bundled in the Restructuring Unit. The ongoing reduction and disposal of portfolios will reduce potential loan loss provisions here. This applies to charges related to risk positions in the capital market business, too, which have been significantly reduced starting as far back as 2007.

In view of staff cuts, which were effectively completed in 2009 and which played a major role in the lowering of administrative expenses, there is less room for cost reductions in 2010. In the area of human resources, we expect higher costs for training and in some cases also for recruiting as part of restructuring activities and for efforts to strengthen risk management. Our goal is to further reduce operating expenses.

Overall, we are expecting HSH Nordbank to post a loss in 2010. We anticipate that earnings in 2011 will be better than 2010.

ANTICIPATED REFINANCING SITUATION

Broad based refinancing mix

As conditions on the financial market normalise, banks will increasingly be able to raise funds on their own, i.e. without state guarantees. This will be done primarily through unsecured bonds and Pfandbriefe. A reduction in total assets as a result of the financial crisis lowers the overall refinancing requirements.

HSH Nordbank plans for 2010 and 2011 to pursue a balanced approach to refinancing its lower business volume on its own. Under the Bank's issue plan, it will place increased amounts of unsecured bonds and Pfandbriefe with institutional investors in Germany. Funds are expected to be raised through secured funding channels, such as securitisations, commercial loans and development banks. In the short-term maturity band, the Bank has access to time and sight deposits by banks and customers. In addition to the expansion of the interbank repo business, we also use central banks around the world as a secure source of liquidity to meet our short-term funding requirements. In spite of success in stabilising and realigning the Bank, it cannot be ruled out that our issuer rating will be changed, which will in turn affect our fund raising activities.

EU STATE-AID PROCEEDINGS

The Bank's realignment concept formed the basis of a restructuring plan filed with the Commission of the European Union (EU Commission) on 1 September 2009. On 29 May 2009, the EU Commission granted preliminary approval for a period of six months for recapitalisation measures, which were completed in mid-2009. In its decision dated 22 October 2009, the EU Commission opened a formal investigation of whether the restructuring plan and the aforementioned measures comply with state aid provisions. At the same, the EU commission extended its preliminary approval for these measures until the conclusion of its formal investigation.

Since this time, the Bank, together with the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein and under the leadership of the Federal Republic of Germany, has engaged in intensive and constructive discussions with the EU Commission. These resumed at the beginning of 2010. The EU Commission has subsequently approved in principle the Bank's realignment concept presented in the restructuring plan. As is standard practice in similar subsidy disputes, the EU Commission makes final approval contingent on certain condition being met.

Discussions with the EU Commission currently centre on fees for second loss guarantees provided by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein as well as the specific terms for a future reduction of the stake held by these states. In addition, certain details related to conditions imposed by the EU still remain unresolved. These include the dates for disposing of certain holdings.

The continued existence of HSH Nordbank depends on the definitive approval by the European Commission of the stabilisation measures taken by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein. Furthermore, the conditions on which such approval is granted must be achievable as part of an economically viable business plan, and specifically, may not jeopardise regulatory effectiveness of the regulatory capital relief under the stabilisation measures.

We firmly believe that the EU Commission will grant final and permanent approval to the stabilisation measures and the restructuring of HSH Nordbank once all open issues have been resolved. We expect a decision from the EU Commission by mid-2010.

Events after December 31, 2009

After the balance sheet day, there were no major events pertaining to the Bank's net assets, financial position and results of operations beyond those cited at various places within the management report, in particular in relation to the EU subsidy proceedings.

Risk Report

RISKS AT THE HSH NORDBANK GROUP

HSH Nordbank manages its risks on a uniform basis by the global head principle. All management instruments, including risk reporting to the Management Board and Risk Committee, a committee of the Supervisory Board, follow this principle. The risk-bearing capacity of the Group is ensured in the same way. Since the risks which are relevant to HSH Nordbank do not align neatly with the legal divisions between individual units, this report is intended as a review of risks relevant to the Group as a whole, meaning HSH Nordbank AG as well as those subsidiaries designated as relevant to risk management. By way of exception, the key features of the internal control and risk management system for accounting and risk provisioning are presented for the AG rather than the Group.

AN OVERVIEW OF THE STATE OF RISK

Stabilizing the financial markets and realignment of HSH Nordbank

The state of risk at HSH Nordbank has significantly improved overall in the course of the year under review. The capital increase and risk shield boosted the Banks capital ratios, which had fallen as a result of the 2008 net loss, so that the regulatory capital requirements were clearly exceeded after implementation of these measures in 2009. The capitalization measures also increased the Bank’s risk coverage potential to EUR 11 billion, while the economic capital requirement fell by about half. This re-established the risk-bearing capacity of HSH Nordbank in the year under review. The calmer state of the financial markets also contributed to early achievement of the refinancing goals for 2009 as a whole.

The increased charges are the result of the consequences of the economic crisis. While the economy has recovered from its lowest point, default rates have continued to rise in recent months, as the crisis has left its mark on many companies. Loan loss provisions were increased by EUR -1,997 million in 2009, much of which was for commitments to the shipping industry, an important one for HSH Nordbank.

On 1 December 2009 HSH Nordbank completed the internal split into the Core Bank and Restructuring Unit, as planned. The Restructuring Unit is part of the fundamental strategic realignment. Its central function is to operate as a separate Board-level brief within the Bank to reduce in a controlled and gradual manner the positions in business areas no longer regarded as strategic and specific risk positions of HSH Nordbank, disposing of them with regard to results and liquidity in order to strengthen the Core Bank. Decisions on reducing portfolios are taken on the basis of defined principles, such as limiting losses in value, utilizing potential for write-ups, making careful use of liquidity and the risk shield, and cost efficiency. The transfer of responsibility for portfolios to the Restructuring Unit makes it possible for the Core Bank’s front office units to focus more on their target customers.

RISK MANAGEMENT SYSTEM

Principles of risk management

Active risk management is a fundamental component of HSH Nordbank’s overall bank management. This was the position from which the Bank started in 2008 to work systematically through the points for improving the risk culture which had been identified in the course of the crisis, e.g. by strengthening the market tracking function.

- HSH Nordbank defines risk to mean unfavourable future developments that may have an adverse impact on the Bank's asset, earnings or liquidity position. Material risks for the Bank are classified as default risk, market risk, operational risk, liquidity risk and other risks. The individual elements of risk management constitute, in their entirety, a system that ensures the identification, analysis, evaluation, management and ongoing monitoring and reporting of risks.

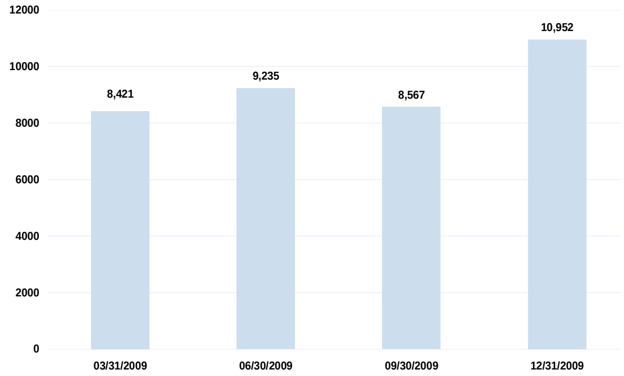
- Responsibility for risk management is clearly assigned within the Bank. The Management Board bears overall responsibility for the Bank's risk management activities, including the methods and procedures to be applied in measuring, managing and monitoring risk.
- Taking into account all material risk categories, the risk strategy represents the organizational and strategic focus of risk management. It includes the planned development of all key business activities taking account of risk strategy factors and, in particular, taking the capacity to bear risk into consideration.
- A risk manual, which is published throughout the Bank, sets out the methods and instruments used in risk management.
- Both the Management Board and the Risk Committee of the Supervisory Board are informed about the Group's risk situation in a comprehensive quarterly risk report.
- The Restructuring Unit as a separate Board-level brief of HSH Nordbank is fully integrated into the Group's risk management. The same methods and processes apply to it as at the Core Bank.

Risk-bearing capacity

To monitor its risk-bearing capacity and to safeguard it in a sustainable way, HSH Nordbank has integrated a capital adequacy process into its risk management. The management of risk-bearing capacity is closely related to capital and value added management.

- The economic capital required to protect against unexpected losses (overall risk) is regularly compared with the available economic risk coverage potential.
- This comparison takes place within the Bank's integrated limit system, which forms the basis for economic risk limitation for all risk categories across the Group.
- The economic risk coverage potential is calculated using the net asset value approach. Besides equity (including changes in net asset value), the net asset value takes into account unrealized reserves and losses on securities, equity participations and the lending business as well as negative effects on the income statement.
- The guarantee provided by the states of Hamburg and Schleswig-Holstein reduce the risk coverage potential since the second quarter of 2009 by the first loss piece of HSH Nordbank of EUR 3.2 billion. At the same time, the economic capital requirement for default risk is reduced generally, as there is no economic capital requirement for default risks after June 2009 for positions covered by the guarantee.
- The full recognition of the guarantee in the risk coverage potential was completed as at 31 December 2009. This increased the risk coverage potential by reducing cost components in calculating the unrealized reserves and losses on the lending business. Conversely, recognition of the future guarantee costs to be paid to the states of Hamburg and Schleswig-Holstein lead to a reduction in the risk coverage potential.
- In the course of the Bank's strategic realignment, a global limit for the overall risk was derived from the risk coverage potential in the third quarter of 2009; individual limits for default, market, operational and liquidity risks were then determined on this basis. As the full risk coverage potential is not allocated to the key risk categories, this leaves a buffer for covering specifically the risks under specific stress scenarios and risks which are currently unquantifiable.
- The overall risk takes into account the default risk, market risk, operational risk and liquidity maturity transformation risk as part of liquidity risk. The economic capital requirement for default, liquidity and market risks is calculated by consistent use of a value-at-risk (VAR) approach with a confidence level of 99.9% and a one-year risk horizon. The market risks are scaled up to the one-year horizon on the basis of VAR calculated daily. Since July 2009, different liquidation horizons have been assumed in this scaling for the Core Bank portfolio and the positions of the Restructuring Unit. Operational risks are calculated using the standard approach in the German Solvency Ordinance (SolvV). The economic capital requirements for the individual risk categories are aggregated into an overall economic risk. No risk-reducing correlations are applied.
- The analysis of the risk-bearing capacity is carried out quarterly at HSH Nordbank and also as part of the annual planning process.

Due to a change of the valuation method the comparability of the risk coverage potential as of 31 December 2009 with figures up to and including 30 September 2009 is limited. The risk coverage potential has been reduced by this adjustment, other things being equal. As the use of the values calculated according to the new method does not change the status of HSH Nordbank's risk-bearing capacity on 30 June or 30 September 2009, retrospective adjustment was waived. In the course of the past four quarters, the risk coverage potential has developed as follows:



Economic risk coverage potential (EUR million)	03/31/2009	06/30/2009	09/30/2009	12/31/2009
Equity Capital for economic purposes	14,549	14,232	14,232	12,942
First loss piece under guarantee transaction	-	-3,200	-3,200	-3,200
Unrealised gains/losses (net)	-6,128	-1,797	-2,465	1,210
Total	8,421	9,235	8,567	10,952

After the charges from the 2008 net loss (taken into account from 31 December 2008 in the risk coverage potential), inclusion of the loss expected for the 2009 financial year (taken into account in the risk coverage potential since 31 March 2009) and full recognition of the risk shield provided by the states of Hamburg and Schleswig-Holstein (taken into account in the risk coverage potential since 31 December 2009), the risk coverage potential at end-2009 was EUR 10,952 million. The capital increase in mid-2009 as such led to an increase in risk coverage potential, while the Bank's excess under the guarantee transaction led to a decrease.

For losses related to default risk, we make a distinction between expected and unexpected loss. Expected loss is default or impairment as a result of changes in credit rating expected to occur within one year and is compensated for by the calculated risk costs. The maximum amount by which an actual loss can exceed the expected loss with a certain degree of probability (99.9%) within a certain period of time (1 year) is known as unexpected loss. Risk parameters used to determine unexpected loss include probability of default (PD), loss-given default (LGD) and exposure at default (EaD). EaD includes both the outstanding loan amount as well as the anticipated call on provisions for contingent liabilities and commitments. Unexpected losses must be covered by the risk coverage potential. The economic capital requirement for default risks has decreased significantly as a result of the guarantee from the states of Hamburg and Schleswig-Holstein, and amounted to EUR 2,859 million at the reporting date (31 December 2008: EUR 6,629 million).

In response to the liquidity shortage in the markets, HSH Nordbank introduced a VAR approach for quantifying the liquidity maturity transformation risk as early as the start of 2008. This long-term/structural liquidity risk is an expression of the danger of increased refinancing costs on the open liquidity position. As planned, the liquidity-at-risk calculation was refined at the start of 2009 on the basis of the data acquired in the course of 2008. Our analyses have shown that the liquidity maturity transformation risk in the previous year was overestimated as a result of the conservative liquidity-at-risk approach. The adjustments result in a more accurate presentation of the Bank's actual risk situation. In all, liquidity-at-risk amounted to EUR 673 million as at 31 December 2009, EUR 232 million below the previous year's level, which was also recalculated using the refined method for better comparability. The insolvency risk, which in the current financial market crisis is the more significant expression for the Bank of the liquidity risk, compared with the maturity transformation risk, cannot be compared with the risk coverage potential, as it is not expressed in terms of magnitude of loss. Information on managing the insolvency risk is included in the section “Liquidity risk”.

The economic capital requirement for market risk rose EUR 329 million compared with 31 December 2008 to

EUR 657 million. This increase was primarily due to the integration of other risk factors in market risk measurement (e.g. credit spread risk, basis risk) and the methodological modifications in calculating capital requirement (e.g. increasing the liquidation horizons). In the course of scaling the market risk calculated daily (VAR) based on a confidence level of 99.0% and a one-day holding duration up to the economic capital requirement for market risk positions for the purpose of managing the risk-bearing capacity with a confidence level of 99.9% and a one-year risk horizon, we have adopted different liquidation horizons since July 2009 for the Core Bank portfolio and the positions of the Restructuring Unit. In addition, since July 2009 the daily net income from trading for all portfolios has been added to the relevant loss limit, so that the security premium used in calculating the economic capital requirement for positions subject to market risk was discontinued.

Operational risks have been calculated since the start of 2008 using the standard approach in the German Solvency Ordinance (SolvV). The corresponding economic capital requirement as at 31 December 2009 amounted to EUR 261 million (31 December 2008: EUR 291 million).

The economic overall risk declined significantly compared to end-2008 as a result of the effects described above, and amounted to EUR 4,450 million as at the reporting date (31 December 2008: EUR 9,016 million). The security of the guarantee transaction applies to the position values as at 31 March 2009, and is retroactive to 1 April 2009. The regulatory effect was evident for the first time in the capital reporting for 30 June 2009. The following diagram shows the change in total economic risk over the course of the last four quarters:

Economic capital required

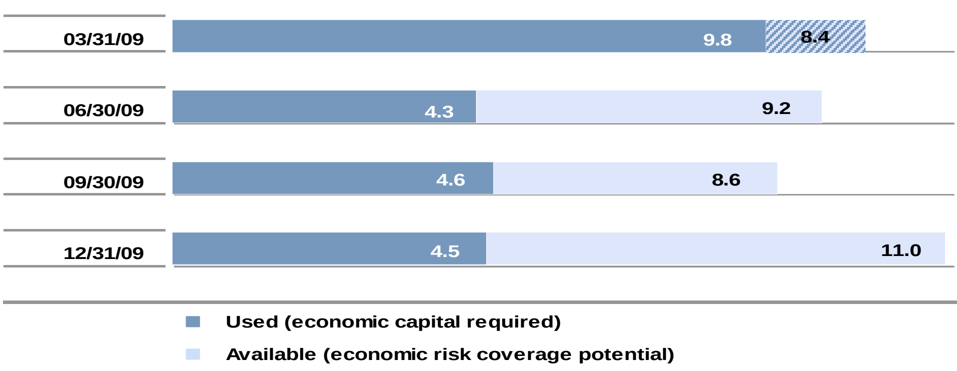
The following table shows the economic risk coverage potential of the Group, the risk limits and the economic capital requirement for the individual risk types and the remaining risk coverage potential buffer.

Group risk-bearing capacity (EUR million)	absolute 12/31/2009	absolute 12/31/2008	as % of risk coverage potential 12/31/2009	as % of risk coverage potential 12/31/2008
Economic risk coverage potential	10,952	9,862	100	100
Risk limits				
of which: Default risk	3,060	9,163	28	93
Market risk	1,470	1,086	13	11
Liquidity risk	750	750	7	8
Operational Risk	261	420	2	4
Total	5,541	11,419	51	116
Economic capital required				
of which: Default risk	2,859	6,629	26	67
Market risk	657	328	6	3
Liquidity risk	673	1,768	6	18
Operational Risk	261	291	2	3
Total	4,450	9,016	41	91
Risk coverage potential buffer	6,502	846	59	9

Utilisation of the risk coverage potential as at 31 December 2009 was 41%. The unused portion of 59% is used to cover specifically the risks from specific stress scenarios and risks currently not quantifiable. The risk-bearing capacity was accordingly secured at the end of the year under review (as was already the case in the third quarter of 2009), after being effectively nonexistent from the end of 2008 to the point of the capital increase and the risk shield provided by the states in June 2009. As a result of the development of the balance from unrealized reserves and losses and the negative effect on the income statement, the risk coverage potential actually available at end-2008 was below the total of the risk limits set for the year, although the risk coverage potential actually exceeded the total for economic capital. The risk-bearing capacity developed as follows:

Use of risk coverage potential

EUR billion



	Use in % Normal Case	Use in % Stress Case
03/31/09	117	243
06/30/09	46	79
09/30/09	53	81
12/31/09	41	57

To get better estimates of the anticipated effects of potential crises on the overall risk situation of HSH Nordbank beyond the utilization of risk coverage potential on the reporting date, we carry out regular stress tests which simulate the increase in economic capital requirements under specific scenarios for default, market and liquidity risks. When the overall risk at Group level under the simulated stress conditions still clearly exceeded the stressed risk coverage potential in the first quarter of 2009, the risk-bearing capacity as at 31 December 2009 (as in the two preceding quarters) was still adequate even in the stress situations.

HSH Nordbank uses the recognized risk management instruments for both regulatory and economic risk management. The Bank was, for example, one of the first banks approved by the Federal Banking Supervisory office to calculate its capital cover for default risks on the basis of internal ratings (advanced IRB approach). In addition to these statistical risk management tools, HSH Nordbank manages risks on a classic approach. For this purpose, reviews are made repeatedly during the year under review of credit risks, with the goal of promptly implementing the necessary specific risk management processes as needed, e.g. in transferring a commitment to intensive supervision.

In the course of the portfolio analyses, HSH Nordbank reviews its internal risk planning and identifies potential need for loan loss provisioning and possible RWA changes. A distinction is made in this between loss risks which are dealt with in the planned income statement (planned losses) and additional loss risks resulting from supplementary stress assumptions. RWA changes are treated similarly under plan and stress assumptions. The analysis of the customer lending business is done on the basis of detailed PD/LGD analyses. The credit investment portfolio is also reviewed by internal experts on the basis of a market value analysis. Single event risks – i.e. risks from commitments with low probability of default but large volume – are also analysed under stress conditions. The results of risk planning provided the basis for the amount of the capital and guarantee measures by the states of Hamburg and Schleswig-Holstein and the corresponding agreement with SoFFin and in connection with the EU subsidy agreement.

Organization of risk management

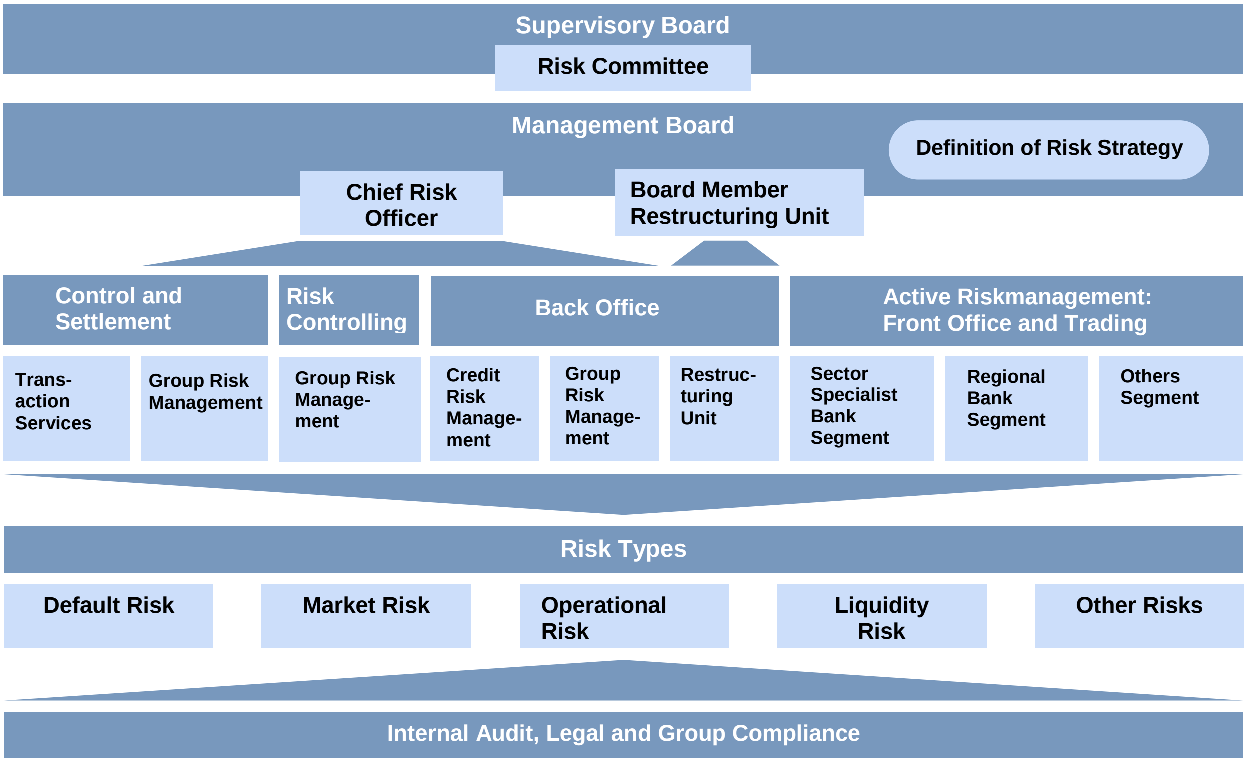
The organization of risk management at HSH Nordbank is geared towards the requirements of the business model. The regulatory requirements are also taken into account. The risk and financial responsibility of the Chief Risk Officer (CRO) and Chief Financial Officer (CFO) were divided in the year under review between two Board positions.

- The Management Board defines the Bank’s risk strategy on an annual basis as part of its overall responsibility. The involvement of the Supervisory Board ensures that the risk strategy is aligned with the interests of shareholders.
- The CRO is, as a member of the Management Board, responsible for risk controlling including risk monitoring and back-office functions in the Bank’s Core Bank. Accordingly, he is responsible for the Group Risk Management and Credit Risk Management units. The Board member for the Restructuring Unit is responsible for back office functions in this segment. The CRO is also responsible for the second risk assessment for the Restructuring Unit.
- In Credit Risk Management, Group Risk Management and the Restructuring Unit, the tasks of the independent back office function are bundled. In addition, Credit Risk Management functions include preparing the market-independent risk assessment, the review and determination of ratings, the calculation of collateral value and the processes and regulations for the Bank’s lending business. Group Risk Management is responsible for back office functions for work-out loans by the Core Bank and Restructuring Unit. The Restructuring Unit is responsible for decisions on reduction of positions in the commitments transferred to it. In addition to the market-independent risk assessment by the Restructuring Unit, a second assessment is carried out here by Credit Risk Management for non-problem and intensively managed loans.
- The CRO and the Head of the Restructuring Unit make decisions independently of the Management Board members responsible for front-office and trading units. This ensures the functional separation of front-office and trading activities, on the one hand, and risk controlling, settlement and control and back-office activities, on the other, at all organizational levels of the Bank, as stipulated by the relevant regulatory requirements.
- The CRO regularly reports to the Management Board and the Supervisory Board’s Risk Committee on the Group’s risk situation.
- The methods and instruments for measuring, managing and monitoring risk are developed centrally by Risk Controlling in the Group Risk Management unit. It ensures that the main risks to which the Group is exposed remain transparent and manageable.
- Transaction Services are responsible for the settlement and control of trading activities.
- Active risk management for the Core Bank is carried out in particular in the front-office and trading units,

whose business activities mean that they are directly responsible for risks and results. The risks are analysed and monitored decentrally by portfolio managers in the business area concerned.

- The Restructuring Unit created in December 2009 is responsible for positions of business areas no longer considered strategic and special risk positions. This also includes central responsibility for disposal of the credit investment portfolio, with regard to results and liquidity. Between October 2008 and November 2009, Group Risk Management was responsible for this.
- To reflect the realignment of the Bank and the changes in the Management Board, responsibility for management of strategic positions of the overall bank, management of the risk-bearing capacity and capital measures during the course of the year was transferred on 8 December 2009 from the Asset Liability Committee to the Management Board.
- Since June 2009, lending decisions for new loans above a certain amount are handled by a cross-divisional management group, which manages all liquidity outflows required on the assets side for the business. The group comprises market Board members and the Heads of the Group Treasury, Finance, Credit Risk Management and Capital Markets Credit business areas. The position of capital market Board member was not filled at the start of 2010.
- Internal Audit is an instrument established by the Management Board and is required to report directly to that body. It audits in a risk-oriented and process-independent manner the effectiveness and appropriateness of the Bank’s risk management, covering both Core Bank and Restructuring Unit. Internal Audit plays a supporting role in key projects, whilst maintaining its independence and avoiding any conflicts of interest.
- Legal and Group Compliance as an independent unit monitors and manages the Group’s legal and compliance risks.
- The global head principle helps to ensure uniform management of the divisions around the world. In line with this principle, the global heads – who are primarily directors of corporate divisions – assume responsibility for the global management of the divisions, administrative functions and services that are assigned to them. The global head principle is also applied to risk controlling, thus guaranteeing the ongoing evolution of uniform, Group-wide risk controlling.
- The Bank has established rules according to which any transactions involving new products or new markets must be subject to a formal auditing process. The aim is to ensure that the recognition of the products in the relevant systems and their inclusion in the relevant process are ensured, and that such transactions are only entered into with the approval of the Board member.
- As part of Group-wide risk management, the Bank takes into account each of the relevant subsidiaries when managing and controlling individual types of risk.

Organisation of risk management



- Modifications to HSH Nordbank's systems, processes and organization (particularly for risk management in the capital market business area) were defined in 2008 and implemented in 2009. These include specifically the process for new products and markets, internal risk reporting, integration of further factors for market risk (e.g. credit spread risks) and liquidity risk controlling.
- The lending decision process was further developed in the year under review by the Credit Risk Management unit[1] with the goal of strengthening the back office function to ensure a balance between risk and return goals, particularly for cyclical transactions. Together, these measures make a significant contribution to the further development of the risk culture. In the next step the Board member for Credit Risk Management has decided that the functions of credit analysis, loan management and collateral management will be integrated into the back office function in 2010. The lending decision process previously dominated by the front office areas will accordingly be replaced by a substantially risk oriented approach.

[1] Cf. the section on organization of default risk management.

Internal control and risk management systems for the accounting process

Tasks and goals

With regard to the accounting process, the internal control system promoted the orderliness and reliability of the accounts. It ensures specifically that all transactions are entered, processed and documented fully and correctly in accordance with statutory provisions, the Statutes and other internal guidelines, that accounting records are correct and complete, and that the assets and liabilities are recognized and measured correctly in the annual financial statements in accordance with the generally accepted accounting principles. With regard to the accounting, the internal control system accordingly serves to convey a true and fair view of the assets, financial position and earnings of HSH Nordbank AG. Further the internal control system makes a key contribution to the efficiency of the accounting process.

Organizational structure

The internal control system is based on the organizational structure of HSH Nordbank AG and the tasks, competences and responsibilities regulated in this. The organization of risk management at HSH Nordbank is geared towards the requirements of the business model. The regulatory requirements are also taken into account.

The Bank's internal audit as a process-independent instrument of the Management Board reviews the appropriateness and effectiveness of the internal control and risk management system. While maintaining its independence, the internal audit unit is also integrated into the further development of the internal control and risk management system.

The Bank has further formed an Audit Committee which regularly receives reports on the orderliness of the internal control and risk management system. In the 2009 financial year the Audit Committee met four times.

The divisions have decentralized responsibility for the internal control system. Tasks, competences and responsibilities are determined at the level of subprocesses in the divisions. The Finance Division is responsible for the accounting process and the orderliness of the accounting.

In the 2009 financial year the Bank further expanded the existing control system, including further developing the process organization. In this connection a central internal control system office will act as a management unit. The central ICS office is also particularly responsible for the organizational further development of the internal control system and reporting to the Management Board.

Control environment and procedures

A key basis of the internal control system is the documented regulations of HSH Nordbank AG. These cover all internal instructions and rules, which are documented in a database and available to all staff. This also contains the relevant internal guidelines for the accounting process. The current plans of accounts are also accessible in the database. An instruction on financial accounting establishes that the Finance Division is responsible for determining the framework conditions for accounting. By contrast, the divisions are responsible for orderly posting to financial accounts, and must accordingly ensure complete and correct recognition of transactions. Responsibility for an account is determined and documented when the account is opened. Controls and documentation of the posting procedures are established in writing for each division. Controls include specifically compliance with the dual control principle and separation of functions in entering and processing transactions. There are also automatic controls within the IT systems. The transactions posted are documented in vouchers, journals and the ledger. Use of the financial accounting system requires application for user authorization through a defined process; authorizations are reviewed and administered by a central office.

The financial accounting system is the basis for preparing the annual financial statements of HSH Nordbank AG. The material and timing requirements of the Finance Division for preparing the financial statements are communicated to the other divisions in an instruction on the financial statements. The Finance Division brings together the data entered in the individual divisions and supplementary reports which are relevant for the financial statements. To ensure complete and correct processing of data relating to the accounts, general and subsidiary ledgers are reconciled, interfaces and general ledger accounts which can be posted manually monitored, and technical accounting procedures implemented and controlled. Any errors arising in technical processing are analysed and corrected. In the course of preparing the financial statements, the correct recognition of the underlying facts in regard to contents in the annual financial statements is checked. The data processed in the accounting is accordingly subject to both technical and material quality by the responsible Finance Division. The central guideline for preparing the annual financial statements of HSH Nordbank AG in accordance with GAAP is the accounting manual, which is based on the relevant standards in the German Commercial Code

(HGB) and contains the rules for uniform recognition and measurement. The accounting manual and other instructions are published in German (and where necessary also in English) in the Bank and regularly updated.

The Bank has established a process for entering and documenting events which require retroactive adjustment of items in the financial statements and have a material effect on the assets, financial positions and earnings. All events are communicated by the responsible party to the unit in the Finance Division responsible for the process and are entered in a central list. The Finance Division determines whether these involve a change in the accounting methods, an error or a changed estimate, and whether adjustment is required under established materiality limits. This is followed by quality assurance by another unit in the Finance Division and approval by management.

In connection with the further development of the internal control system in the 2009 financial year, all controls will in future be monitored in a permanent procedure. The goal is regular and risk-oriented consideration of all processes, their inherent risks and the controls established to reduce these. Like all the processes considered, the accounting process is reviewed regularly to identify and allocate material risks and adopt the subprocesses relevant to the risks. Key controls are defined and reviewed for suitability to minimize risks and their actual effectiveness. On this basis, the necessary measures for establishing the appropriateness and effectiveness of the controls are defined and implemented.

Regulatory requirements

Since the start of 2008 the Bank has determined the necessary capital required for default, market and operational risks on the basis of the German Solvency Ordinance (SolvV). After approval by the Federal Banking Supervisory Office, we use the advanced IRB approach for default risks. The Bank will therefore use the same parameters for regulatory reports that already apply internally in risk management and default risk management and will there utilize the associated capital relief. The Bank determines the amounts to recognized for market risk positions on the basis of the required or optional standard procedures. The Bank recognized operational risks using the standard approach. All the limits applicable in this respect were complied with at the quarterly reporting dates. The overall limit was complied with from the time of adoption of the 2009 annual financial statements on 27 April 2009 to the legal signature of the risk shield guarantee by the states of Hamburg and Schleswig-Holstein on 2 June 2009. In the further course of the year under review, all the applicable limits in this connection were consistently complied with.[2]

In August 2009 the Federal Financial Supervisory Authority (BaFin) published a new version of MaRisk (minimum requirements for risk management). Key reasons for revision were the international regulatory initiatives resulting from the financial markets crisis, e.g. by the Financial Stability Board (FSB). Particular topics for operationalization and expansion were the rules on risk-bearing capacity, stress tests, management of liquidity risks, risk concentrations, details of compensation systems and risk management at Group level. The Bank will complete implementation of the resulting new requirements in 2010.

In accordance with the requirements of § 26a of the German Banking Act (KWG) and the German Solvency Ordinance, the Bank has published key qualitative and quantitative information on capital, risks incurred, risk measurement procedures and risk management in a separate report. Special requirements apply to HSH Nordbank as a bank using the advanced IRB approach. The document goes beyond the disclosure in the present annual report on the basis of the accounting regulations applied to give a comprehensive picture of the regulatory framework and the Bank's current risk situation on the basis of the regulatory ratios. We have also published the document voluntarily for the reporting date 30 June 2009, to show the effects of the capitalization by the shareholders Hamburg and Schleswig-Holstein on the minimum capital requirements. The reports can be viewed on the Bank's Internet site www.hsh-nordbank.de, under "Investor Relations". With this publication HSH Nordbank implements the requirements of the third pillar of Basel II (market discipline).
As part of its efforts to analyze, monitor and report on risks, HSH Nordbank has a centralized data storage system that takes into account the requirements of the Solvency Ordinance. This includes in particular the provision of data and information for regulatory reporting and disclosure in accordance with Basel II. The Bank completed development of a system for calculating the regulatory capital adequacy of HSH Nordbank in 2008. Both systems were reviewed and accepted by the Federal Banking Supervisory Authority in 2008. There was a further review by the Federal Banking Supervisory Authority in the reporting year in the context of the risk shield provided by the states of Hamburg and Schleswig-Holstein.

[2] Regulatory ratios: See section "Net assets and financial position".

DEFAULT RISK

In view of HSH Nordbank's strong orientation towards the lending business, entering into, managing and limiting default risks represent one of the Bank's key competencies. The default risk is broken down into credit, country, equity holding and settlement risks. In addition to traditional credit risk, credit risk also includes issuer and counterparty risk. Settlement risk consists of delivery risk and clearing risk. Clearing risk consists of possible loss of value if there are delivery or acceptance claims under a matured transaction which have not yet been met by both parties. Delivery risk arises where the Bank has performed its contractual obligations but the counterparty has yet to do so. All the elements of default risk referred to are taken into account within the context of the management of capital. For risk concentrations (in particular at borrower/country level) and equity holding risks, additional management measures are in place.

The organization and methods for managing default risk are constantly developed to reflect changes in market conditions and new regulatory requirements.

Organization of default risk management

The organizational structure of HSH Nordbank ensures functional separation of front-office, back-office and risk controlling functions at all levels up to and including the Management Board.

- The Credit Risk Management division in its independent back office function is responsible for formulating and implementing appropriate management for lending risks. Its tasks include quality assurance for risk evaluation in the lending business by preparing the market-independent risk assessment for lending decision documentation, the review and determination of ratings, the calculation of collateral value and the processes and regulations for the Bank's lending business. As a result of these responsibilities it is possible to identify systematic errors in evaluating credit risks and managing the lending business at an early stage.
- There were decisive changes in the structure of the Credit Risk Management division in the year under review. To strengthen the back office function, the units dealing with preparing the back office assessment and setting ratings were given enhanced status within the organisation. In addition, a separate monitoring unit was created, which is responsible for developing and operating an early warning system and segment risk analysis.
- In the course of the measures taken by the Bank in the financial market crisis, the existing lending decision process was also intensively analysed and significantly refined. For example, in 2009 the credit risk strategy was developed into an integrated market strategy and credit risk strategy for the individual front office units which consolidates the consideration of opportunities and risks in the relevant markets. The integrated market strategy and credit risk strategy also establishes a comprehensive, obligatory and exclusive framework for all lending business. Linking the market and risk perspectives allows us to ensure that lending guidelines ("lending standards") conform with current market developments and HSH Nordbank's standing in this market. Credit risk management manages and monitors the development of the integrated market strategy and credit risk strategy, which is reviewed semi-annually.
  In November 2009, introduction of new competence guidelines established direct participation by the back office functions in the lending decision, in addition to the existing independent assessments by front and back office. In the event of any discrepancy between the front-office and back-office assessments, a decision is reached by means of an escalation process. This procedure eliminates entry into transactions against the decision of the back office units. Competence levels for assessments and lending decisions are aligned with internal rating class and nominal volume. Until November 2009, the focus was on the economic capital requirement as a management variable.
- HSH Nordbank makes use of the option to dispense with back-office risk assessment for all lending business classified as non-risk relevant that involves certain transactions types and for loans below certain amounts as set out by the escape clause in MaRisk. The definition of lending business classified as non-risk relevant has been focused on nominal volume since November 2009. Until that time, the focus was on the economic capital requirement as a management variable.
- Operations in the lending area are based on the rules and internal guidelines set out in the HSH Nordbank Credit Manual, particularly the lending, competence, risk assessment, rating, collateral and LGD guidelines and the guidelines on the monitoring of exposure, the value calculation guidelines and the guidelines on the definition of default, which describe the main principles of the Bank's lending and credit monitoring activities. Under these principles, credit risks recorded in accordance with the extended definition as set out

in section 19 (1) of the German Banking Act (KWG) are viewed and treated individually according to the collateral provided, the type of loan, the rating class and the degree of credit risk. This is based on the aggregate exposure of the HSH Nordbank Group to the borrower unit in accordance with section 19 (2) of the German Banking Act. For this purpose, the relevant borrower is always the economic risk-bearer.

- With regard to the distinction between secured and unsecured loans, the types of collateral considered acceptable by the Bank are set out in the Bank's collateral and LGD guidelines. Compliance with the requirements of the Solvency Ordinance (e.g. identifiable market value, ability to realize collateral value, no correlation with secured loan, legal enforceability, matching of maturities) is taken into account. The list of recognized forms of collateral may be expanded by means of a review by a market-independent team of specialists from the Credit Risk Management, Group Risk Management and Legal and Group Compliance units through the RSU Rating Service Unit GmbH & Co. KG (RSU).
- Management of individual credit risks is supplemented in particular by rules governing the monitoring of exposure and the early detection of risks.
- With regard to the Core Bank, Group Risk Management is responsible for the independent monitoring of risks at portfolio level, independent reporting, managing country risks and the processing and management of restructuring cases and risk provisions. With regard to the Restructuring Unit, Group Risk Management is responsible for the independent monitoring of risks at portfolio level, independent reporting, managing country risks and the processing and management of restructuring cases and risk provisions.
- Expertise in reducing portfolios is bundles in the Restructuring Unit as an independent Board-level brief with further back office functions. The Restructuring Unit is responsible for decisions on reduction of positions in the commitments transferred to it. In addition to the market-independent assessment by the Restructuring Unit, there is a second assessment by Credit Risk Management.
- The Restructuring Unit processes and manages the restructuring cases for the positions for which it is responsible independently. It also handles processing of liquidation commitments for its own positions and positions of the Core Bank, where decision making authority for the latter is still vested in the relevant decision maker in the Core Bank.
- To ensure Group-wide controlling of default risks, relevant subsidiaries such as HSH Nordbank Securities S.A., HSH Real Estate AG and HSH Nordbank Private Banking S.A. are included in risk reporting.

Managing default risk

Default risks account for the major part of the risk potential of HSH Nordbank. The Bank has developed an advanced range of instruments to enable it to analyze, evaluate and actively manage these risks.

The risk shield provided by the states of Hamburg and Schleswig-Holstein reduces the economic capital requirement for default risk, as there has been no economic capital requirement for default risks since June 2009 for positions covered by the guarantee. HSH Nordbank manages both the guaranteed and unguaranteed portfolio in accordance with regulatory and economic principles. For example, there is a further limit on the economic capital requirement for default risks for the guaranteed positions without taking the guarantee into account. The goal is to keep any claim against the states of Hamburg and Schleswig-Holstein under the risk shield as small as possible.

Default risk exposure

The outstanding loan amount indicates the volume of loans, securities, equity holdings, derivative financial instruments and other off-balance sheet business such as irrevocable, undrawn credit commitments that are at risk. As at 31 December 2009 the outstanding loan amount totalled EUR 205,168 million.

The outstanding loan amount is shown broken down by the Bank's internal rating classes in the following table. The outstanding loan amount with an investment grade rating (rating classes 1 (AAAA) to 5) stands at EUR 129,438 million (previous year: EUR 183,493 million).

Default risk structure by rating (EUR million)	2009	Loan amount outstanding 2008
1 (AAAA) to 1 (AA+) 1)	48,675	70,103
1 (AA) to 1 (A-) 1)	40,406	53,856
2 to 5	40,357	59,534
6 to 9	31,406	47,064
10 to 12	14,015	7,099
13 to 15	16,327	6,390
16 to 18	13,982	5,864
Total	205,168	249,910

1) Allocation to the first two rating classes was changed in the year under review. The values shown for 2008 have been adjusted here accordingly.

The outstanding loan amount is shown broken down by the Bank's main sectors in the following table.

Default risk structure by sector (EUR million)	2009	Loan amount outstanding 2008
Industry	20,672	22,461
Shipping	34,941	40,763
Trade and transportation	13,092	15,725
Credit institutions	41,924	55,563
Other financial institutions	32,917	39,636
Real estate and property	26,799	39,168
Other services	12,896	8,918
Public sector	17,704	23,638
Private households	4,223	4,031
Other	0	7
Total	205,168	249,910

The allocation to industry as at 31 December 2009 follows the new industrial classification (SIC 2008) of the Federal Statistical Office for the main classifications. Comparability with figures for 31 December 2008 is accordingly limited.

The outstanding loan amount is shown broken down by residual maturities in the following table.

Default risk structure by maturity (EUR million)	2009	Loan amount outstanding 2008
Up to 3 months	15,940	23,230
> 3 month to 6 months	8,906	8,457
> 6 months to 1 year	27,558	28,806
> 1 year to 5 years	81,123	94,935
> 5 years to 10 years	45,481	56,981
> 10 years	26,160	37,501
Total	205,168	249,910

Rating procedures /LGD

During the initial development of various internal rating modules, as well as during their further development and ongoing validation, HSH Nordbank collaborates intensively with other banks. This takes place at the Landesbank Association through the RSU Rating Service Unit GmbH & Co. KG and also in collaboration with Sparkassen Rating und Risikosysteme GmbH (SR), a subsidiary of the German Savings Bank Association (DSGV).

RSU, which was formed in 2003 as a result of a cooperation between Landesbanks aimed at developing internal rating procedures, is a subsidiary of the participating banks and is responsible for new development, uniform management and further development of rating systems complying with banking regulatory quality requirements and for the operation of the rating modules in a uniform IT environment. In its activities, RSU is provided with methodological and technical support by specialists from the participating institutions. Besides the rating modules supported by RSU, HSH Nordbank also uses rating procedures provided, maintained and further developed by SR.

HSH Nordbank plays a leading role in the management of the Shipping, Leasing and Leveraged Finance modules and is also jointly responsible for the International Real Estate and Country and Transfer Risk modules. A rating model for credit financing for funds was developed in 2008 in the RSU Association with the cooperation of HSH Nordbank. The module was introduced at HSH Nordbank in January 2009 for internal management.

In the year under review, the predictive quality of the rating modules with regard to the forecast probabilities of default was examined jointly on the basis of the anonymous pooled data in a validation process. Following this process, the suitability of the modules for the Bank's portfolio and the transferability of the results were analyzed and confirmed within the Bank by providing proof of representative status.

Credit conversion factors (CCF) are empirically calculated and applied to determine contingent liabilities and commitments anticipated in the event of a default. The outstanding loan amount weighted with a CCF is called Exposure at Default (EaD). To forecast the Loss Given Default, HSH Nordbank has developed a differentiated LGD method for lending and trading transactions for all divisions. Item-specific collateral recovery rates and borrower-specific recovery rates are estimated on the basis of historical loss information. The default amount is calculated on the basis of the EaD using the LGD. The LGD and CCF procedures were reviewed and continuously developed as part of the annual validation process in the year under review. In the year under review the Bank's LGD and CCF methods were introduced in the RSU Association. The 2009 validation was accordingly carried out for the first time under the leadership of HSH Nordbank together with the other Landesbanks.

The Banks, Corporates, International Authorities, Country and Transfer Risk, Insurance Companies, Leveraged Finance and Leasing and Funds rating modules used within HSH Nordbank, as well as the standard rating used for smaller domestic corporate clients, are based on the scorecard approach. Using this approach, quantitative and qualitative characteristics and factors are identified which are used to assign borrowers to various credit rating classes. A scorecard approach can only be used if there is a sufficient number of relatively homogeneous borrowers.

As this condition is often not fulfilled for special lending, simulation-based rating techniques are predominantly used. Special-purpose financing for shipping, real estate, projects and aircraft, for example, is valued with the help of cash flow simulation models. The primary source for the reduction of debt service is the income generated from the financed asset or property. The cash flow of the asset or property is simulated in various scenarios reflecting different macroeconomic and industry-specific conditions and the future development of factors such as rental levels, vacancy rates and charter rates. As a result, an individual default probability (probability of default, or PD) is obtained for each borrower, enabling assignment to a specific credit rating class.

To ensure the comparability of the various portfolio segments the Bank uses an identical rating master scale for all modules, which also makes possible mapping with external ratings. As part of the development and validation of methods, the internal guidelines are also constantly updated.

The Bank's approach of applying the methods newly developed and refined with Basel II in mind is not only applied to determine the future regulatory capital requirement, but also incorporated in full at an early stage into the internal management system. This means that all of the parameters relating to Basel II form the basis for the integrated approach to overall bank management and risk management at HSH Nordbank. For example, the corresponding risk parameters are used in preliminary costing calculations and in determining competencies. They are also factored into the Bank's integrated risk limitation system and its planning and strategy processes.

Managing the default risk in preliminary and actual costing

HSH Nordbank applies a uniform method across the Bank for the preliminary costing of lending transactions, including a present-value calculation of the expected and unexpected losses from default risk positions, taking into account any currency transfer risks. This calculation reflects the entire contribution margin, up to the value added after cost of capital/tax effects. The risk parameter ratings, LGD and CCF calculated internally for each transaction are used in the preliminary costing. Similarly, monthly actual costing (profit centre accounting) of the transactions is also carried out. The costs and the added value based on them are calculated using the current risk parameters of the individual transactions.

Stress tests

HSH Nordbank performs quarterly stress tests to determine the economic capital requirement for default risks. For this, the relevant risk parameters in calculating the economic capital requirement are varied, e.g. by changing the anticipated default probability and default rates. The result is a check whether the risk limit budgeted for default risk is met for the relevant stress scenarios. These stress tests also serve to meet the regulatory requirements of the Solvency Ordinance.

Risk concentrations

Risk concentrations must be effectively limited for both regulatory and economic reasons. To manage and monitor risk concentrations effectively at borrower and country level, corresponding limits for economic capital have been set. These limits were derived from the risk coverage potential, taking into account the portfolio granularity. At least once a year the limits are examined on the basis of the Bank's risk-bearing capacity and approved by the Management Board in compliance with the risk strategy. Sector and rating-class-specific risk concentrations are monitored within the integrated limit system. This allows for early identification of unwelcome developments and the implementation of corresponding countermeasures.

With regard to the limiting of risk concentrations at borrower level, the decision on any new lending business which would result in the limit being exceeded lies with the Management Board. The Management Board and Risk Committee were informed about all cases where limits have been exceeded in new and existing business, as well as about any measures introduced, as part of the quarterly risk report.

A further limit on risk concentrations is imposed at the level of regulatory borrower units (in accordance with § 19 (2) KWG) as part of internal major risk management. The process used for managing large risks ensures compliance with the regulatory limits for large loans at both institution and institution group level, and allows the Bank to detect potentially excessively large loans at an early stage and take suitable precautionary measures before they actually arise. In addition, there are limits on classic lending and trading business.

Country risk

HSH Nordbank considers country risk to mean the risk of agreed payments either not being made at all or only partly or with delay on account of state restrictions on cross-border payments (transfer risk). The risk is not related to the debtor's rating.
The limitation of country risk represents an additional management dimension within the context of managing concentration risks. The risks of foreign lending transactions are managed using economic capital. Fundamental risk drivers taken into account in the measurement of the country risk include the rating and LGD of the country where an economic risk applies. The country ratings and country LGDs are based on a method that was developed as part of the joint project by the Landesbanks/RSU. Furthermore, portfolio granularity aspects are taken into account in order to correctly represent cluster effects.

The concentration risks for all countries at Group level are limited by the country limits for economic capital derived from the risk-bearing capacity. In addition, for countries in which the Bank has its core business areas, limits are also defined by the Management Board at global head level, taking strategic importance into account. The utilization of limits is monitored centrally on an ongoing basis by the units responsible for country risk management.

Given the intensified financial market crisis, country risk management has identified high-risk countries which will probably be particularly affected by the adverse macroeconomic effects of the crisis. Tight limits were introduced for these high-risk countries, which are subject to ongoing review. The country risk concept for these limits includes all country risks, going beyond the transfer risk described above. Because of the deterioration in their fiscal data, a number of countries in the euro zone are subject to increased monitoring. In April 2009, additional limits were imposed for Ireland, and in January 2010 for Greece.

The following table “Country exposure by region” provides an overview of country exposure by region, which reached a level of EUR 111,887 million as at 31 December 2009. Country exposure is defined as the nominal exposure relating to lending and trading transactions, taking into account transfer-risk-relevant collateral. The item “Other” includes e.g. ABS and funds which cannot be unambiguously attributed to a country or region.

Country exposure by region (EUR million)	Loan amount outstanding 2009	2008
Western Europe	61,160	76,670
of which euro zone countries	29,713	35,958
Central and Eastern Europe	3,464	3,776
of which euro zone countries	249	357
African countries	1,665	2,319
North America	25,274	32,889
Latin America	3,346	5,229
Middle East	845	1,624
Asien-Pacific region	14,927	19,470
International organisations	76	77
Other	1,130	2,017
Total	111,887	144,071

Securitization

The securitization of loan portfolios is a key component of HSH Nordbank's risk management. Given the virtually illiquid state of the securitization market, the scope for trading in such transactions continued to be very limited in 2009. The principal aim of transactions since 2004 was risk transfer. This was achieved by means of synthetic securitization through entering into credit default swaps (CDS) and issuing and placing credit-linked notes (CLN). The risk relief resulting from these transactions served to reduce risk concentration in the loan portfolio in terms of individual borrowers and sectors. The only transaction remaining after 2008 (Baltic Star 1) for securitizing ABS was liquidated in the year under review.

Equity holding risk

Equity holding risk is understood to mean the danger of a financial loss due to value impairments on equity holdings.

Under regulatory requirements, equity holdings must either be consolidated, deducted from equity capital or backed with equity as an asset in the 'equity holdings' class. In this context, regulatory law regards equity holding risk as a subcategory of default risk.

The opportunities and risks of an equity holding commitment are analysed in detail before entering into a transaction. Equity holdings are only entered into if they are in alignment with the Bank's strategic goals.

A key instrument for monitoring and managing equity holding risk is regular company valuation. At least once a year, impairment tests are performed on all direct equity holdings and the relevant indirect equity holdings of HSH Nordbank. Significant equity holdings are subjected to detailed valuation, in compliance with the relevant standards of the Institute of independent Auditors in Germany (IDW). All other equity holdings are subject to risk-oriented review.

In addition, all equity holdings in the portfolio are subject to analysis annually. The focus here (among other aspects) is on identifying potential risks in the individual companies. Based on this analysis, measures are taken to counter identified risks actively. If necessary, exit strategies are formulated for strategically insignificant equity holdings.

Regular reporting on the development of business and the economic position of the companies is carried out at varying intervals and intensities, according to the materiality for the Bank. In addition, partnership agreements are formulated to ensure that HSH Nordbank can assert as much management influence as possible over its equity holdings. The Bank also takes steps to ensure that it is represented in the management bodies of particularly important companies.

Loan loss provisions

Within the scope of risk management the bank pays very great attention to default risks. Borrower credit risk is hedged by recognizing individual value adjustments on receivables and provisions on contingent liabilities in the amount of the expected default; this takes place in accordance with uniform Group-wide principles. Beyond that, the Bank forms general value adjustments on receivables for which no impairment allowances have been recognized but which are subject to latent risks. For loans to borrowers with a high country risk, country-specific general impairment allowances are recognized based on the internal country rating and collateralization. The Bank calculates the exposure at default less the present value of all incoming payments still expected. The expected incoming payments comprise in particular all expected interest and redemption payments as well as payments from the liquidation of collateral, with liquidation costs taken into account.

For problem loans – including cases of liquidation and loan restructuring – the level of the impairment allowance is based on the uncovered portion of the loan drawn following a revaluation of the collateral. The revaluation of collateral takes into account the Bank's experience in the realization of collateral value and appropriate individual risk premiums. The suitability of allowances for loan losses is constantly monitored throughout the problem loan administration process.

Loans and advances to customers decreased significantly by c. 7% in the year under review, due to the Bank's limited new business and exchange rate effects. The main reason for the very clear decline in loans and advances to banks of c. 44% is a waiver of claims by the Bank in the previous year in favour of its subsidiary HSH Nordbank Securities, which is active in credit investment, which was no longer required in the year under review. The adverse trend in the economic situation of borrowers again led to continuing high loan loss provision in the year under review in corporates. The following "loan loss provisions" table provides an overview:

Total loan loss provisions (EUR million)	12/31/2009	12/31/2008
Loans and advances to customers	110,820	119,020
Loans and advances to banks	20,796	37,070
Volume of impaired loans[1]	9,819	5,500
Individual valuation allowances for loans and advances to customers[2]	-3,440	-2,186
Portfolio valuation allowances for loans and advances to customers	-284	-246
Individual valuation allowances for loans and advances to banks[2]	-363	-368
Portfolio valuation allowances for loans and advances to banks	-9	-46
Total loan loss provisions for balance sheet items	-4,096	-2,846
Provisions for individual risks in the lending business	-523	-352
Provisions for portfolio risks in the lending business	-14	-70
Total loan loss provisions for off-balance sheet items	-537	-422
Total loan loss provisions	-4,633	-3,268

1) The figures for the previous year were adjusted

2) The 2008 figures were adjusted for comparability. The figures for the previous year include impairment losses on securities totalling EUR 830 million

In the year under review, the Group's loss rate amounted to 0.24% (previous year: 0.31%). The Bank loss ratio is the actual loan defaults (the aggregate of the utilization of individual value adjustments, direct write-downs on loans and payments received on receivables written off) expressed as a percentage of total loan volume. Defaults for 2009 totalled EUR 499 million (previous year: EUR 800 million), while the total loan volume for 2009 amounted to EUR 211,541 million (previous year: EUR 256,971 million).

As of 31 December 2009, Bank risk provisions in the form of individual value adjustments/provisions for default risk amounted to EUR -4,325.9 million (previous year: EUR -2,905.7 million), which was equivalent to 2.04% of the total loan volume (previous year: 1.13%). General loan-loss provisions (including country-specific general loan-loss provisions) totalled EUR -307 million (previous year: EUR -361 million).

MARKET RISK

Market risks entail potential losses that may result from detrimental changes in the market value of positions in the trading and banking book. Among the market movements of relevance to the Bank are fluctuations in interest rates and credit spreads (interest rate risks), exchange rates (foreign exchange risks), stock prices, indices and fund prices (equity risks) as well as commodity prices (commodity risks), 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 an overall share of the global limit for market risks. As part of this loss ceiling, the risk arising from all transactions exposed to market risk is restricted by means of a system of loss and risk limits.
- Market risk is managed directly in the Bank's Financial Market Division. Selected strategic positions exposed to market risks were managed by the Asset Liability Committee until 8 December 2009. To reflect the Bank's realignment and the changes in the Management Board, responsibility was transferred to the entire Management Board at the end of the year under review.
- Daily market risk reports ensure that the Management Board and the trading units are kept constantly informed of the level of exposure to market risks and the current limit utilization.
- In accordance with MaRisk requirements, the organizational separation of market risk controlling, settlement and control, on the one hand, and the trading units responsible for the positions, on the other, is ensured at all levels. All key methodological and operational tasks relating to risk measurement and monitoring are grouped together in the Group Risk Management division.
- The Restructuring Unit manages the positions assigned to it from the capital market and credit investment businesses. Settlement and control, financial and risk controlling are handled by Core Bank divisions independent of the Restructuring Unit.
- HSH Nordbank Securities S.A. has been identified as a subsidiary that must be included in the Group-wide market risk controlling process. Risk limits and monitoring are done centrally by HSH Nordbank AG.

Market risk management

Market risk measurement and limitation

The basis of the system for measuring and managing market risk is a value-at-risk approach. The market risk of a position is the loss in value (in euro) which, with a defined probability, will not be exceeded within a defined period until the position is hedged or liquidated.
Within the Bank, value-at-risk (VaR) is calculated using historical simulation methods. Calculations are based Group-wide on a confidence level of 99.0% and a holding period of one day over an observation history of 250 equally weighted trading days.

The material market risks at HSH Nordbank are interest rate risk (including credit spread risk) and exchange rate risk. The VAR of HSH Nordbank covers these risk categories and also equity and commodities risk for both the trading and investment portfolios. No separate limit is applied to the different types of risk. A limit is set for the total market risk for the bank. To manage market risks, the VAR is limited for the various reporting units. There are clearly defined processes for limit adjustment and overshoot.

Market risks from the lending business and the Bank's liabilities are transferred to the trading units and taken into account in the corresponding risk positions. There, they are managed as part of active portfolio management and hedged through external transactions.

Further development of market risk measurement

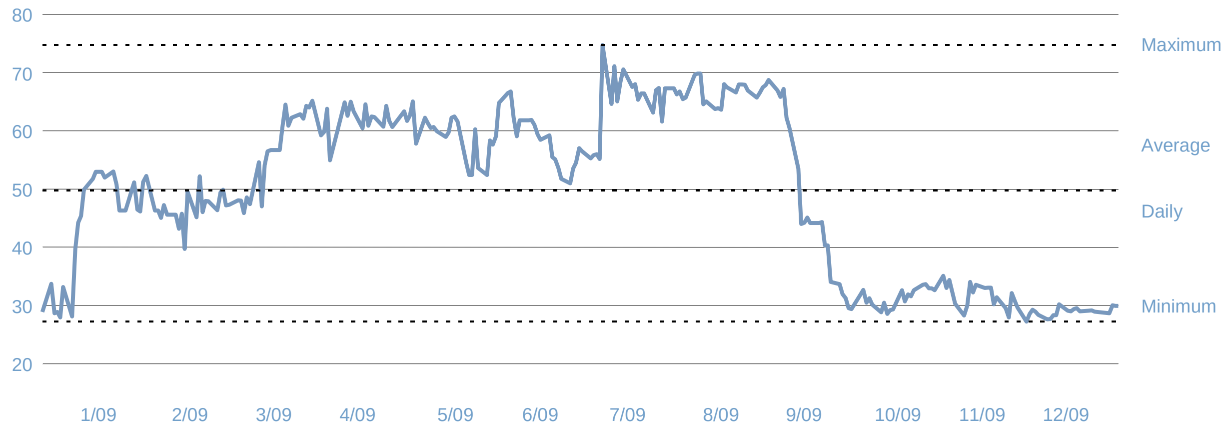
The Bank developed measurement of credit spread risks further in 2009, supplementing the existing VAR method. A bond's credit spread is a premium for the issuer's default risk. Credit spread risk refers to the danger that the value of a position may rise or fall as a result of a change in the spread. In July 2009, measurement of credit spread risks from CDS, single name bonds and loan notes were integrated into daily VAR measurement for the Group. In addition, measurement of credit spread risks was methodologically further developed, particularly for securitized positions. Full integration of credit spread risks into daily VAR measurement – for which a monthly approximation was already introduced in the year under review – is planned in 2010.

The Bank analysed all basis risks in the entire portfolio in the year under review. The swap positions in particular include basis spread risks. Basis spread risk refers to the potential loss of value from differing payment frequencies and reference interest rates on the variable side of swaps. In the course of integrating basis spread risks into daily market risk measurement, the necessary modifications for the main HSH Nordbank currencies (USD, GBP, CHF, JPY) were made in the year under review. The remaining work on integrating secondary currencies (DKK, SEK) will be completed in the first half of 2010.

Daily value-at-risk during the year under review

The following diagram illustrates the movements in the daily value-at-risk for the entirety of HSH Nordbank's trading and banking book positions during 2009. Market risk was between EUR 27 million and EUR 75 million. As at 31 December 2009, the value-at-risk of the trading book positions amounted to EUR 6 million, with the banking book VAR totalling EUR 30 million. On the last trading day of 2009, the Bank's total VAR was EUR 30 million, while the VAR limit for market risk was EUR 80 million, giving a figure of 37% for limit utilization.

Daily value at risk in the course of 2009 (€ m)



The table "Value at risk" shows the value at risk for the entirety of the Bank's trading and banking book positions. Maximum and minimum refer to the upper and lower limits of the range in which the risk ratio in question moved during the year under review. Overall risk is calculated by aggregating the individual market risk types. The Group's market risk is calculated in full, and taking into account Group-wide correlations in HSH Nordbank AG. Market risks from derivatives, including volatility risks arising from options, are included in the figures shown below. Since July 2009, credit risks from single name bonds, CDS and loan notes are included in the figures shown. Integration of credit spread risks from securitization positions is planned for 2010.

The increase in total market risk compared with end-2008 is primarily due to the widening of the Pfandbrief spread in the Group Treasury portfolio and an increase in exchange rate risk. The latter was driven by increased volatility of the exchange rates used in the valuation, with the EUR/USD exchange rate subject to particularly wide fluctuations in March 2009. Integration of credit spread risks in daily VAR measurement increased total market risk at the date of introduction by c. EUR 20 million. The decrease in VAR, particularly in the third quarter, was a methodological result of the elimination of data for the corresponding period in the previous year for the historical observations for the last 250 trading days, the improvement in portfolio recognition and the portfolio reduction under the Bank's realignment. In the course of risk-bearing capacity management, the VAR was extrapolated by aggregating the individual risk categories to total risk of EUR 657 million.

Daily value at risk[3] (EUR million)

	Interest rate risk *		Credit spread risk*		Foreign exchange risk		Equity risk		Commodity risk		Market risk (aggregiated)	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
Average	33.7	22.5	27.0	--	20.6	10.3	5.3	10.3	0.3	0.5	49.8	27.0
Maximum	47.8	34.7	40.0	--	47.3	27.0	9.9	15.2	1.7	1.3	74.8	48.2
Minimum	20.7	13.1	20.7	--	2.2	3.9	2.6	4.4	0.0	0.1	27.2	16.8
End of period value	25.4	24.9	21.3	--	2.3	10.7	2.7	4.4	0.2	0.2	29.9	24.0

* Credit spread risks are a subcategory of interest rate risk. Due to their importance for HSH Nordbank they are shown here separately, rather than as part of interest rate risk.

[3] The VAR is not additive as a result of correlation effects.

Backtesting

The Bank performs regular backtesting to verify the appropriateness of its value-at-risk forecasts. This involves comparing the theoretical daily profit/loss derived from the market performance observed on the following day with the VAR figures for the previous day as forecast using historical simulation, assuming unchanged positions. The results of backtesting are taken into account in the ongoing development of the Bank's value-at-risk methodology.

Stress tests

In addition to limit-based management of the daily VAR, at least two weekly stress tests are carried out to investigate the effects of unusual market fluctuations on the value of positions. To this end, the Bank varies its modelling against the calculation of risk under normal circumstances.

For example, in the course of interest rate risk stress tests, a change in risk factors under extraordinary market conditions is simulated, e.g. by shifting or rotating the interest rate curve. At end-2009 the scenario for positive interest rate movements showed a potential loss of EUR 43 million. The scenario for rising exchange rates showed a potential loss of EUR 8 million.

The Bank also carries out separate stress tests for currencies, equities, commodities and volatilities, where uniform shifts are assumed for the individual positions. The Bank supplements these stress tests by other parametric scenarios and historic scenarios (e.g. 11 September 2001).

The Bank regularly calculates the change in the present value of banking book positions, assuming interest rate shocks of +130 and -190 basis points to analyze interest rate risks. This satisfies on a timely basis the new regulatory requirements for calculating the effects of a sudden and unexpected change in interest rates on positions in the trading book.

LIQUIDITY RISK

HSH Nordbank divides its liquidity risk into insolvency risk and liquidity maturity transformation risk. Insolvency risk refers to the danger of the Bank not being able to meet its own payment obligations or refinancing requirements as they fall due, or not to the desired extent. Liquidity maturity transformation risk refers to the risk that a loss may occur as a result of the differing fixed conditions periods for assets and liabilities, known as liquidity maturity transformation positions, and the fluctuations in the Bank's own refinancing premium. Liquidity maturity transformation risk is also an integral part of the risk-bearing capacity concept. The Bank deploys a variety of instruments to measure, manage and limit its liquidity risks.

Based on the information on the current financial and economic crisis and the results of backtesting activities, the Bank further developed the structure and parameters for measuring and limiting insolvency risk in December 2009. This also took into account the lowered rating of

HSH Nordbank was by a rating agency, which also affected the modelling for the stress scenarios. Overall, the adjustments led to a more conservative presentation of the Bank's liquidity situation.

The split into Core Bank and Restructuring Unit had no effect on management of liquidity risks. The individual divisions within the Restructuring Unit are integrated into the processes and methods for managing liquidity risks, like all relevant business areas of the Bank.

Organization of liquidity risk management

- Liquidity management is done by the Group Treasury unit as a cross-divisional banking function for the Core Bank and Restructuring unit. The goal is to ensure the Bank's solvency at all times, in all locations and currencies.
- The Group Treasury unit is also responsible for the implementation of funding operations, as well as market-smoothing activities.
- The liquidity buffer from securities and receivables from lending (collateral pool) was again supported and further developed by Group Treasury, to make optimal use of the potential for secured refinancing.
- The Bank draws up liquidity planning for strategic multiyear management of liquidity as a resource. For short-term liquidity management, comparisons of plan and actual figures are carried out, based on a monthly analysis of changes relevant to liquidity, so that deviations from the plan can be countered.
- The Group Risk Management unit is responsible for defining the methods used for measuring and limiting the Group's liquidity risks. It also measures risks and monitors limits as part of the daily reporting of liquidity risks. This supports Group Treasury in managing the liquidity of all maturity bands and enables it to counter potential risks at an early stage.
- As part of Group-wide controlling of liquidity risks, HSH Nordbank Securities S.A. was identified as the only relevant subsidiary and incorporated into the Group-wide examination of liquidity risk. Management also includes the special purpose entities Carrera and Poseidon.
- The Bank has a contingency plan comprising a catalogue of measures as well as documented processes and clearly assigned responsibilities for the event of a liquidity crisis.
- The Bank's liquidity policy defines the Group's framework for dealing with liquidity and the associated risks.

Liquidity risk management

Liquidity risk measurement

To measure the Bank's insolvency risk and funding requirements, transactions impacting its liquidity are converted into cash flow figures, and incoming and outgoing payments are assigned to maturity bands to produce a liquidity maturity statement. The difference between incoming and outgoing payments is the liquidity excess or shortfall (gap) in the individual maturity bands. Measure of insolvency are

- Individual gaps for the first to the fourteenth day, to show concentrations of outgoing payments, and
- Cumulative gaps from one day to 12 months, to show future liquidity requirements.

In the year under review the Bank further developed the methodology for modelling payment flows, e.g. for loan commitments. In addition, further products and their cash flows were included in the liquidity maturity statements, e.g. the planned new lending business including rollovers. Liquidity maturity statements are compiled daily at Group level, for the Bank as a whole, for foreign branch offices and for HSH Nordbank Securities S.A. In addition to all business shown in the statement of financial position, these statements include loan commitments granted, guarantees, transactions with forward value dates and other business not shown in the statement of financial position. Maturity scenarios are used for a number of positions to map economic maturities more effectively. Factors such as possible minimum levels of deposits and current accounts as well as the realization periods and amounts of assets are always modelled conservatively. The liquidity maturity statements take the current market situation into account as a basic scenario (normal case view). In addition to calculating the liquidity maturity statement in EUR equivalent values, the Bank calculates a separate liquidity maturity statement for all USD transactions daily. This ensures adequate management of the Bank's USD position.

Besides the normal case liquidity maturity statement, the Bank takes into account a deterioration in the market situation through a daily calculation of the results of a market liquidity stress test in the form of a stressed liquidity maturity statement. This, for example, takes into account more difficult refinancing conditions and looks at other cash flows under stress assumptions.

HSH Nordbank has been using a VAR approach to quantify its liquidity maturity transformation risk since the start of 2008. Liquidity VAR is calculated using a historic simulation (99.9% confidence level) of liquidity spreads and their present effect on transactions which would be theoretically necessary to be able to close out the current maturity transformation position immediately. The assumption here is that these hypothetical closing out transactions can actually be entered into the market, so that full refinancing is possible. As planned, the liquidity VAR calculation was refined at the start of 2009 on the basis of the data acquired in the course of 2008. The Bank's analyses have shown that the liquidity maturity transformation risk in the previous year was overestimated as a result of the conservative liquidity-at-risk approach used. The adjustments result in a more accurate presentation of the Bank's actual risk situation. For example, the gaps are closed even using the covered funding potential, and minimum levels of customer deposits are taken into account.

Limiting and monitoring liquidity risk

Both the individual gaps and the cumulative gaps for the first 14 days have limits set in the context of insolvency risks. Furthermore, limits are applied to the cumulative gaps for five additional maturity bands up to 12 months.

The insolvency risk is limited in principle by the ability of HSH Nordbank to utilize its entire liquidity cover potential. This liquidity cover potential consists of various components, expressed in the total overall limit. The liquidity potential (limit) is the respective ceiling for the cumulative gaps of the individual maturities and consists of a securities portfolio which is maintained as a precaution in the event of a crisis (crisis liquidity), additional liquid securities and loan notes on the basis of their convertibility into cash, unsecured funding options and secured potential funding from the issue of Pfandbriefs and commercial loans eligible for rediscount at central banks. In the year under review the limit was supplemented by further components, e.g. the funding potential from usable new lending. As an adjustment to the market situation, since 2009 unsecured funding potential has also been included in a significantly more restrictive way in the liquidity cover potential, which has been significantly reduced as a result, other things being equal. The liquidity cover potential components are examined and validated on an ongoing basis in accordance with internal minimum requirements. To minimise the likelihood of full utilization or breaching the ceilings, security buffers and risk premiums were taken into account in the limits. These individual premiums involve e.g. haircuts or other security premiums which reflect uncertainty over the future development of the relevant limit components.

Group Risk Management calculates and monitors utilization of the limits every day and reports its findings to the Management Board and Group Treasury. If limits are exceeded, Group Treasury determines and implements appropriate measures and Group Risk Management monitors their implementation.

The Management Board and responsible management units are also notified monthly in aggregated form of limit utilization in the normal and stress case, in the stress scenarios and the overall estimate of the Group's liquidity situation.

The liquidity VAR for liquidity maturity transformation risks is determined monthly by Group risk Management and reported to the Management Board and responsible management. The limits are at Group level, and are an integral part of the risk-bearing capacity concept.

Decreasing limit utilization over the course of the year

The state of the financial markets was still difficult at the start of 2009, but has normalized significantly over the course of the year. Secured funding, e.g. through repo transactions, is now possible again without restrictions, and even unsecured funding has become increasingly possible since the middle of the year. Overall, the refinancing situation of the banks has eased substantially over the course of the year under review.

This development in the market in combination with the downgrading of the long and short term ratings by a rating agency initially had a negative impact on the liquidity position of HSH Nordbank, leading to higher utilization of the liquidity cover potential. The Bank accordingly made greater use of the liquidity supplied by the central banks by borrowing from the central banks against its collateral pool, and placed a number of benchmark bonds guaranteed by the Special Fund for Financial Market Stabilization (SoFFin). In January, April and July 2009, HSH Nordbank successfully placed benchmark bonds guaranteed by SoFFin with maturities of two and three years and a total volume of EUR 9.0 billion. The Bank also received EUR 5.3 billion in June 2009 and EUR 2.4 billion in September 2009 under one-year tenders.
This significantly benefited the liquidity situation in these maturities.

In addition, the following measures were taken in the year under review to improve the Group liquidity situation:

- Increase the collateral pool by identifying further assets eligible for discount at central banks (e.g. commercial loans) and depositing these with the relevant central banks.
- Increase the cover pool for covered issues.
- Risk-adequate pricing and restrictive lending and irrevocable loan commitments.
- Measures to strengthen customer deposits to offset the decrease in deposits by banks and nonbanks after

the rating downgrades.

- Selling assets, e.g. from the credit investment portfolio, and restructuring portfolios.

Overall, the Bank's liquidity situation has stabilized compared with end-2008, so that e.g. more funding has been attracted than planned. For 2010 and 2011, refinancing will take further increased efforts, and will be secured by implementing concrete measures.

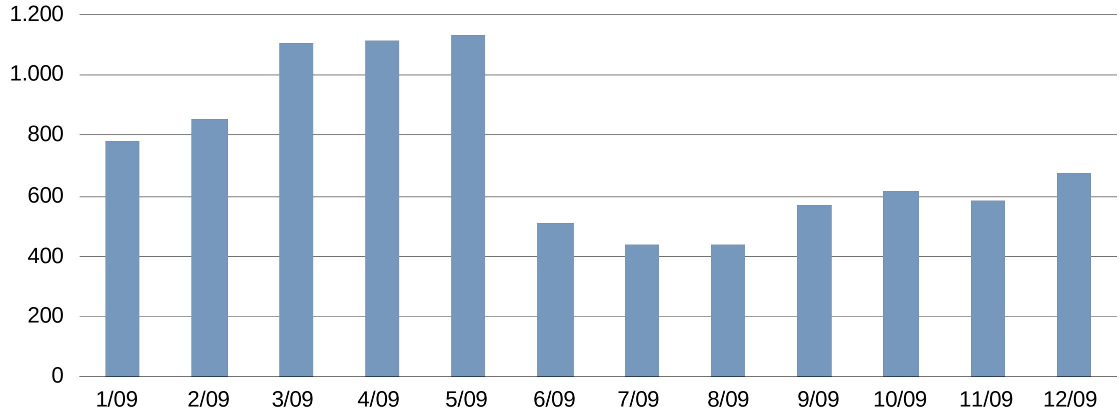
The following table shows the relative utilization levels of the limits and ceilings for individual cumulative liquidity gaps in the normal case and stress case as at 30 December 2009. Utilization represents the share of the cumulative gap in total liquidity cover potential, which also includes utilization of borrowing options at the central banks.

Limit on cumulative liquidity gaps Use of liquidity potential (%)	Normal Case		Stress Case	
	30/12/2009	30/12/2008	30/12/2009	30/12/2008
1st day	1	0	7	4
7th day	14	38	21	50
14th day	25	52	35	67
3rd week	33	56	44	79
4th week	38	52	54	79
8th week	48	58	68	94
3rd month	57	78	83	129
6th month	67	72	101	128
9th month	74	71	110	138
12th month	73	65	113	138

In the normal case presentation, liquidity cover potential was shown as at the reporting date at 74% in nine months. The stress case liquidity maturity statement shows only moderate utilization of liquidity cover potential at times in the range up to three months, which is particularly relevant for insolvency risk. From the sixth month, the liquidity cover potential is no longer sufficient to meet the cumulative gap. Maximum utilization is 113% in the 12th month. Methodological refinement in measuring and limiting cumulative gaps means there is limited comparability in this table between the year-end values for 2008 and 2009. Basically, however, the level of utilization of liquidity cover potential as at 30 December 2009 shows significant positive development in both the normal case and the stress case compared with end-2008, despite more conservative modelling and limit parameters.

The liquidity VAR as an expression of liquidity maturity transformation risk varied on a monthly basis in the year under review between EUR 435 million and EUR 1,136 million. As at 30 December 2009 it was EUR 673 million.

Liquidity-value-at-risk in 2009 (EUR million)



Since June 2009, the SoFFin guarantee framework has been taken into account to its usable extent in the liquidity VAR calculation. The resulting additional refinancing possibilities, the capital increase and the overall improvement in the liquidity situation led to a decrease of more than half in the liquidity VAR compared with the previous month.

Backtesting

In the course of backtesting, we review the modelling of products with stochastic payments streams in the liquidity maturity statement on the basis of statistical analysis of historical payment streams. Choice of the relevant products is based on the volume and risk content of the product in terms of the uncertainty in previous modelling. In the year under review we carried out backtesting for numerous products, e.g. current account loans, sight deposits, savings deposits, cash collateral for OTC derivatives, early redemption of own issues and loan notes, determinist and stochastic credit commitments, roll-over credits.

Stress tests

Our regular stress tests for insolvency risk involve unusual scenarios and their effects on the Group's liquidity situation. In determining the stress tests, the risk (and hence key parameters) was identified for all transaction types in the liquidity maturity statement which change the cash flow profile in the relevant stress situation. For example, inflows could be lower or later and outflows higher or earlier than expected.

Stress tests were chosen on the basis of an analysis of historical events and hypothetical models. The rating downgrade of HSH Nordbank accordingly required redefinition and restructuring of the stress scenarios. In addition, experience from the downgrade was incorporated in new modelling and parameter configuration. Based on an assumed deterioration in the market liquidity crisis, market-specific scenarios (e.g. global recession) and scenarios specific to the Bank (e.g. a downgrade of HSH Nordbank AG) are examined in the various stress scenarios. In each of these scenarios, it is assumed that some new lending will have to be continued and maturing loans to customers will have to be extended and refinanced, while the options for extending repayment terms for deposits are partly restricted or totally impossible, resulting in a financing gap. In addition, the model assumes that large numbers of credit facilities that the Bank has granted are drawn down and that the Bank's own issues and securitized liabilities are redeemed early. Stress test results are reported to the Management Board and Group Treasury at least once a month.

Both the market-specific and bank-related stress scenarios from December 2009 show that the liquidity requirement is covered by liquidity cover potential for several weeks, even in updated and strict worst case assumptions. These results demonstrate that the Bank is sufficiently prepared for possible crises.

Liquidity ratio of HSH Nordbank AG

The regulatory ratio for liquidity risks is the liquidity ratio in the German Solvency Ordinance. The Bank manages its liquidity ratio actively through specific market transactions. For internal management, it uses a lower limit above the regulatory minimum of 1.0. During the year under review, the Bank's liquidity ratio was above the regulatory minimum at all times, with a value between 1.17 and 2.17. The average value for 2009 was 1.66 (previous year: 1.25).

Liquidity ratio (LiqV)

Month-end values	2009	2008		2009	2008
January	1.37	1.27	July	1.92	1.29
February	1.17	1.23	August	1.67	1.26
March	1.30	1.18	September	1.88	1,23
April	1.50	1.18	October	2.17	1.18
May	1.41	1.26	November	1.92	1.18
June	1.72	1.35	December	1.87	1.34

OPERATIONAL RISK

HSH Nordbank defines operational risk (OpRisk) as the risk of direct or indirect loss caused by the inappropriateness or failure of the internal infrastructure, internal processes or staff or as a result of external factors (risk categories). This definition includes legal and reputation risks.

HSH Nordbank considers operational risk control and the fostering of corresponding risk awareness within the Group to be a key aspect of its management systems. This is because of the dynamic business conditions, the Bank's ongoing restructure measures, limited scope for risk transfer, as well as the increased demands by rating agencies and other market participants.

The internal division of the Bank into Core Bank and Restructuring Unit had no effect on management of operational risks. The individual divisions within the Restructuring Unit are integrated into the processes and methods for managing operational risks, like all relevant business areas of the Bank.

Organisation of operational risk management

- HSH Nordbank has an independent central controlling unit for identifying, analyzing, evaluating and monitoring operational risks. This unit is responsible for developing and supporting the relevant controlling instruments and providing expertise and advice on operational risks, as well as encouraging risk awareness within the Group. The central risk controlling unit also reports independently to the units of the Bank that are responsible for managing these risks.
- The central controlling unit for operational risks is backed up by a local network of experts. All business units have OpRisk officers and OpRisk assistants who are responsible for applying the controlling instruments and who act as the link between central risk controlling and the relevant divisions. The OpRisk officers and OpRisk assistants receive training for their duties from the Risk Controlling department.
- All methods and procedures within the context of controlling operational risks are also employed at the Bank's locations abroad.
- The subsidiaries designated as relevant – HSH Nordbank Securities S.A., HSH Real Estate AG, HSH Nordbank Private Banking S.A. and HSH Facility Management Holding AG – are integrated into operational risk from the Group-wide perspective.

Operational risk management

Operational risks can affect all products, processes and organizational entities. For this reason, particular attention is paid to effective risk awareness so that the expertise possessed by the Bank's staff can be utilized for identifying operational risks.

In the course of realignment of the Bank, a significant reduction in headcount is planned. The reduction in headcount planned for 2009 and 2010 was almost achieved in the year under review. This leads to a risk in some divisions that performance of the impending tasks with the necessary care will be possible to only a limited extent. To counter the resulting operational risks, the Bank has taken measures to curb high staff fluctuation, to manage the internal job market, and to intensify external recruiting. This enabled the Bank to fill key vacancies in the Credit Risk Management, Group Rick Management and Internal Audit units. In addition, specific measures were initiated to improve the staffing situation in management of intensive management and work-out cases.

Measures were also taken in 2009 to improve the qualitative and quantitative resources for decentralized operational risk management in the divisions.

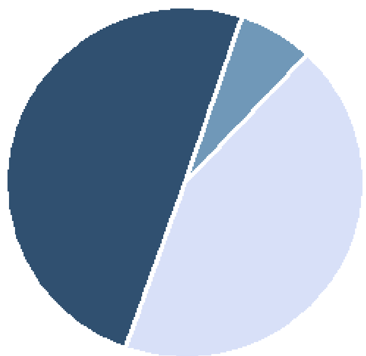
Training throughout the bank is planned for 2010 to further increase risk awareness for operational risks.

Risk event database

Risk events resulting from operational risks are combined for the Bank and the relevant subsidiaries in a central risk event database. The organizational entities concerned record the risk events locally and forward this data to the central risk controlling unit, which checks the data, collates collective risk events, if applicable, and prepares analyses and reports. The results of the analysis of risk events allow us to take preventive action. In addition, Internal Audit examines and assesses all the Bank's activities and processes from a risk-oriented, process-independent perspective, and identifies any measures that can be taken to reduce operational risk. This covers both the Core Bank and Restructuring Unit.

The central risk event database takes into account all risk events with a gross loss of at least EUR 2,500. A gross loss is the sum of the cash outflow, income foregone and internal resources consumed. In addition, unexpected revenue from operational risks is also logged in the risk event database for amounts in excess of EUR 2,500, as risk events with net income for the Bank can indicate e.g. procedural weaknesses. The categorization of risk events makes it possible to systematically analyze the causes of losses and thereby contributes indirectly to the identification of operational risk events.

Share of risk categories in gross operational losses (%, 2009)



The largest individual gross losses in 2009 were in the category External Influences.

Since 2006, HSH Nordbank has been participating in the exchange of information on operational risk events as part of the Operational Risk Data Pool (DakOR) at the level of the Association of German Public Sector Banks (VÖB). The Bank played a key role in the establishment of this pool.

Risk inventory

Since 2005, HSH Nordbank has carried out a Group-wide risk inventory annually. Based on the information about the risk situation of organizational entities gained from this inventory, operational risk reporting to the management units is supplemented by the addition of forward-looking risk estimates to encourage the proactive management and monitoring of operational risks. In cooperation with the other Operational Risk Data Pool (DakOR) member banks, a standard scenario catalogue for risk inventory was developed in the year under review. This was supplemented by HSH Nordbank with internal scenario, and used for the first time in 2009 for the bottom-up logging of loss potential. The individual scenarios were consolidated in core topics, e.g. reorganization and outsourcing, and supplemented by a cross-divisional top-down analysis. The results of the risk inventory will be used as the basis for scenario analyses in individual cases to estimate the danger of particularly serious operational risk events; this will be important in particular for the derivation of suitable measures.

Legal risks

Under the German Solvency Ordinance (SolvV), legal risks also fall under operational risks. The Legal and Group Compliance unit is responsible for overseeing such risks. All organizational entities are given comprehensive advice on legal matters by regularly trained employees to ensure that risks are minimized, contained or prevented. A structured process with clear requirements and responsibilities serves to ensure that the Bank's contracts and agreements are kept up-to-date.

OTHER RISKS

Compliance risk

Compliance risk encompasses legal and regulatory sanctions or financial losses due to failure to comply with laws, regulations and guidelines and organizational standards and codes of conduct. The Compliance unit at HSH Nordbank is responsible for managing risks with regard to the German Securities Trading Act and related standards, prevention of fraud and money laundering and international financial sanctions.

There has been a considerable further increase in the compliance requirements on financial institutions. This can be attributed to new legal and regulatory requirements on the one hand (also as a result of the financial market crisis), and to significant compliance risk events in the international financial services sector on the other. HSH Nordbank has responded by continuously developing its compliance system and taking market standards into account.

A key milestone in expanding compliance in 2009 was the introduction of a Code of Conduct. The Code of Conduct is based on systems and processes introduced or expanded in recent years. It covers all behavioural requirements for compliance, which are explained in detail in internal instructions. The Code of Conduct applies to all employees, managers and the Management Board of HSH Nordbank AG, and is a binding part of personal goal agreements. The contents were communicated in a bank-wide training programme.

The Code of Conduct introduced an international whistle-blower office where employees and managers can report indications of possible violations of compliance regulations, possibly even anonymously. The whistle-blower office was staffed with independent ombudspeople from BDO Deutsche Warentreuhand Aktiengesellschaft Wirtschaftsprüfungsgesellschaft.

In the year under review, further development of instruments in the individual compliance areas included instruments for monitoring employee securities transactions, customer acceptance in terms of money laundering risks, and identification of fraud risks.

Strategic risk

Strategic risk is the danger of financial loss being incurred as a result of long-term decisions which are erroneous or based on incorrect assumptions, particularly with respect to the performance of individual areas of business or the banking sector as a whole.

The strategic realignment of HSH Nordbank initiated at end-2008, the successful capital increase and risk shield by the states of Hamburg and Schleswig-Holstein, and the SoFFin guarantees all reduced the strategic risk. Particular contributions were the concentration on core business areas, transfer of nonstrategic and high risk business to the Restructuring Unit and the significant reduction in the international network as part of alignment. To strengthen the Bank's risk culture, the risk functions and back office function competences were significantly enhanced, including reorganization of the lending decision process.

CORE BANK RISKS

The risks of the "Core Bank" subportfolio are shown separately below. The risks dealt with are the Core Bank's default and market risks. Management of liquidity, operational and other risks is handled at Group level for both the Core Bank and the Restructuring Unit.

Default risk in the Core Bank

The processes and methods for determining default risks in the Core Bank have already been covered in detail in the section "Default risks".

As at 31 December 2009 the outstanding loan amount for the Core Bank totalled EUR 119,938 million.

Default risk exposure

The outstanding loan amount of the Core Bank is shown broken down by the Bank's internal rating classes in the following table. The outstanding loan amount with an investment grade rating (rating classes 1 (AAAA) to 5) stands at EUR 81,455 million.

Default risk structure by rating (EUR million)	Loan amount outstanding 2009
1 (AAAA) to 1 (AA+)	27,011
1 (AA) to 1 (A-)	26,811
2 to 5	27,633
6 to 9	19,178
10 to 12	7,550
13 to 15	7,385
16 to 18	4,370
Total	119,938

The outstanding loan amount is shown broken down by the Bank's main sectors in the following table.

Default risk structure by sector (EUR million)	Loan amount outstanding 2009
Industry	11,640
Shipping	25,410
Trade and transportation	8,416
Credit institutions	29,303
Other financial institutions	16,435
Real estate and property	11,038
Other services	8,014
Public sector	7,674
Private households	2,008
Other	0
Total	119,938

The outstanding loan amount in the Core Bank is shown broken down by residual maturities in the following table.

Default risk structure by maturity (EUR million)	Loan amount outstanding 2009
Up to 3 months	11,770
> 3 month to 6 months	5,064
> 6 months to 1 year	19,225
> 1 year to 5 years	45,874
> 5 years to 10 years	26,397
> 10 years	11,608
Total	119,938

Country risk

The following table "Foreign commitments by region" provides an overview of the Core Bank's country exposure by region, which reached a level of EUR 54,863 million as at 31 December 2009.

Country exposure by region (EUR million)	Loan amount outstanding 2009
Western Europe	28,565
of which euro zone countries	14,837
Central and Eastern Europe	2,006
of which euro zone countries	114
African countries	1,433
North America	9,594
Latin America	2,142
Middle East	517
Asien-Pacific region	10,521
International organisations	26
Other	59
Total	**54,863**

Market risk in the Core Bank

The processes and methods for determining market risks in the Core Bank have already been covered in detail in the section "Default risks".

The Core Bank's market risk is essentially characterized by interest and exchange rate risk from lending and refinancing. There are equity risks only to a limited extent.

Daily Value at Risk (VaR) at Core Bank (EUR million)	12/31/2009
Interest rate risk	13.5
Credit spread risk	1.2
Foreign exchange risk	2.9
Equity risk	1.9
Commodity risk	0.2
Market risk (aggregated)	15.1

As at 31 December 2009, the value-at-risk of the Core Bank's trading book positions amounted to EUR 5.5 million, with the banking book VAR totalling EUR 15.8 million. On the last trading day of 2009 the Core Bank's total VAR was EUR 15.1 million.

RISKS OF THE RESTRUCTURING UNIT

The risks of the Restructuring Unit subportfolio are shown separately below. The risks dealt with are the Restructuring Unit's default and market risks. Management of liquidity, operational and other risks is handled at Group level for both the Core Bank and the Restructuring Unit.

Risk reporting for the Restructuring Unit is generally secured by management and reporting systems in the Group Risk Management unit. In addition to regular risk reporting, an expanded reduction and management reporting system is being introduced at portfolio level for the Restructuring Unit. The aim of this is to take into account special characteristics of the reduction, to be able to respond flexibly and promptly to changes in the portfolios. This reporting already exists today to a great extent, but will be further expanded in the next few months.

For reducing the loan portfolio, structured reduction is planned in addition to standard loan processing. This distinguishes between three categories of commitments: normal cases, intensively managed cases and work-out loans. With normal cases, various reduction strategies are followed, using a value-oriented approach. For intensively managed cases, it may be necessary to take into account increased risks of reduction for an individual case. For work-out cases, a concept is developed and assessed for each individual case, and here reduction is generally only possible after a successful work-out.

For reducing the capital market business, positions are allocated to various categories on the basis of current market valuation and impairment losses already recognized. Depending on the characteristics of the category in question, reduction is done in the framework of a loss budget set by the Management Board, including consideration of possible increased risks or potential for write-ups in the individual case.

Default risk in the Restructuring Unit

The processes and methods for determining default risks in the Restructuring Unit have already been covered in detail in the section “Default risks”.

As at 31 December 2009 the outstanding loan amount for the Restructuring Unit totalled EUR 85,230 million.

Default risk exposure

The outstanding loan amount of the Restructuring Unit is shown broken down by the Bank’s internal rating classes in the following table. The outstanding loan amount with an investment grade rating (rating classes 1 (AAAA) to 5) stands at EUR 47,983 million.

Default risk structure by rating (EUR million)	Loan amount outstanding 2009
1 (AAAA) to 1 (AA+)	21,664
1 (AA) to 1 (A-)	13,595
2 to 5	12,724
6 to 9	12,228
10 to 12	6,465
13 to 15	8,942
16 to 18	9,612
Total	85,230

The outstanding loan amount is shown broken down by the Restructuring Unit’s main industries in the following table.

Default risk structure by sector (EUR million)	Loan amount outstanding 2009
Industry	9,032
Shipping	9,531
Trade and transportation	4,676
Credit institutions	12,621
Other financial institutions	16,482
Real estate and property	15,761
Other services	4,882
Public sector	10,030
Private households	2,215
Other	0
Total	85,230

The outstanding loan amount in the Restructuring Unit is shown broken down by residual maturities in the following table.

Default risk structure by maturity (EUR million)	Loan amount outstanding 2009
Up to 3 months	4,170
> 3 month to 6 months	3,842
> 6 months to 1 year	8,333
> 1 year to 5 years	35,249
> 5 years to 10 years	19,084
> 10 years	14,552
Total	85,230

Country risk

The following table "Foreign commitments by region" provides an overview of the Restructuring Unit's country exposure by region, which reached a level of EUR 57,024 million as at 31 December 2009.

Country exposure by region (EUR million)	Loan amount outstanding 2009
Western Europe	32,595
of which euro zone countries	14,876
Central and Eastern Europe	1,458
of which euro zone countries	135
African countries	232
North America	15,680
Latin America	1,204
Middle East	328
Asien-Pacific region	4,406
International organisations	50
Other	1,071
Total	57,024

Further reduction of the credit investment portfolio

In the course of the financial market crisis, the credit investment portfolio led to heavy charges for HSH Nordbank. The Bank consequently decided in September 2008 to liquidate the entire credit investment portfolio, with regard to results and liquidity. Total exposure of the portfolio was reduced by c. 22% overall in 2009, utilizing market opportunities and with regard to foreign exchange effects, and at end-2009 amounted to EUR 17.1 billion. As at 31 December 2008, the volume had been EUR 21.8 billion, Down from EUR 30.0 billion as end-2007.

Following a consolidated charge in the income statements for the 2007/2008 financial years of EUR 2.9 billion, there was a slight overall recovery in 2009, reflected to the amount of EUR 140 million in the income statement. The revaluation reserve was improved by EUR 308 million.

In addition there were unrealized losses in the Group credit investment portfolio as at 31 December 2009 amounting to EUR 1.1 billion (31 December 2008. EUR 1.8 billion). Under IFRS, unrealized losses arise in the asset category of loans and receivables (LAR) from market value losses which are not classified as rating-related and a permanent impairment.

The emphasis in the recovery in value in the 2009 financial year was on synthetic CDO and bonds of individual issuers (corporate and financial bonds). Here, there were significant market gains in some cases, some of which were realized by selling several positions. By contrast, there were charges to the income statement form individual structured products, particularly RMBS of home equity loans.

Additional information[4], specifically on the credit investment portfolio and leveraged loans as at 31 December 2009 is contained in a separate publication on the Bank's Internet site at www.hsh-nordbank.de under "Investor Relations", in accordance with a recommendation of the Financial Stability Board on a commission by the finance ministers and central bank governors of the G-7 nations.

[4] This is not part of the management report and not a subject of the audit of the annual financial.

Market risk in the Restructuring Unit

Market risks in the Restructuring Unit are calculated using the same processes and methods as in the Core Bank.[5]

Market risks in the Restructuring Unit arise mainly out of the credit investment portfolio. The credit spread risk is accordingly dominant here.

[5] Cf. the section "Market risk"

Daily Value at Risk (VAR) at Restructuring Unit (EUR million)	12/31/2009
Interest rate risk	18.2
Credit spread risk	21.4
Foreign exchange risk	1.5
Equity risk	1.8
Commodity risk	0.0
Market risk (aggregated)	24.2

As at 31 December 2009, the value-at-risk of the Restructuring Unit's trading book positions amounted to EUR 1.1 million, with the banking book VAR totalling EUR 24.6 million. On the last trading day of 2009 the Core Bank's total VAR was EUR 24.2 million.

SUMMARY AND OUTLOOK

As a result of the consequences of the global financial and economic crisis in March 2009, the Bank has adopted an initiated a far-reaching strategic realignment[6]. The goal was to create a Core Bank with a focused business model, a significantly improved risk profile in all divisions, significantly smaller total assets and adequate capitalization. The creation of an internal Restructuring Unit for business areas which are not longer strategic and special risk positions as at 1 December 2009, marked implementation of a key pillar to this concept. The Bank will continue to consistently pursue the reduction in the loan and capital market portfolios in the Restructuring Unit in accordance with results and liquidity. A further recovery in the capital markets would favour this reduction. As the environment continues challenging, however, further significant charges must be expected in all types of business in the Restructuring Unit.

As a result of the financial and economic crisis, the restructuring of problem loans to reduce the impact on earnings will be a central factor for the Bank's success. A start has already been made on a corresponding increase in resources.

After carrying out the capital increase of EUR 3 billion, the Bank's core capital ratio has risen significantly. The core capital quota is expected to maintain the minimum of 7% required by SoFFin, despite the anticipated difficult earnings situation for the Bank in 2010. With a view to the expected future developments, the additional risk shield will protect the bank against possible unexpected losses of up to EUR 10 billion. This significant increase in capital is expected to provide appropriate capital for the implementation phase of the strategic realignment over the next three years.

As both the capital increase and the risk shield are regarded under EU law as subsidies, the EU Commission initiated proceedings in the year under review. The EU Commission has since accepted the realignment concept, including the capitalization measures. The EU Commission is expected to approve the stabilization measures and reorganization of HSH Nordbank finally after clarifying the remaining outstanding points. The final decision by the EU Commission is expected by mid-2010.

In the course of the measures taken by the Bank in the financial market crisis, the existing lending decision process was also intensively analysed and significantly refined. For example, in 2009 the credit risk strategy was developed into an integrated market strategy and credit risk strategy for the individual front office units which consolidates the consideration of opportunities and risks in the relevant markets.

HSH Nordbank carried out a weakness analysis for credit risk management in 2009 and formulated a concept for improving risk organization and a lending decision process in accordance with the regulatory requirements (KWG, MaRisk). A key element in the new credit risk organization will be the centralization of all relevant functions (including credit analysis, previously carried out in the front office, and loan and collateral management) in the risk function. The concept is being further developed with a view to the future overall organization of the CRO unit. Key aspects to be considered in implementation are avoiding negative effects on core processes in front office functions, establishing a best practice decision process for credit and market risks with appropriate competence levels and decision making documentation and competitive processing times, with current and foreseeable new regulatory requirements.

HSH Nordbank also intends to further optimize its existing methods, processes and systems in the areas of market and liquidity risk management. Key aspects for consideration are the current and foreseeable new regulatory requirements, accurate recognition of risks and the specific organizational requirements of HSH Nordbank. The existing model for calculating the risk adjusted return on capital (RAROC) and the early warning system will also be reviewed.

The risk and bank management systems described above are intended to take systematic account of risks. This also applies to expectations of future market and business trends. In the Bank's opinion, this is a correct presentation of the opportunities and risks arising from the future development of its business activities in, among other things, the outlook and this risk report. Despite clear signs of recovery, the financial markets and economic crisis is expected to continue in 2010. In particular because of the capital measures completed in the year under review, which still need to be finally approved by the EU, it is expected that HSH Nordbank will maintain its risk-bearing capacity and solvency.

[6] Cf. the section “Business outlook”

Final declaration to the report on relations with affiliated companies in accordance with § 312 AktG

The Management Board of HSH Nordbank AG is required under § 312 of the German Joint Stock Company Act (AktG) to submit a report on relations with affiliated companies for the 2009 financial year.

The final declaration of the Management Board on the report is as follows:

“In the transactions listed in the report on relations with affiliated companies, HSH Nordbank AG has in each case received appropriate compensation in the circumstances known to us at the time the transactions were conducted. No measures were taken or omitted on the instruction or in the interests of the two controlling companies.“

Hamburg/Kiel, 12 March 2010

Nonnenmacher van Gemmeren

von Oesterreich Visker

ANNUAL ACCOUNTS

Balance sheet of HSH Nordbank AG as at 31 December 2009

Assets				(Note)	€ k	€ k	12/31/2009 € k	12/31/2008 € k
1. Cash reserve								
a) Cash on hand						9,801		10,381
b) Balances with central banks						936,100		1,096,934
thereof:							945,901	**1,107,315**
with Deutsche Bundesbank		€ k	655,220					
	(P. year	€ k	972,162)					
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 institutions						321,932		284,591
thereof: eligible for refinancing at the Deutsche Bundesbank		€ k	283,049					
	(P. year	€ k	272,507)					
b) Bills of exchange						-		19,866
thereof:							321,932	**304,457**
eligible for refinancing at the Deutsche Bundesbank		€ k	-					
	(P. year	€ k	19,866)					
3. Loans and advances to banks				(5, 6, 20-24)				
a) Payable on demand						5,881,687		5,530,722
b) Other loans and advances						14,914,592		31,539,587
							20,796,279	**37,070,309**
4. Loans and advances to customers				(5, 6, 21-24)			110,819,631	119,019,510
thereof: secured by mortgages		€ k	12,549,855					
	(P. year	€ k	15,522,890)					
public-sector loans		€ k	11,848,420					
	(P. year	€ k	12,822,237)					
secured by ship mortgages			12,604,232					
	(P. year	€ k	18,049,556)					
5. Debentures and other fixed-interest securities				(8, 21-26,32)				
a) Money market instruments								
aa) from other issuers					97,913	97,913		232,647
thereof: eliglible as collateral at the Deutsche Bundesbank		€ k	-					
	(P. year	€ k	175,085)					
b) Bonds and debentures								
ba) from public-sector issuers					4,714,353			6,234,588
thereof: eligible as collateral at the Deutsche Bundesbank		€ k	3,972,564					
	(P. year	€ k	5,890,432)					
bb) from other issuers					26,250,791	30,965,144		26,151,439
thereof: eligible as collateral at the Deutsche Bundesbank		€ k	16,139,596					
	(P. year	€ k	15,728,204)					
c) Own debentures						14,415,894		12,729,396
Nominal value		€ k	14,468,020				45,478,951	**45,348,070**
	(P. year	€ k	12,724,051)					
To be carried forward							178,362,694	202,849,661

Balance sheet of HSH Nordbank AG as at 31 December 2009

Assets				(Note)	12/31/2009 € k	12/31/2008 € k
				Carried forward	178,362,694	202,849,661
6. Shares and other non-fixed-interest securities				(8, 23, 25, 26, 32)	730,492	1,058,674
7. Equity holdings in non-affiliated companies				(12, 25, 32, 56)	539,080	720,436
thereof: in banks		€ k	55,493			
	(P. year	€ k	68,150)			
8. Interests in affiliated companies				(11, 25, 32, 56)	1,825,251	2,005,860
thereof: in banks		€ k	659,581			
	(P. year	€ k	833,368)			
in financial service institutions		€ k	174			
	(P. year	€ k	180)			
9. Trust assets				(27)	366,720	363,878
thereof: trust loans		€ k	23,055			
	(P. year	€ k	30,084)			
10. Intangible fixed assets				(13, 32)	37,640	35,148
11. Tangible fixed assets				(14, 32)	87,555	97,109
12. Other assets				(28)	1,659,827	4,352,923
13. Prepaid expenses				(5, 16, 29)	330,873	342,314
14. Deferred taxes				(15)	1,030,589	649,609
				Total assets	184,970,721	212,475,612

Balance sheet of HSH Nordbank AG as at 31 December 2009

				12/31/2009	12/31/2008
Liabilities	**(Note)**	**€ k**	**€ k**	**€ k**	**€ k**
1. Liabilities to banks	(16, 33-36)				
a) Payable on demand			2,477,823		4,829,068
b) With agreed maturities or notice periods			44,149,061		65,786,192
				46,626,884	**70,615,260**
2. Liabilities to customers	(16, 34-36)				
a) Savings deposits					
aa) With agreed notice period of three month		79,481			87,827
ab) With agreed notice periods of more than three months		1,954			1,992
			81,435		89,819
b) Other liabilities					
ba) Payable on demand		9,917,236			8,993,278
bb) With agreed maturities or notice periods		45,539,319			48,503,717
			55,456,555		57,496,995
				55,537,990	**57,586.814**
3. Securitised liabilities	(16, 34-36, 60, 61)				
a) Debentures issued			63,443,409		62,619,388
b) Other securitised liabilities			522,582		4,100,467
thereof: money market instruments	€ k 182,630 (P. year € k 3,223,073)			**63,965,991**	**66,719,855**
4. Trust liabilities	(37)			**366,720**	**363,878**
thereof: Trust loans	€ k 23,055 (P. year € k 30,084)				
5. Other liabilities	(38)			**3,077,598**	**2,551,277**
6. Deferred income	(5, 16, 39)			**456,723**	**490,689**
7. Provisions	(17)				
a) Provisons for pensions and similar obligations			416.045		420,200
b) Tax provisions			51.168		47.423
c) other provisions	(40)		1.192.949		1,335,625
				1,660,162	**1,803,248**
8. Subordinated debt	(41)			**5,216,259**	**5,302,554**
9. Profit participation capital	(42)			**439,041**	**966,100**
thereof: maturing in less than two years	€ k 384,702 (P. year € k 827,100)				
10. Funds for general banking risks				**1,051,693**	**1,051,693**
To be carried forward				**178,399,061**	**207,451,368**

Balance sheet of HSH Nordbank AG as at 31 December 2009

Liabilities	(Note)	€ k	€ k	12/31/2009 € k	12/31/2008 € k
Carried forward				**178,399,061**	**207,451,368**
11. Equity capital	(43)				
a) Subscribed capital					
aa) Share capital		2,460,174			881,226
ab) Silent participations		2,410,699			3,046,929
			4,870,873		3,928,155
b) Capital reserves			1,509,175		88,123
c) Retained earnings					
Other retained earnings		1,007,966	1,007,966		1,007,966
d) Accumulated loss			(816,354)		-
				6,571,660	**5,024,244**
Total liabilites				**184,970,721**	**212,475,612**
1.Contingent liabilities	(52)				
a) Liabilities from guarantee and indemnity agreements				**9,208,687**	**12,162,662**
2. Other commitments	(52)				
a) Irrevocable loan commitments				**15,280,388**	**24,163,014**

Statement of income of HSH Nordbank AG for the period 1 January to 31 December 2009

	(Note)	€ k	€ k	2009 € k	2008 € k
1. Interest income from	(44)				
a) lending money market transactions		11,824,463			17,820,422
b) fixed-interest securities and book-entry securities		1,142,623			1,514,261
			12,967,086		19,334,683
2. Interest expenses			11,618,331		17,998,550
				1,348,755	1,336,133
3.Current income from	(44)				
a) shares and other non-fixed-interest securities			131,459		230,977
b) equity holdings in non-affiliated companies			21,730		27,410
c) equity holdings in affiliated companies			120,664		306,342
				273,853	564,729
4. Income from profit pooling, profit transfer and partial transfer agreements	(44)			813	10,579
5. Commission income	(44, 45)		292,395		426,021
6. Commission expenses	(45)		569,036		133,217
				(276,641)	292,804
7. Net expenses on financing transactions	(44)			54,768	252,059
8. Other operating income	(44, 46)			120,460	125,910
9. General administrative expenses					
a) Personnel expenses					
aa) Wages and salaries		296,768			299,890
ab) Compulsory social security contributions, expenses for retirement pensions and other employee benefits		79,938			80,502
			376,706		380,392
thereof: € k 41.230 (P. year € k 39.657)					
b) Other administrative expenses	(47)		400,969		420,717
				777,675	801,109
10. Depreciation, amortisation and impairments on intangible assets and tangible assets				18,152	22,908
11. Other operating expenses	(48)			45,296	109,533
12. Depreciation and impairments on loans (and advances) and certain securities and additions to provisions in the lending business				1,622,761	2,839,310
To be carried forward				(1,051,412)	(1,694,764)

Statement of income of HSH Nordbank AG for the period 1 January to 31 December 2009

				2009	2008
	(Note)	€ k	€ k	€ k	€ k
	Carried forward			**(1,051,412)**	**(1,694,764)**
13. Depreciation and impairments on equity holdings, in non-affiliated as well as affiliated companies and securities treated as fixed assets				**418,873**	**1,346,180**
14. Expenses from the transfer of losses				**147,776**	**138,160**
15. Profit on ordinary activities				**(1,618,061)**	**(3,179,104)**
16. Extraordinary income			49,088		-
17. Extraordinary expenses			169,861		164,036
18. Extraordinary result	(49)			(120,773)	(164,036)
19. Income tax expense			(363,586)		100,777
20. Other taxes not shown under item 11			207	**(363,379)**	426 **101,203**
21. Income from the transfer of losses	(50)			**559,101**	**351,323**
22. Annual net income/deficit				**(816,354)**	**(3,093,020)**
23. Withdrawals from the capital reserve				**-**	**3,034,539**
24. Withdrawals from retained earnings					
a) other retained earnings				**-**	**58,481**
25. Accumulated loss				**(816,354)**	**-**

Notes

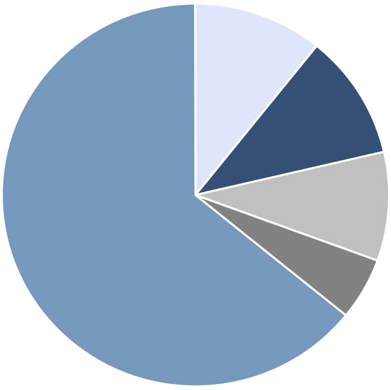
GENERAL INFORMATION AND NOTES

(1) HSH Nordbank AG and its shareholders

HSH Nordbank AG, with registered offices in Hamburg and Kiel, was established by the merger of Hamburgische Landesbank – Girozentrale, Hamburg, and Landesbank Schleswig-Holstein Girozentrale, Kiel, on 2 June 2003.

For accounting and tax purposes the merger took effect retroactively as of 1 January 2003.

The following overview shows the owners of HSH Nordbank AG with their respective direct and indirect holdings of the voting capital:



- Free and Hanseatic City of Hamburg 10.89%
- Federal State of Schleswig-Holstein 10.43%
- Nine Investorgroups adviced by J.C. Flowers & Co LLC 9.19%
- Savings Banks Association for Schleswig-Holstein 5.31%
- HSH Finanzfonds AöR 64.18%

(2) Capital measures

To ensure the survival and viability of HSH Nordbank AG, the shareholders implemented measures to increase equity capital in the second quarter of 2009 in line with resolutions passed in the regional parliaments of Hamburg and Schleswig-Holstein. These ensure that regulatory capital requirements are met and the contractual obligations to the Special Fund for Financial Market Stabilisation (SoFFin) relating to the Tier 1 capital ratio are satisfied. Specifically, this involves a capital increase and the provision of a guarantee facility by HSH Finanzfonds AöR, an institution under public law established for this express purpose by the shareholders, the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg. The institution’s guarantee is in turn covered by a matching guarantee from the public-sector shareholders.

Capital increase

At an Extraordinary General Meeting held on 20 May 2009 the Bank’s owners voted to increase its capital by EUR 3 billion. All the new shares were subscribed by HSH Finanzfonds AöR. Payment was made in full in June 2009.

The capital increase took effect upon entry in the commercial register on 25 June 2009.

Provision of a guarantee facility

In addition to the capital increase, on 2 June 2009 the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg granted HSH Nordbank AG a guarantee facility of EUR 10 billion via HSH Finanzfonds AöR in order to limit the effects of the financial market upheaval. The agreement on the provision of the guarantee facility is subject to approval by the European Commission in line with the law on state aid.

As of the start date, the guarantor thus indemnifies actual defaults on reference assets recognised in the Bank's consolidated financial statements as at 31 March 2009. Derivatives, debt instruments with embedded derivatives that have to be separated under IAS 39 and equity instruments are therefore not initially protected by the guarantee. If during the restructuring and winding down process measures consistent with the guarantee are implemented in respect of protected commitments, defaults under these financial instruments continue to be covered by the guarantee.

Mere fluctuations in market value and capital losses incurred on the disposal of performing assets are also not covered by the guarantee. The guarantee is denominated in Euro, and any exchange rate risk arising from the protection of portfolios in different currencies remains with HSH Nordbank AG.

The guarantor is liable for defaults that exceed the specific loan loss provisions recognised as at 31 March 2009 for the relevant individual commitments and a first loss piece of EUR 3.2 billion on the protected reference portfolio. Losses in excess of this amount are covered as a second loss piece up to a maximum of EUR 10 billion. HSH Nordbank AG and the guarantor can jointly agree to reduce the first loss piece of EUR 3.2 billion.

The default on an individual commitment is equal to the outstanding amount, at most the amount repayable as at 31 March 2009, plus all interest owed and any other ancillary payments. Losses may only be allocated under the guarantee once the guarantee case has been examined and approved by the guarantor.

The guarantee came into effect on 2 June 2009 and will expire when the document is returned to the guarantor after the last reference commitment in the hedged portfolio has been met irrevocably and in full or has resulted in a guarantee case for the full amount. HSH Nordbank AG may reduce the guarantee to EUR 4 billion between 1 January 2010 and the end of 2013 through partial cancellations of no more than EUR 3 billion per year. The guarantee may be cancelled in full from 2014 onwards. Once reduced, the maximum amount cannot be increased again.

The guarantee had no protective effect as at the reporting date, as the cumulative impairments due to changes in credit standing in the protected reference portfolio did not exceed the first loss piece to be borne by the Bank (cf. also note 19).

In exchange for the guarantee HSH Nordbank AG pays a contractually agreed premium of 4% p.a. on the guarantee volume outstanding at the time. The EU Commission is currently reviewing the appropriateness of the remuneration as part of the state aid proceedings. Expenditure on the guarantee premium is recognised under commission expense. The premium payments are recognised as an expense pro rata temporis.

(3) Deposit guarantee fund, guarantor's obligation (Gewährträgerhaftung) and maintenance obligation (Anstaltslast)

HSH Nordbank AG is a member of the Landesbanken/Girozentralen support fund, which falls under the support system of the German Savings Banks Organisation. Within this system, the regional savings bank guarantee fund, the Landesbanken/Girozentralen support fund and the support fund of the Landesbausparkassen (cf. also note 53) have a joint liability scheme. The support system ensures the ongoing liquidity and solvency of all affiliated institutions.

The transitional agreement reached in the Brussels Agreement of 17 July 2001 on the expiration of the maintenance obligation (Anstaltslast) and guarantor's obligation (Gewährträgerhaftung) mechanisms on 18 July 2005 also applies to HSH Nordbank AG pursuant to Section 2 of the State Treaty dated 4 February 2003 between the Free and Hanseatic City of Hamburg and the State of Schleswig-Holstein 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. The guarantee obligation likewise covers liabilities established after this date but before 18 July 2005 if they do not mature after 31 December 2015.

As previous co-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 HSH Nordbank AG by way of the merger, as is Westdeutsche Landesbank, Düsseldorf, for liabilities agreed upon before the expiry of the guarantee obligation.

(4) Accounting standards applied

We prepared the financial statements and management report of HSH Nordbank AG as of 31 December 2009 in accordance with the provisions of the German Commercial Code (HGB), the German Stock Corporation Act (AktG), the Ordinance Regarding Accounting for Banks and Financial Service Institutions (RechKredV) and the German Mortgage Bond Act (PfandBG). In addition, we complied with the pertinent statements of the Institute of Independent Auditors in Germany (IDW).

ACCOUNTING AND VALUATION PRINCIPLES

Accounting is based on the assumption that the Bank is a going concern. HSH Nordbank justifies this assumption primarily by the recapitalisation in the year under review by Hamburg and Schleswig-Holstein and a viable restructuring concept which will ensure the Bank's independent competitiveness. In evaluating the going concern status there are still material uncertainties in drawing up the consolidated financial statements with regard to the conclusion of the EU state aid proceedings. The continuing existence of HSH Nordbank AG depends on the European Commission approving the stabilisation measures implemented by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein on a permanent basis. It is further necessary for this approval to be subject only to conditions which,

- can be met within commercially viable corporate planning, and
- specifically, do not endanger the regulatory effectiveness of the regulatory capital relief under the stabilisation measures.

(5) Loans and advances

We state loans and advances to banks and loans and advances to customers (asset items 3 and 4) at their nominal value or cost of acquisition. Premiums or discounts are transferred to prepaid expenses or deferred income and written back over the term of the loan or the fixed-rate period, whichever is shorter. Pro rata interest is treated on an accrual basis and reported in the corresponding line item. We observe the strict lower-of-cost-or-market principle by rigorously applying our risk provisioning principles, which are described in the following section.

(6) Valuation allowances and allocations to loan-loss provisions (risk provisioning)

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 statement of financial position. Even if not specifically mentioned below, this is done for off-balance sheet transactions by creating provisions. In order to ensure that our risk provisioning covers all identifiable credit and country risks, these are determined in three steps.

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

2. In addition, we set up country-specific general loan-loss provisions for exposure relating to borrowers domiciled in countries rated as non-investment grade. The provision 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 specific risk provisions have already been created. Similarly, other risk-reducing factors (such as valuable collateral, for example) are taken into account.

3. Finally, we create general loan-loss provisions for the remaining exposure not accounted for in the first two steps but still involving latent risks, by applying a risk factor. The risk factor represents the ratio of actual loan defaults (depletion of individual valuation allowances plus direct write-offs less payments on loans written off) over the past five years to the current risk exposure. The calculation procedure is in accordance with the tax-approved procedure pursuant to the bulletin of 10 January 1994 issued by the German Federal Ministry of Finance.

All three types of risk provisioning are written back if the credit risk no longer applies or is reduced. We thereby comply with the obligation to write back impairments in accordance with tax law and with the provisions of the German Commercial Code.

Assessments as to the necessity of risk provisions are based in many cases on the restructuring reports of external restructuring experts. In addition legal uncertainties regarding borrowers are arising in light of the current state aid proceedings, whose outcome may have a significant impact on the amount of risk provisions. Furthermore the forecasts of external providers is taken as the basis for determining risk provisions in the ship financing business and are exhibiting greater volatility due to the current market environment. For the reasons listed, which are a result of this extraordinary crisis, there is more uncertainty when it comes to estimating the key parameters for risk provisions.

If the Bank determines that a partial claim or claim must be rated as unrecoverable, a resolution is drafted in a decision paper to derecognise it and the derecognition is initiated.

(7) Determining fair value

Fair value is defined as the price at which a financial instrument can be traded between two informed, willing and independent parties who are under no obligation to deal. 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).

Fair value can be determined by the mark-to-market method if a market price is available at which a transaction could be performed or has been performed. This is generally the case for securities and derivatives traded on exchanges.

The mark-to-matrix method is used to determine fair value where no market price is available under the mark-to-market method. Fair value is determined on the basis of prices applying at a point in time shortly before the measurement date. Alternatively, transaction prices may be used, i.e. prices from a recent, genuine transaction. If fair value cannot be determined from the market or transaction prices of the financial instrument, either it is derived from the prices of comparable financial instruments or a model valuation is conducted with parameters that are almost completely observable in the market. Alternatively, quality-assured market data from suitable price agencies or validated prices from market partners (arrangers) are used.

Fair value is determined by the mark-to-model 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.

Where valuation techniques and models are concerned, a distinction can be drawn between procedures based exclusively on observable market data or only to an insignificant extent on non-observable parameters (mark-to-matrix) and those based to a significant extent on non-observable parameters (mark-to-model). Observable market data are usually available for liquid securities and simple OTC derivatives traded on liquid markets, such as interest-rate swaps, forward foreign-exchange transactions and foreign-exchange options in certain currencies, and equity derivatives on certain listed equities or indices. Valuation techniques and models that are based on non-observable parameters, and which therefore require assumptions about 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 correlations, volatilities and prepayment rates.

Most securities in the trading portfolio are valued using quoted market prices. If no current price from a liquid market is available, interest-bearing securities are valued using the discounted cash flow method based on rating- and sector-dependent yield curves derived from fixed-income market data.

In a few cases no fair value can be determined for investment portfolio items in shares and other non-fixed-interest securities (asset item 6). These items are not negotiable holdings joint-stock companies, which means no direct market prices of observable market data for a valuation model are available. As with equity holdings in non-affiliated companies (asset item 7) these items are recognised at amortised cost and regularly tested for permanent impairments.

Exchange-traded derivatives are also valued using market prices. If no current price is available, valuation uses recognised valuation models (such as Black-Scholes for European options) that are based on non-observable parameters to an insignificant extent at most.

OTC derivatives are valued using valuation techniques and models. A distinction is drawn between simple derivatives traded in liquid markets, such as interest rate swaps, interest rate-currency swaps, forward foreign-exchange transactions, foreign-exchange options, single-name and index credit default swaps and complex derivatives where markets are illiquid. The former are valued using recognised techniques and models that are based on non-observable market parameters to an insignificant extent at most, while the latter require a significant body of estimates in relation to the selection of both the model and the parameters.

Simple interest rate and cross-currency interest rate swaps can be valued using recognised techniques and models that are based on non-observable market parameters to an insignificant extent at most.

If the valuation of a financial instrument is based partly on non-observable parameters, the resulting fair value – though the best estimated value in accordance with a discretionary decision by the Bank – remains subjective in that there may be alternative parameter selection possibilities that cannot be refuted by observable market data. To that extent, the determination of the fair value of various financial instruments constitutes a significant discretionary decision by the Bank.

(8) Securities

For measurement purposes, our securities portfolio (asset items 5 and 6) is divided up into the investment portfolio, the liquidity reserve and the trading portfolio in accordance with the intended use and pursuant to German Commercial Code provisions.

Given that securities held in the investment portfolio are intended for long-term investment, we value a large portion in accordance with the diluted lower-of-cost-or-market principle. When impairments are not expected to be permanent we recognise the corresponding securities at historical cost. The impairments are seen as temporary if they are not considered indications of future disruptions in the servicing of interest payments and capital repayments. This is the case, for example, with impairments caused by changes in the interest rate level. 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 impairment process we have defined comprehensive criteria (trigger events) for identifying possible permanent impairments. They are identified on a quarterly basis. All securities which have been triggered are subjected to an individual analysis and a two-stage assessment process along with any cover assets or underlyings. Depending on the security's asset class, this individual analysis includes additional indications (e.g. external ratings, calculation of over-collateralisation for mezzanine tranches, cash flow analyses). As long as an individual analysis does not confirm a trigger event in economic terms or no trigger event is identified, no permanent impairment is made. In the case of value reductions projected to be permanent – usually induced by changes in credit standing –, we write down the security to the lower of exchange price, market price or fair value.

We measure the securities held in the liquidity reserve in accordance with the strict lower-of-cost-or-market principle. We accordingly state the value of the securities at the lower of acquisition cost or exchange price, market price or fair value, irrespective of the duration of the reduction in value.

Securities in the trading portfolio are valued at the exchange or market price on the reporting date (fair value) less a risk discount. For balance-sheet treatment and the representation of hedges we refer to our remarks under note 11.

Interest resulting from the total securities portfolio is reported as interest income; pro rata interest is treated on an accrual basis. Valuation gains or losses and realised profits are allocated to financial investment result (item 13 in the income statement) for securities in the investment portfolio, to credit risk income/expense (item 12 in the income statement) for securities in the liquidity reserve, and to net income from trading activities (item 7 in the income statement) for securities in the trading portfolio.

Dividends and other payouts are reported under current income from equities and other non-fixed-income securities.

HSH Nordbank AG generated collateral eligible for refinancing at the ECB in the amount of EUR 866 million via the vehicle Northern Blue. For this purpose loans and advances to customers of EUR 1,176 million were transferred to the SPV via silent assignment. Refinancing of the EUR 1,176 million was provided 100% by HSH Nordbank AG through the purchase of SPV notes. As the risk was not transferred, the assigned loans and advances to customers will continue to appear on the statement of financial position of HSH Nordbank AG. The value of the SPV notes is determined by the value of the receivables assigned to the SPV. The SPV notes acquired from the SPV's refinancing are given no value to avoid duplicate recognition of the risk.

(9) Derivative financial instruments

Derivative financial instruments are recognised and measured in accordance with the accounting principles of commercial law. Internal transactions are required to comply with uniformly determined conditions. The terms must be in line with market conditions.

Like other assets and liabilities, options purchased or written are recognised in the amount of the premium paid or received. If necessary we conduct write-downs or create provisions to comply with the lower-of-cost-or-market principle and the recognition-of-loss principle.

To the extent that a margin system is used in the case of financial instruments, the margin payments are recognised as assets or liabilities. We comply with the recognition-of-loss principle by conducting write-downs or creating provisions in respect of any pending losses.

In the 2009 reporting year a provision for impending losses was created for the first time for derivatives whose counterparties exhibited increased credit risks. Net expense from financing transactions was charged EUR 52 million to create the provision for impending losses.

(10) Structured products

Structured products are carried in accordance with statement on accounting IDW RS HFA 22. Structured products that are valued in accordance with the strict lower-of-cost-or-market principle are not the subject of separate accounting. Structured assets that are valued in accordance with the diluted lower-of-cost-or-market principle are measured and shown in the statement of financial position on a standard basis if the derivative components are hedged by one or more opposite derivative instruments and can therefore be valued as offsetting transactions in accordance with Statement BFA 2/95 of the expert banking committee (BFA) of the German Institute of Public Auditors (IDW).

(11) Hedge accounting

We designate groups of securities, loans and derivatives as micro, macro and portfolio valuation units in terms of risk and reward, in accordance with generally accepted principles. If the strict requirements for this have been fulfilled, we value the corresponding hedged items and hedging items as offsetting transactions, taking into account the recognition-of-loss principle. If perfect hedging relationships exist with regard to the interest rate risk in the investment portfolio, we do not revalue the corresponding hedged items and hedging items to reflect changes in interest rates. The reporting of results from hedging operations follows the corresponding reporting of the hedged items.

We evaluate the effectiveness of hedges based on qualitative criteria (compatibility of the essential parameters of the underlying and hedging transactions such as interest rate, nominal volume, term for micro valuation units) and quantitative procedures (macro valuation units in the investment portfolio and portfolio valuation units).

For derivative financial instruments for which an effective hedging relationship was not identifiable we created provisions for contingent losses of EUR 110 million in the financial statements for 2009 (previous year: EUR 87 million).

For securities in the liquidity reserve that are hedged against interest rate risks individually or at portfolio level, we have created compensatory hedging arrangements at portfolio level. In the event of negative net value when underlying and hedging transactions are netted, provisions for impending losses are created in accordance with the recognition-of-loss principle.

Separate subportfolios are formed within the trading portfolio by currency and risk type. Where no market values are available for financial instruments, fair value is calculated on the basis of active market parameters using generally accepted valuation models. When risk-adjusted mark-to-market valuation is applied, we initially recognise all positive and negative results. In order to comply with the principle of caution under German commercial law, we then apply a discount to the positive results. This discount represents a potential loss (value-at-risk) determined by mathematical models and is based on all the positions in HSH Nordbank AG's trading book. The value-at-risk (VaR) is measured in such a way that there is a 99% probability that a potential loss on trading book positions will not be exceeded within a holding period of ten days. The value-at-risk discount is determined by adding together the value-at-risk figures for all trading units. The total of the positive valuation result less the VaR discount is recognised in the balance sheet under other assets. For negative unrealised effects on results from portfolio valuation and from individual valuations of trading book positions a provision for impending losses is created.

(12) Equity holdings in non-affiliated and affiliated companies

We carry equity holdings in non-affiliated and affiliated companies at the lower of cost of acquisition or fair value. For the disclosures pursuant to Section 285 No. 11 of the German Commercial Code we have compiled a separate listing, which is published in the electronic German Federal Gazette and can be inspected in the company register.

(13) Intangible fixed assets

Intangible assets are valued at cost of acquisition and amortised. For standard software we assume a useful life of five years. Where a fall in value occurs which is expected to be permanent, we conduct exceptional write-downs.

(14) Tangible fixed assets

Tangible fixed assets are valued at cost of acquisition or production. For depreciable assets we calculate straight-line depreciation, with the following periods of useful life taken as a basis:

Tangible 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.
IT equipment	4
Other operating equipment	3 to 13
Leasing assets	Customary useful life
Low-value items (EUR 150-1000)	5

In the case of tangible assets we conduct extraordinary write-downs where a permanent fall in value has occurred. Should the reasons for this no longer be applicable, write-ups up to a maximum amount of the (amortised) acquisition or production cost are conducted.

Any acquisition or production cost subsequently incurred is capitalised and depreciated on an adjusted basis. Expenditure on the maintenance of property, plant and equipment is recognised as expense in the appropriate accounting period.

Items of tangible assets with a purchase price up to EUR 150 are recognised as an expense in the year of acquisition in accordance with fiscal procedures.

(15) Deferred taxes

Deferred tax assets and liabilities arise from the different carrying amounts for assets and liabilities in the statements of financial position drawn up for commercial and tax purposes and are computed accordingly. We recognise deferred taxes on differences that will be offset in future years. Deferred tax assets are calculated on the basis of these timing differences, provided realisation is sufficiently probable. Deferred taxes are calculated using the tax rates and rules anticipated to be valid at the time when the deferred tax assets are to be realised. As prescribed, we do not discount. Deferred tax liabilities are netted against deferred tax assets.

(16) Liabilities

Liabilities are stated at the amount repayable. Premiums and discounts are shown as deferred income and prepaid expenses respectively, and are written back over the term. Pro rata interest is treated on an accrual basis and reported in the corresponding liabilities line item.

(17) Provisions

Provisions for pension obligations have been calculated on the basis of actuarial principles based on the 2005 G mortality tables of Professor Klaus Heubeck and are recognised at their values pursuant to commercial law. The discount rate of 6% p.a. prescribed by tax rules was applied.

Other provisions are stated in the amount of the expected call on the provisions according to reasonable commercial assessment, taking positive contributions – such as the anticipated realisation value of collateral – adequately into account.

(18) Currency translation

Currency translation is performed pursuant to Section 340h of the German Commercial Code as well as to statement BFA 3/95 of the expert banking committee (BFA) of the IDW. Asset and liability items and outstanding positions denominated in foreign currencies are always classified as “specially hedged” in each currency pursuant to Section 340h (2) sentence 2 of the German Commercial Code and measured accordingly. Expenses and income from the currency translation are accordingly reported in the income statement pursuant to Section 340h (2) sentences 1 and 2 of the German Commercial Code.

Assets and liabilities in foreign currency are translated at the rates in force on the reporting date. Outstanding spot transactions are translated at the spot rate on the reporting date, and outstanding forward transactions at the forward rate on the reporting date. Differences in assets and liabilities arising from the valuation of hedging transactions are netted out and reported under other assets and other liabilities.

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

(19) Accounting treatment of the guarantee facility

The guarantee facility granted by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg did not have any effect on the statement of financial position as of the reporting date as the cumulative impairments due to credit ratings of the protected reference portfolio did not meet the initial loss threshold to be borne by HSH Nordbank AG of EUR 3.2 billion (cf. note 2). As soon as the first-loss piece has been exceeded due to defaults, write-downs or newly created risk provisions, a compensation claim against HSH Finanzfonds AöR is to be recognised under loans and advances to customers (asset item 4) and taken to profit and loss. Income is to be reported under the item in which the expense from the reference asset is entered.

NOTES ON BALANCE SHEET ASSETS

(20) Receivables from associated savings banks

Loans and advances to banks include receivables from associated savings banks in the following amounts:

In € k	12/31/2009	12/31/2008
	1,181,186	2,185,717

(21) Affiliated companies

The following items include receivables from affiliated companies in the stated amounts:

In € k	12/31/2009	12/31/2008
Loans and advances to banks	2,290,295	9,250,301
Loans and advances to customers	2,419,093	2,780,506
Debentures and other fixed-interest securities		
Bonds and debentures	855,532	683,705

(22) Non-affiliated companies

Receivables from non-affiliated companies in which an equity interest is held are included in the following items:

In € k	12/31/2009	12/31/2008
Loans and advances to banks	266,915	786,962
Loans and advances to customers	1,559,159	1,024,294
Debentures and other fixed-interest securities		
Bonds and debentures	15,215	201,734

(23) 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 report subordinated assets under the following items:

In € k	12/31/2009	12/31/2008
Loans and advances to banks		
Other receivables	158,620	144,753
Loans and advances to customers	390,424	375,263
Debentures and other fixed-interest securities		
Bonds and debentures	348,021	1,076,307
Shares and other non-fixed-interest securities	1,121	7,350

(24) Residual maturities

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

In € k	12/31/2009	12/31/2008
Loans and advances to banks		
Other receivables		
Due within 3 months	8,322,539	16,118,303
Due between 3 months and 1 year	1,767,977	7,715,493
Due between 1 year and 5 years	2,926,116	5,217,270
Due in more than 5 years	1,897,960	2,488,521
Loans and advances to customers		
Due within 3 months	16,255,975	15,757,709
Due between 3 months and 1 year	14,729,701	11,276,250
Due between 1 year and 5 years	46,214,907	48,322,379
Due in more than 5 years	33,619,048	43,663,172
Due with undetermined maturity	-	-
Debentures and other fixed-interest securities		
Due in the following year	12,960,470	15,519,375

(25) Negotiable securities

	Listed		Unlisted		Total	
In € k	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Debentures and other fixed-income securities	32,803,527	38,562,686	12,675,424	6,785,384	45,478,951	45,348,070
Shares and other non-fixed-income securities	47,577	101,016	270,493	375,721	318,070	476,737
Equity holdings in non-affiliated companies	51,352	45,000	448,895	26,764	500,247	71,764
Interests in affiliated companies	-	-	1,255,072	261,848	1,255,072	261,848

(26) Negotiable securities not valued using the lower-of-cost-or-market principle

In € k	12/31/2009	12/31/2008
Debentures and other fixed-income securities		
Carrying amount of securities valued using the moderate lower of cost or market principle	14,752,847	8,153,316
Carrying amount of securities reported above their fair value	9,920,105	5,748,347
Market value of securities reported above their fair value	8,732,363	4,890,058
Shares and other non-fixed-income securities		
Carrying amount of securities valued using the moderate lower of cost or market principle	125,850	270,565
Carrying amount of securities reported above their fair value	99,277	101,550
Market value of securities reported above their fair value	96,144	94,438

For securities in macro valuation units the write-downs avoided are shown at their gross value, i.e. without taking hedging transactions into account.

The difference between the carrying amount of securities valued using the moderate lower of cost or market principle and the total amount of securities shown in the investment portfolio is mainly due to positions which have been permanently impaired and securities which must be separated.

The difference between the carrying amount of securities valued using the moderate lower of cost or market principle and the carrying amount of securities reported above their fair value is due to the carrying amount of securities positions in the investment portfolio which have unrealised gains.

(27) Trust assets

Trust assets concern the following items:

In € k	12/31/2009	12/31/2008
Loans and advances to banks	990	991
Loans and advances to customers	365,730	362,887
Total	**366,720**	**363,878**

(28) Other assets

The major components of other assets are:

In € k	12/31/2009	12/31/2008
Due from tax authorities	520,022	578,138
Due from profit and loss transfer agreements and dividends	419,029	477,768
Premiums paid from options trading and interest limitation agreements	364,431	622,272
Adjustment item outstanding trading book profits	201,919	679,712
Receivables from tax consolidation	49,765	49,765
Shares in closed-end real estate funds	21,023	29,965
Due from security deposits	2,161	15,917
Adjustment item for currency translation	1,290	1,667,693
Cheques, bonds due for payment, interest and dividend coupons, other papers for collection	-	3,547

(29) Prepaid expenses

The major items comprising prepaid expenses are:

In € k	12/31/2009	12/31/2008
Accruals from interest swaps, swaptions and options	158,644	156,938
Discount accruals from issuing business	88,972	99,859
Premium accruals from claims	38,404	34,823
Discount accruals from liabilities	18,493	19,687

(30) Genuine repurchase agreements

As a borrower in genuine repurchase agreements, we have sold assets in the following amounts (carrying amounts) and simultaneously contracted to repurchase the same assets at a later date. The assets continue to be carried in our balance sheet; the consideration received in return for the assets is reported under the corresponding liability item.

In € k	12/31/2009	12/31/2008
Carrying amount of repo asset items	4,543,842	3,556,542

(31) Assets transferred as collateral

In addition to the assets sold under repurchase agreements (cf. note 30) and the receivables serving as cover assets for bonds issued (cf. notes 60 and 61), we have transferred further assets as collateral. These are mainly securities lodged as collateral for participation in stock exchanges and clearing organisations, and with central banks and Eurex as collateral for refinancing.

In € k	12/31/2009	12/31/2008
Assets transferred as collateral, thereof for	34,392,274	42,900,718
Liabilities to banks	33,778,206	42,497,839
Liabilities to customers	614,068	402,879

In 2009 the method for calculating assets transferred as collateral was refined and the result was more detailed reporting in comparison to the 2008 financial statements. The figures for the previous year were adjusted accordingly.

HSH Nordbank AG securitised customer loans as part of structured transactions and generated senior notes eligible for refinancing at central banks which were delivered in the amount of EUR 866 million to the ECB trust deposit.

(32) Statement of changes in fixed assets

In € k	Historical cost of acquisition	Additions[1]/ write-ups	Disposals[1]	Trans-fers	Cumulative depreciations	Depcreciations	Carrying amount	Carrying amount
	01/01/2009	2009	2009	2009	12/31/2009	2009	12/31/2009	12/31/2008
Securities	10,702,674	10,302,275	2,893,463	-	743,899	290,149	17,367,587	9,632,553
Equity holdings in non-affiliated companies	882,474	169,174	293,792	-	218,776	56,739	539,080	720,436
Equity holdings in affiliated companies	2,462,762	74,971	63,681	-	648,801	191,896	1,825,251	2,005,860
Buildings and property	48,585	111	627	-	11,985	1,074	36,084	37,566
Plant and equipment	74,625	1,341	4,932	-	37,026	6,552	34,008	40,563
Leasing assets	22,760	-	616	-	4,681	901	17,463	18,980
Intangible fixed assets	170,434	16,321	5,684	-	143,431	9,625	37,640	35,148
Total	**14,364,314**	**10,564,193**	**3,262,795**	**-**	**1,808,599**	**556,936**	**19,857,113**	**12,491,106**

[1] Including exchange rate changes for assets denominated in foreign currencies.

The reported real estate includes land and buildings used for the Bank’s own business activity with the following carrying amounts:

In € k	12/31/2009	12/31/2008
Carrying amount of buildings and property used as business premises	22,009	23,663

The intangible fixed assets are made up of the following items:

In € k	12/31/2009	12/31/2008
Software	37,640	34,999
Goodwill	-	149
Total	**37,640**	**35,148**

NOTES ON BALANCE SHEET LIABILITIES

(33) Liabilities to associated savings banks

Liabilities to banks include liabilities to associated savings banks in the following amounts:

In € k	12/31/2009	12/31/2008
	1,713,402	2,027,459

(34) Affiliated companies

Liabilities to affiliated companies are included in the items below:

In € k	12/31/2009	12/31/2008
Due to banks	3,985,025	4,359,527
Due to customers	4,363,847	5,158,836
Securitised liabilities Debentures issued	-	-
Subordinated debt	-	-

(35) Non-affiliated companies

Liabilities to non-affiliated companies in which an equity interest is held are included in the following items:

In € k	12/31/2009	12/31/2008
Liabilities to banks	193,836	141,027
Liabilties to customers	84,049	98,132
Securitised liabilities Debentures issued	99,310	102,311
Subordinated debt	-	-

(36) Residual maturities

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

In € k	12/31/2009	12/31/2008
Liabilities to banks with an agreed maturity or notice period of		
up to 3 months	16,235,728	42,853,672
between 3 months and 1 year	13,495,604	6,323,348
between 1 year and 5 years	8,041,139	9,284,360
more than 5 years	6,376,590	7,324,812
Liabilities to customers		
Savings deposits with an agreed notice period of more than 3 months		
up to 3 months	257	-
between 3 months and 1 year	399	598
between 1 year and 5 years	1,298	1,394
more than 5 years	-	-
Other liabilities with an agreed notice period of		
up to 3 months	12,043,365	16,119,167
between 3 months and 1 year	6,631,554	4,405,888
between 1 year and 5 years	10,223,597	10,937,699
more than 5 years	16,640,803	17,040,963
Securitised liabilities		
debentures issued		
due in following year	22,039,931	21,761,598
other securitised liabilities		
up to 3 months	375,356	3,332,919
between 3 months and 1 year	147,226	659,766
between 1 year and 5 years	-	107,782
more than 5 years	-	-

(37) Trust liabilities

Trust liabilities are included in the following items:

In € k	12/31/2009	12/31/2008
Liabilities to banks	1,427	4,710
Liabilities to customers	365,293	359,168
Total	**366,720**	**363,878**

(38) Other liabilities

The major components of this item are as follows:

In € k	12/31/2009	12/31/2008
Security deposits for assumption of debt	1,186,240	1,285,300
Adjustment item for currency valuation	678,465	-
Premiums received from options trading and interest limitation agreements	420,390	577,328
Pro rata interest on subordinated liabilities, profit participation rights and silent participations	321,563	311,353
Liabilities from profit and loss transfer agreements and dividends	179,784	178,564

(39) Deferred income

Deferred income primarily includes:

In € k	12/31/2009	12/31/2008
Defferals from interest swaps, swapoptions and options	315,401	325,915
Discount deferrals from receivables	76,302	80,989
Premium deferrals from issuing business	11,166	13,443

(40) Other provisions

Other provisions primarily relate to the following items:

In € k	12/31/2009	12/31/2008
Provisions in credit business	537,008	422,003
Provisions for securities trading and financial derivatives	243,493	526,638
Provisions for restructuring measures	146,015	155,824
Provision for guarantees	60,000	-
Provisions for personnel expenses	52,829	46,420
Provisions for invoices outstanding	41,850	26,283
Provisions for litigations risks and costs	41,688	30,333
Provisions for deposit guarantee fund	10,000	22,500
Provisions for archiving costs	5,500	5,500

(41) Subordinated debt

Subordinated debts denominated in EUR, JPY and USD have been issued in the form of debentures and registered and bearer bonds. The original maturities range from five to 40 years. Interest rates range from 0.42% to 6.51% p.a.

Individual items exceeding 10% of total subordinated liabilities:

In € m	Currency	Interest rate	Maturity	Cancellation possibilities
750	**EUR**	**4.375%**[1]	**02/14/2017**	**Issuer cancellation right**[2]
1,000	**EUR**	**3M-Euribor + 0.3%**[3]	**02/14/2017**	**Issuer cancellation right**[2]

[1] 3-month Euribor + 0.84% from 02/14/2012 to 02/13/2017.

[2] Initially until the expiry of the third Target business day before 02/14/12, then quarterly on 05/14, 08/14, 11/14 and 02/14 with a notice period of 3 Target business days.

[3] 3-month Euribor + 0.80% from 02/14/2012 to 02/13/2017.

The terms and conditions for subordinated debts are such as to meet the requirements of Section 10 (5a) of the German Banking Act (KWG) on inclusion as liable capital. Subordinated debts in the amount of EUR 200 million (previous year: EUR 190 million) will mature within two years.

In the financial year 2009, interest expense from subordinated debts amounted to EUR 164 million (previous year: EUR 246 million).

(42) Profit participation capital

The claims of profit participation certificate holders to repayment of capital rank behind other claims. The other terms and conditions of profit participation capital are also such as to meet the requirements of Section 10 (5) of the German Banking Act (KWG) for recognition as liable capital. Profit participation capital in the amount of EUR 385 million (previous year: EUR 827 million) will mature within two years.

Registered profit participation certificates to a total nominal value of EUR 439 million have original maturities ranging between 8 and 12 years and bear interest of between 5.37% and 7.35% p.a. No current interest was payable for the 2009 financial year due to the accumulated loss.

The interest payable on profit participation capital is linked to the distributable profit of HSH Nordbank AG.

The profit participation rights bear a loss of EUR 86 million.

(43) Equity capital

Pursuant to Section 25 (1) of the Ordinance Regarding Accounting for Banks and Financial Service Institutions (RechKredV), subscribed capital consists of the share capital of HSH Nordbank AG and silent participations.

The share capital of HSH Nordbank AG amounts to EUR 2,460 million, divided into 246,017,368 registered shares with a notional par value of EUR 10.00 each. All the issued shares have been fully paid up. As of the balance sheet date there were no outstanding subscription rights to shares in HSH Nordbank AG.

In accordance with the package of measures to ensure the survival and viability of the HSH Nordbank AG and meet regulatory capital requirements, the shareholders conducted a capital increase in the second quarter of 2009 in line with resolutions passed in the regional parliaments of Hamburg and Schleswig-Holstein. The Extraordinary General Meeting held on 20 May 2009 approved a capital increase for cash of EUR 3 billion. 157,894,737 new shares were issued, each representing a notional par value of EUR 10.00 of share capital, at a price of EUR 19.00 per share. The agreed premium was allocated to the capital reserve in full. All the new shares were subscribed by HSH Finanzfonds AöR. The capital increase took effect upon entry in the commercial registers in Hamburg und Kiel on 25 June 2009.

As of the reporting date the largest shareholder was HSH Finanzfonds AöR, Hamburg, established in 2009, with 64.18% of the voting rights. The voting rights held by the Free and Hanseatic City of Hamburg including the indirect share held by HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH was 10.89% (previous year: 30.41%). The Federal State of Schleswig-Holstein holds 10.43% of the voting rights (previous year: 29.10%). The proportion of the voting rights held by the Schleswig-Holstein Savings Bank Association fell during the financial year from 14.82% to 5.31%. As at 31 December 2009 the nine groups of investors advised by J.C. Flowers & Co. LLC held 9.19% of the voting rights (previous year: 25.67%).

HSH Finanzfonds AöR, with its registered office in Hamburg, has notified us in accordance with section 20 (1) of the German Stock Corporation Act (AktG) that it directly owns more than one-quarter of the shares in HSH Nordbank AG, and at the same time in accordance with Section 20 (4) AktG it indirectly owns a majority holding. The shares in HSH Nordbank AG held by HSH Finanzfonds AöR are apportioned to the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein in accordance with Section 16 (4) AktG. Furthermore the shares in HSH Nordbank AG held by HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH, a subsidiary of the Free and Hanseatic City of Hamburg, are also apportioned to the Free and Hanseatic City of Hamburg in accordance with Section 16 (4) AktG.

The Management Board is authorised, with the consent of the Supervisory Board, to increase the Bank's share capital before 30 June 2011 by EUR 174,909,090 against contributions in kind by means of a one-time issue of 17,490,909 new registered no-par-value shares ranking for dividends from 1 January of the year in which the implementation of the capital increase is entered in the Commercial Register (Authorised Capital 2008/1). Neither HSH Nordbank AG nor any affiliated or majority-owned companies hold treasury stock. There is no cross-shareholding as defined by Section 19 AktG.

The terms and conditions of the silent participations have been arranged so as to fulfil the requirements of Section 10 (4) of the German Banking Act (KWG) for recognition as Tier 1 capital. Among other things, the conditions provide for the repayment of the silent participations as subordinate to other liabilities.

If a net loss is incurred for the current financial year, no distributions to profit participation capital or silent participations can be made. Furthermore these equity instruments must participate in the loss. In the 2009 financial year silent participations in the amount of EUR 473 million (previous year: EUR 351 million) participated in the Bank’s loss.

The silent participations have been placed with the Bank’s stockholders (EUR 611 million), on the international capital markets (EUR 1,555 million) and with institutional investors in Germany (EUR 718 million). After loss participation the total silent participations as of 31 December 2009 were EUR 2,411 million.

NOTES ON THE INCOME STATEMENT

(44) Breakdown of income items by geographical market

In € k	2009				2008			
	Germany	Rest of Europe	Asia	America	Germany	Rest of Europe	Asia	America
Interest income	10,757,975	1,533,182	165,588	490,341	15,773,133	2,508,022	363,741	689,787
Regular income from shares and other non-fixed-interest securities, equity holdings in non-affiliated and affiliated companies	260,320	12,952	-	671	536,642	26,126	-	1,961
Income form profit pooling, profit transfer or partial profit transfer agreements	813	-	-	-	10,579	-	-	-
Commission income	216,602	59,428	4,132	12,233	289,563	100,574	21,024	14,860
Net income from financing transactions	59,679	-122,079	378	7,254	-231,719	10,596	42	-30,978
Other operating income	102,040	11,392	544	6,484	107,891	10,377	1,534	6,108

(45) Net commission income

Net commission income is composed as follows:

In € k	2009	2008
Lending business	119,558	266,996
Foreign business	10,123	15,098
Payment and account transactions	5,270	4,016
Securities business	-1,705	2,563
Guarantee business	-433,546	1,283
Other business	23,659	2,848
Total	**-276,641**	**292,804**

Net commission income as of 31 December 2009 includes expenses for the guarantee of HSH Finanzfonds AöR in the amount of EUR 364 million and for the guarantee facility of the Special Fund for Financial Market Stabilisation (SoFFin) in the amount of EUR 118 million under guarantee business.

(46) Other operating income

Other operating income mainly comprised the following items in the past financial year:

In € k	2009	2008
Proceeds from releases of provisions	61,987	58,434
Reimbursement of expenses	8,371	9,514
Rental income	3,629	3,888
Proceeds from disposal of collateral	1,817	-
Leasing income	1,329	2,032
Income from interest on receivables from the tax office	346	28,967

(47) Fees for work by the statutory auditors

As parent company, HSH Nordbank AG is included in the consolidated financial statements of HSH Nordbank AG.

In accordance with Section 285 (17) of the German Commercial Code (HGB), the total fee paid to the statutory auditors is therefore not shown.

(48) Other operating expenses

Other operating expenses include the following major items:

In € k	2009	2008
Interest expenses pursuant to section 233 AO	14,193	-
Write-downs on shares of a close-end real estate fund	4,500	4,253
Losses from fixed asset disposals	4,296	357
Expenses arising from creation of provisions	4,112	94,059
Expenses for temporarily acquired assets	3,546	1,099
Canteen expenses	2,588	2,930

(49) Extraordinary result

Restructuring costs amounted to EUR 170 million (previous year: EUR 164 million) while income of EUR 49 million resulted from the release of restructuring provisions. The extraordinary loss was connected to the Bank's reorientation.

Taxes on income affects the extraordinary loss by EUR 0 million (previous year: EUR 31 million).

(50) Income from the transfer of losses

The income from the assumption of losses resulted from income from loss participation by profit participation capital (EUR 86 million) and silent participations (EUR 473 million).

OTHER NOTES

(51) Leasing business

Assets related to the leasing business include EUR 252 million shown under loans and advances from customers and EUR 17 million shown under tangible fixed assets. Liabilities from the leasing business are reported as EUR 97 million under liabilities to banks and EUR 43 million under liabilities to customers.

(52) Contingent liabilities and other commitments

Reported contingent liabilities relate mainly to financial guarantees provided in the course of our lending business. The other commitments are irrevocable loan commitments. As in the previous year, there were no placement or underwriting obligations as of 31 December 2009.

(53) Letters of comfort

Except in the case of political risk, HSH Nordbank AG assumes unlimited responsibility for ensuring that its affiliated companies HSH Nordbank Private Banking S.A., Luxembourg, and HSH Nordbank Securities S.A., Luxembourg, are able to meet their obligations.

In addition, HSH Nordbank 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 HSH Nordbank AG held an equity interest in HSH N Residual Value Ltd.

(54) Other financial obligations

The transactions listed below include payment obligations that do not qualify for recognition resulting from pending contracts or ongoing debts, as well as other financial obligations that could have a material effect on the future financial position of HSH Nordbank AG.

There are shareholder liabilities of EUR 335 million for outstanding payments on subscribed nominal capital that have not yet been called (previous year: EUR 507 million).

In respect of the equity interest in Liquiditäts-Konsortialbank GmbH, Frankfurt am Main, there is an additional maximum funding obligation of € 17 million.

The maximum funding obligation that would result from membership of the joint liability scheme of the Sparkassen-Finanzgruppe, if a case occurs where support is needed, is EUR 422 million (previous year: EUR 384 million). If the resources of the savings bank guarantee fund are insufficient for the financial rescue, the additional funding can be claimed immediately.

Further obligations totalling EUR 11 million result from long-term leases for land and buildings that are used for commercial purposes with three companies in which the Bank holds an equity interest. These obligations will mature in 2012.

Long-term rental agreements for office space are responsible for obligations of around EUR 6 million each year.

As part of its guarantor function the Bank also has a liability towards Deka Bank Deutsche Girozentrale together with the other shareholders.

There are no material other financial obligations apart from those listed above.

(55) Other transactions necessary for an assessment of the Bank's financial situation

In order to ensure adequate liquidity, HSH Nordbank AG has obtained a guarantee facility from the Special Fund for Financial Market Stabilisation (SoFFin) for the issue of debt instruments up to a total of EUR 30 billion. The Bank is utilising EUR 17 billion of this as of 31 December 2009.

The guarantee facility expired at the end of 2009 in agreement with SoFFin.
Independently of this, the SoFFin guarantee for the issues to the value of EUR 17 billion still applies. SoFFin has made an offer to the Bank to extend bonds maturing in 2010, if necessary.

Through HSH Finanzfonds AöR, the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein have given HSH Nordbank AG a guarantee of EUR 10 billion to cover risks. The guarantee takes effect as soon as risks in defined portfolios exceed the Bank's agreed first-loss piece of EUR 3.2 billion (cf. also note 2).

(56) Notes on shareholdings

The complete list of shareholders pursuant to Section 285 No. 11 HGB has been compiled in a separate listing, which is published in the electronic German Federal Gazette and can be inspected in the register of companies.

HSH Nordbank AG is a partner with unlimited liability in Fernkälte Geschäftsstadt Nord, Hamburg, GbR Realrace 2005, Hamburg, GbR Tocotax, Hamburg, GLB GmbH & Co. OHG, Frankfurt am Main, and GbR Altgesellschafter der Deutschen Leasing AG, Bad Homburg v.d.H.

Furthermore the Bank owns equity holdings exceeding five per cent of the voting rights in the following major corporations:

Name and registered office
Bürgschaftsbank Schleswig-Holstein GmbH, Kiel
Bürgschaftsgemeinschaft Hamburg GmbH, Hamburg

(57) Transactions with related parties

In exchange for the guarantee of HSH Finanzfonds AöR, HSH Nordbank AG pays a contractually agreed premium of 4% p.a. which has been assessed as being fair market value by external third parties. The EU Commission is currently reviewing the appropriateness of the remuneration as part of the state aid proceedings.

(58) Notes on foreign currencies

The amounts of assets and liabilities denominated in foreign currency as of the reporting date are as follows:

In € k	12/31/2009	12/31/2008
Assets	67,555,259	71,927,815
Liabilities	23,279,326	34,222,964

(59) Derivatives business

The following section presents the business of HSH Nordbank AG in the area of derivative financial instruments (forward transactions within the meaning of Section 36 of the Ordinance Regarding Accounting for Banks and Financial Service Institutions (RechKredV)) at the reporting date.

In financial year 2009 the system for calculating data for the report on the derivatives business was changed. This system was used for the first time for the figures shown for 31 December 2009. The figures for the previous year were adjusted accordingly.

In addition to the nominal amounts of contracts divided up into interest rate risk, interest rate and exchange rate risk, exchange rate risk and other price risk, the following tables also show the term structure, counterparty classification and details of trading book transactions in derivative financial instruments.

Furthermore a breakdown of premiums paid or received under options or interest cap agreements accounted under other assets and other liabilities on the balance sheet is reported.

Disclosures on volumes

In € m	Nominal values		Positive market values		Negative market values	
	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Interest rate swaps	517,046	549,546	12,969	14,699	12,038	13,098
FRA	6,944	20,393	1	44	5	46
Interest rate options	-	-	-	-	-	-
Swaptions						
Bought	2,297	3,777	166	260	-	-
Sold	3,713	7,822	-	-	281	543
Caps, floors	24,447	34,768	259	381	191	318
Exchange-traded contracts	6,290	20,293	1	-	-	-
Other forward interest rate transactions	13,268	14,382	194	149	206	170
Interest rate risks	574,005	650,981	13,590	15,533	12,721	14,175
Interest rate/currency swaps	41,861	37,616	781	2,493	1,280	766
Interest rate and currency rinsks	41,861	37,616	781	2,493	1,280	766
Forward exchange transactions	33,171	87,522	491	3,852	616	3,465
Currency options						
Bought	2,108	6,666	201	419	-	-
Sold	2,010	6,429	-	-	198	396
Currency risks	37,289	100,617	692	4,271	814	3,861
Stock options						
Bought	641	735	59	82	-	-
Sold	174	287	-	-	45	81
Stock futures trading	-	265	-	-	-	-
Exchange-traded contracts	72	6	6	7	17	24
Stock/index-based swaps	362	382	3	4	64	102
Other equity derivatives	-	-	-	-	-	-
Commodity contracts	376	90	136	256	116	185
Shares and other price risks	1,625	1,765	204	349	242	392
Protection sold	2,467	3,043	32	225	23	175
Protection bought	3,164	3,827	331	282	30	219
Credit derivatives	5,631	6,870	363	507	53	394
Total	660,411	797,849	15,630	23,153	15,110	19,588

Breakdown by maturity

In € m	Interest rate risks		Credit risks		Currency risks		Share and other price risks	
	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Residual maturity								
Up to 3 months	110,355	110,453	96	1,009	29,593	65,988	348	408
Up to 1 year	66,237	131,060	120	2,100	3,132	28,643	299	428
Up to 5 years	243,384	228,565	4,742	3,386	3,909	5,144	598	745
Over 5 years	195,890	218,519	673	375	655	842	380	184
Total	615,866	688,597	5,631	6,870	37,289	100,617	1,625	1,765

Breakdown by counterparty

In € m	Nominal values		Positive market values		Negative market values	
	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
OECD banks	554,773	666,751	11,427	18,259	13,716	17,958
Non-OECD banks	160	1,713	9	66	1	15
Non-banks (including stock exchanges)	100,915	123,980	4,015	4,684	1,215	1,520
Public authorities	4,563	5,405	179	144	178	95
Total	**660,411**	**797,849**	**15,630**	**23,153**	**15,110**	**19,588**

Trading book transactions

In € m	Nominal values		Positive market values		Negative market values	
	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Interest rate contracts	502,852	536,932	11,563	12,283	10,651	11,744
Interest rate and currency contracts	34,195	28,723	176	1,747	815	226
Currency contracts	15,062	35,534	309	1,128	350	887
Share and other contracs	677	617	153	259	120	251
Credit derivatives	3,986	6,185	58	454	43	377
Total	**556,772**	**607,991**	**12,259**	**15,871**	**11,979**	**13,485**

Credit derivatives

In € m	Nominal values		Positive market values		Negative market values	
	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Protection sold	2,467	3,043	32	225	23	175
thereof trading book transactions	1,964	2,740	28	215	17	172
Protection bought	3,164	3,827	331	282	30	219
thereof trading book transactions	2,022	3,445	30	239	26	205

Carrying amounts of options and interest cap agreements

In € m	Option premiums paid		Option premiums received	
	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Interest rate contracts	130	121	137	127
Currency contracts	46	131	97	157
Share and other contracs	113	161	71	101
Credit derivatives	75	209	115	192
Total	**364**	**622**	**420**	**577**

(60) Statement of coverage for real estate credit institutions and public-sector credit institutions

Pfandbriefe and municipal bonds issued in accordance with the ÖPG[7] by the Bank's predecessor institutions are covered as follows:

[7] Act on Pfandbriefe and Related Bonds of Public Sector Credit Institutions of 8 May 1963.

(a) Coverage of Pfandbriefe

In € k	12/31/2009	12/31/2008
Bearer Pfandbriefe	117,196	258,727
Registered Pfandbriefe	1,712,966	2,204,828
Registered Pfandbriefe deposits as security	6,000	34,500
Pfandbriefe to be covered	**1,896,162**	**2,498,055**
Due to banks	-	-
Due to customers	2,728,557	4,808,220
Total coverage	**2,728,557**	**4,808,220**
Surplus coverage	**832,395**	**2,310,165**

b) Coverage of municipal bonds

In € k	12/31/2009	12/31/2008
Bearer municipal bonds	628,184	989,926
Registered municipal bonds	3,285,849	4,460,993
Registererd municipal bonds deposited as security	5,000	5,000
Bonds to be covered	**3,919,033**	**5,455,919**
Loans and advances to banks	1,351,848	2,558,917
Loans and advances to customers	2,824,039	3,431,523
Securities issued by public-sector borrowers	93,000	43,000
Total coverage	**4,268,887**	**6,033,440**
Surplus coverage	**349,854**	**577,521**

(61) Information in accordance with Section 28 of the Mortgage Bond Act

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 net present value in accordance with PfandBarwertV[8] are as follows:

[8] 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 of 14 July 2005.

	Nominal value		Net present value		Risk-adjusted net present value	
In € m	12/31/2009	12/31/2008	12/31/2009	12/31/2008	12/31/2009	12/31/2008
Mortgage bonds	4,235	2,447	4,360	2,509	4,486	2,488
Cover funds	4,746	2,798	5,020	2,961	5,070	2,891
thereof derivatives	-	-	-	-	-	-
Surplus coverage	**511**	**351**	**660**	**452**	**584**	**403**

In € m	Nominal value 12/31/2009	Nominal value 12/31/2008	Net present value 12/31/2009	Net present value 12/31/2008	Risk-adjusted net present value 12/31/2009	Risk-adjusted net present value 12/31/2008
Public-sector mortgage bonds	8,779	9,200	9,292	9,869	8,620	9,103
Cover funds	10,505	10,037	10,878	10,525	9,949	9,512
thereof derivatives	-	-	-	-	-	-
Surplus coverage	**1,726**	**837**	**1,586**	**656**	**1,329**	**409**

In € m	Nominal value 12/31/2009	Nominal value 12/31/2008	Net present value 12/31/2009	Net present value 12/31/2008	Risk-adjusted net present value 12/31/2009	Risk-adjusted net present value 12/31/2008
Ship mortgage bonds	2,580	3,031	2,651	3,140	2,617	3,074
Cover funds	4,398	3,929	4,391	4,231	3,700	3,317
thereof derivatives	-	-	-	-	-	-
Surplus coverage	**1,818**	**898**	**1,740**	**1,091**	**1,083**	**243**

The mortgage bonds, public-sector bonds and ship mortgage bonds in circulation and the corresponding cover assets have the following maturity structure:

Nominal value in € m	Mortgage bonds 12/31/2009	Mortgage bonds 12/31/2008	Cover funds 12/31/2009	Cover funds 12/31/2008
Up to 1 year	705	910	432	136
Between 1 year and 5 years	2,695	1,506	2,461	1,182
Between 1 year and 2 years	705		340	
Between 2 years and 3 years	920		953	
Between 3 years and 4 years	572	[1]	630	[1]
Between 4 years and 5 years	498		538	
Between 5 years and 10 years	572	31	1,521	1,210
Over 10 years	263	-	332	270
Total	**4,235**	**2,447**	**4,746**	**2,798**

[1] No further breakdown of maturity structure is provided for 2008.

Nominal value in € m	Public-sector mortgage bonds 12/31/2009	Public-sector mortgage bonds 12/31/2008	Cover funds 12/31/2009	Cover funds 12/31/2008
Up to 1 year	1,832	1,628	803	758
Between 1 year and 5 years	2,220	2,746	2,389	1,698
Between 1 year and 2 years	520		573	
Between 2 years and 3 years	429		492	
Between 3 years and 4 years	632	[1]	650	[1]
Between 4 years and 5 years	639		674	
Between 5 years and 10 years	1,990	1,894	3,755	3,610
Over 10 years	2,737	2,932	3,558	3,971
Total	**8,779**	**9,200**	**10,505**	**10,037**

[1] No further breakdown of maturity structure is provided for 2008.

Nominal value in € m	Ship mortgage bonds 12/31/2009	Ship mortgage bonds 12/31/2008	Cover funds 12/31/2009	Cover funds 12/31/2008
Up to 1 year	1,290	556	1,355	858
Between 1 year and 5 years	1,260	2,475	1,760	1,943
Between 1 year and 2 years	950		533	
Between 2 years and 3 years	300		569	
Between 3 years and 4 years	10	[1]	321	[1]
Between 4 years and 5 years	-		337	
Between 5 years and 10 years	30	-	1,180	960
Over 10 years	-	-	103	168
Total	**2,580**	**3,031**	**4,398**	**3,929**

[1] No further breakdown of maturity structure is provided for 2008.

The loans and advances used to cover mortgage bonds and ship mortgage bonds can be broken down by size category as follows:

(a) Mortgage-bond register

Nominal value in € m	Covering mortgages 12/31/2009	Covering mortgages 12/31/2008
Up to € 300,000	43	21
Between € 300,000 and € 5 million	1,092	660
Over € 5 million	3,436	2,047
Total	**4,571**	**2,728**

(b) Ship register

Nominal value in € m	Covering mortgages 12/31/2009	Covering mortgages 12/31/2008
Up to € 500,000	2	1
Between € 500,000 and € 5 million	522	460
Over € 5 million	3,874	3,468
Total	**4,398**	**3,929**

The breakdown of the loans and advances used to provide ordinary cover mortgage bonds by the country in which the property collateral is situated and the use to which properties are put is are as follows:

In € m	Residential			Commercial						12/31/2009
	Apart-ments	Single dwel-lings	Multiple dwel-lings	Office buil-dings	Retail properties	Industrial premises	Other com-mercial proper-ties	Unfin-ished new-buildings and building plots	thereof building plots	Total
Germany	1	9	1,047	647	567	11	579	-	-	2,861
Finland	-	-	-	63	-	-	10	-	-	73
France	-	-	-	649	5	-	-	-	-	654
Netherlands	-	-	49	562	59	-	83	-	-	753
Sweden	-	-	161	7	4	-	-	-	-	172
USA	-	-	-	46	-	-	-	-	-	46
Austria	-	-	-	12	-	-	-	-	-	12
Total	**1**	**9**	**1,257**	**1,986**	**635**	**11**	**672**	**-**	**-**	**4,571**

In € m	Residential			Commercial						12/31/2008
	Apart-ments	Single dwel-lings	Multiple dwel-lings	Office buil-dings	Retail properties	Industrial premises	Other com-mercial proper-ties	Unfin-ished new-buildings and building plots	thereof building plots	Total
Germany	-	1	670	396	383	8	313	-	-	1,771
Finland	-	-	-	-	-	-	-	-	-	-
France	-	-	-	315	-	-	-	-	-	315
Netherlands	-	-	48	470	95	-	17	-	-	630
Sweden	-	-	-	-	-	-	-	-	-	-
USA	-	-	-	-	-	-	-	-	-	-
Austria	-	-	-	12	-	-	-	-	-	12
Total	**-**	**1**	**718**	**1,193**	**478**	**8**	**330**	**-**	**-**	**2,728**

In € m	12/31/2009	12/31/2008
Germany	1	-
Netherlands	-	-
Total of payments at least 90 days in arrears	**1**	**-**

The following table shows the breakdown of the total amount of loans and advances used to cover public-sector bonds by borrowers and their countries of domicile. Arrears state total payments in arrears at least 90 days:

In € m		Country	Regional public authority	Local public authority	Others	12/31/2009 Total
Germany	Nominal value	19	4,468	286	3,377	8,150
	Arrears	-	-	-	1	1
Belgium	Nominal value	250	21	-	-	271
	Arrears	-	-	-	-	-
France incl. Monaco	Nominal value	-	-	-	-	-
	Arrears	-	-	-	-	-
Greece	Nominal value	50	-	100	-	150
	Arrears	-	-	-	-	-
United Kingdom / Northern Ireland / Brit. Channel Islands	Nominal value	-	-	-	10	10
	Arrears	-	-	-	-	-
Ireland	Nominal value	-	-	-	-	-
	Arrears	-	-	-	-	-
Italy	Nominal value	-	76	9	-	85
	Arrears	-	-	-	-	-
Japan	Nominal value	-	-	50	-	50
	Arrears	-	-	-	-	-
Canada	Nominal value	-	26	-	-	26
	Arrears	-	-	-	-	-
Lithuania	Nominal value	25	-	-	-	25
	Arrears	-	-	-	-	-
Luxembourg	Nominal value	-	-	-	13	13
	Arrears	-	-	-	-	-
Netherlands	Nominal value	-	-	-	-	-
	Arrears	-	-	-	-	-
Poland	Nominal value	23	-	-	-	23
	Arrears	-	-	-	-	-
Portugal incl. Azoren and Madeira	Nominal value	200	-	65	-	265
	Arrears	-	-	-	-	-
Switzerland	Nominal value	-	171	-	100	271
	Arrears	-	-	-	-	-
Slovakia	Nominal value	20	-	-	-	20
	Arrears	-	-	-	-	-
Slowenia	Nominal value	90	-	-	-	90
	Arrears	-	-	-	-	-
Spain	Nominal value	-	161	-	25	186
	Arrears	-	-	-	-	-
Czech Republic	Nominal value	12	-	-	-	12
	Arrears	-	-	-	-	-
Hungary	Nominal value	57	-	20	-	77
	Arrears	-	-	-	-	-
Austria	Nominal value	469	56	53	202	780
	Arrears	-	-	-	-	-
Total	Nominal value	**1,215**	**4,979**	**583**	**3,727**	**10,504**
	Arrears	**-**	**-**	**-**	**1**	**1**

In € m		Country	Regional public authority	Local public authority	Others	12/31/2008 Total
Germany	Nominal value	295	3,771	258	3,527	7,851
	Arrears	-	-	-	-	-
Belgium	Nominal value	250	23	-	-	273
	Arrears	-	-	-	-	-
France incl. Monaco	Nominal value	-	-	-	-	-
	Arrears	-	-	-	-	-
Greece	Nominal value	55	100	-	-	155
	Arrears	-	-	-	-	-
United Kingdom / Northern Ireland / Brit. Channel Islands	Nominal value	-	-	-	10	10
	Arrears	-	-	-	-	-
Ireland	Nominal value	-	-	-	-	-
	Arrears	-	-	-	-	-
Italy	Nominal value	-	52	9	-	61
	Arrears	-	-	-	-	-
Japan	Nominal value	-	-	50	-	50
	Arrears	-	-	-	-	-
Canada	Nominal value	-	26	-	-	26
	Arrears	-	-	-	-	-
Lithuania	Nominal value	25	-	-	-	25
	Arrears	-	-	-	-	-
Luxembourg	Nominal value	-	-	-	13	13
	Arrears	-	-	-	-	-
Netherlands	Nominal value	-	-	-	-	-
	Arrears	-	-	-	-	-
Poland	Nominal value	24	-	-	-	24
	Arrears	-	-	-	-	-
Portugal incl. Azoren and Madeira	Nominal value	-	105	50	15	170
	Arrears	-	-	-	-	-
Switzerland	Nominal value	-	172	-	100	272
	Arrears	-	-	-	-	-
Slovakia	Nominal value	20	-	-	-	20
	Arrears	-	-	-	-	-
Slowenia	Nominal value	90	-	-	-	90
	Arrears	-	-	-	-	-
Spain	Nominal value	-	121	-	25	146
	Arrears	-	-	-	-	-
Czech Republic	Nominal value	12	-	-	-	12
	Arrears	-	-	-	-	-
Hungary	Nominal value	57	20	-	-	77
	Arrears	-	-	-	-	-
Austria	Nominal value	405	278	-	79	762
	Arrears	-	-	-	-	-
Total	Nominal value	**1,233**	**4,668**	**367**	**3,769**	**10,037**
	Arrears	**-**	**-**	**-**	**-**	**-**

The following table shows the breakdown of the loans and advances used to cover ship mortgage bonds by the country in which the ships pledged are registered:

In € m	Ocean-going vessels	Inland water vessels	12/31/2009 Further cover	Ocean-going vessels	Inland water vessels	12/31/2008 Further cover
Germany	2,524	-	1,013	2,880	-	63
Greece	5	-	-	6	-	-
Panama	175	-	-	214	-	-
Netherlands	30	-	-	38	-	-
Malta	34	-	-	10	-	-
Italy	7	-	-	9	-	-
Hongkong	34	-	-	17	-	-
Marshall-Islands	124	-	-	126	-	-
Cyprus	136	-	-	149	-	-
Liberia	154	-	-	180	-	-
United Kingdom	4	-	-	5	-	-
Norway	40	-	-	61	-	-
Singapore	-	-	-	25	-	-
Austria	-	-	118	-	-	94
Ireland	-	-	-	-	-	52
Total	**3,267**	**-**	**1,131**	**3,720**	**-**	**209**

In € m	12/31/2009	12/31/2008
Germany	7	-
Marshall-Islands	-	-
Netherlands	-	-
Total of payments at least 90 days in arrears	**7**	**-**

The following table shows the number of foreclosures, judicially-enforced receiverships and sites and ships acquired to avoid losses in relation to the loans and advances used for coverage:

Number	Commercial	Residential	Ships	2009 Total
Foreclosures pending	-	-	-	-
Judicially enforced receiverships thereof included in foreclosures pending	-	-	-	-
Foreclosures completed	-	-	-	-
Proprties acquired to prevent losses	-	-	-	-

Number	Commercial	Residential	Ships	2008 Total
Foreclosures pending	-	-	-	-
Judicially enforced receiverships thereof included in foreclosures pending	-	-	-	-
Foreclosures completed	-	-	-	-
Proprties acquired to prevent losses	-	-	-	-

The following table shows total arrears on the interest due from mortgagors and repayments made during the financial year:

In € m	Commercial	Residential	Ships	2009 Total
Total arrears of interest	-	-	-	-

In € m	Commercial	Residential	Ships	2008 Total
Total arrears of interest	-	-	-	-

(62) Average number of employees

We have calculated the average number of employees based on the quarterly levels on a per capita basis.

	Male	Female	2009 Total	Male	Female	2008 Total
Full-time employees	1,987	1,076	3,063	2,128	1,185	3,313
Part-time employees	73	497	570	61	468	529
	2,060	1,573	3,633	2,189	1,653	3,842
Apprentices/trainees	48	34	82	55	44	99
Total	**2,108**	**1,607**	**3,715**	**2,244**	**1,697**	**3,941**

(63) Corporate governance

HSH Nordbank AG supports the aims of the German Corporate Governance Code and has recognised the Code's rules on a voluntary basis as an unlisted company. The Management Board and Supervisory Board of HSH Nordbank AG have issued a declaration of conformity pursuant to Section 161 of the German Stock Corporation Act (AktG) and made it accessible for shareholders. The declaration is published on the Bank's website and in the annual report for 2009.

(64) Remuneration paid to the members of the Management and Supervisory Boards

The remuneration system for the Management Board up to and including 2009 is made up of a fixed salary and a variable bonus based on the Bank's business performance, particularly the achievement of certain budget figures. There are also appropriate payments in kind. Remuneration for seats on external supervisory bodies is offset against the variable bonus above a certain limit. The Bank does not offer long-term incentives such as share option schemes. In accordance with the recommendations of the German Corporate Governance Code, the total remuneration of the members of the Management Board therefore includes fixed and variable components. The agreements on remuneration are the responsibility of the Executive Committee.

In 2009 HSH Nordbank AG approved a new remuneration system for members of the Management Board which is to be applied from 2010 onwards. The basis for new contracts concluded at the end of 2009 and for all future contracts will be a long-term calculation period, no legal entitlement to variable remuneration until after the Bank is in a position to pay dividends, payouts to be staggered over several years, provision to claw back payments not yet made and limits on payments on departure. Further information is available in the management report (Business Overview: New Remuneration System).

The remuneration of the Management Board in 2009 totalled EUR 3.949 million (previous year: EUR 3.577 million). In 2009 no variable remuneration was paid to members of the Management Board, nor were they entitled to it. The increase in Management Board compensation from the previous year was mainly a result of a special payment in the period under review, partly outweighed by a decrease in current remuneration deriving from a temporary reduction in the number of

Management Board members.

In the financial year under review, EUR 437,000 (previous years: EUR 850,000) was transferred to pension obligetions to active members of the Management Board and members who resigned during the year. As of 31 December 2009 these totalled EUR 2.521 million (previous year: EUR 4.207 million).

Total remuneration paid to former members of the Management Board and their surviving dependents amounted to EUR 3.246 million (previous year: EUR 3.717 million), which as last year included no variable elements. No provision was made for current remuneration (previous year: EUR 1.450 million). In the financial year under review, EUR 2.225 million (previous year: EUR 2.264 million) was allocated to pension obligations to former members of the Management Board. As of 31 December 2009 EUR 29.490 million (previous year: EUR 27.788) was set aside for pension obligations. This total amount includes a reclassification in the amount of EUR 2.123 million (previous year: EUR 3.902 million) from the provisions for active members of the Management Board.

The Annual General Meeting decides on the amount of remuneration to be received by the members of the Supervisory Board. The expected total of EUR 570,000 for 2009 has been recognised in provisions. This provision is offset by a reversal of EUR 105,000 in the provision from the previous year, as EUR 490,000 from the amount set aside in financial year 2008 (EUR 595,000) was paid out to members of the Supervisory Board. This includes VAT of EUR 66,000.

Advances, loans and other liabilities as at 31 December 31 2009 amounted to EUR 187,000 (previous year: EUR 3.042 million) for members of the Management Board and EUR 1.343 million (previous year: EUR 1.532 million) for members of the Supervisory Board.

(65) Seats on supervisory bodies

On the reporting date the following seats were held on supervisory bodies of major corporations or financial institutions (Section 340a (4) No. 1 HGB in conjunction with Section 267 (3) HGB and Section 340a (1) HGB):

(a) Members of the Management Board

Prof. Dr. Dirk Jens Nonnenmacher	DekaBank Deutsche Girozentrale, Frankfurt am Main	Member of the Advisory Board (from 11 February 2009)
Dr. Martin van Gemmeren	HSH Nordbank Securities S.A., Luxemburg	Chairman of the Advisory Board (from 19 December 2009, previously member)
Bernhard Visker	HSH Nordbank Private Banking S.A., Luxemburg	Chairman of the Advisory Board
	HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH, Hamburg	Member ot the Supervisory Board
	LB Immo Invest GmbH, Hamburg	Chairman of the Supervisory Board (from 06 May 2009, previously member)

(b) Employees

Peter Axmann	Sprinkenhof AG, Hamburg	Supervisory Board Member
Carsten Bäcker	HSH Nordbank Securities S.A., Luxemburg	Advisory Board Member
Dirk Gärtner	Closed Holding AG, Hamburg	Supervisory Board Member
Torsten Heick	HSH Nordbank Private Banking S.A., Luxemburg	Advisory Board Deputy Chairman
	Nobis Asset Management S.A., Luxemburg	Advisory Board Deputy Chairman
Reinhard Mix	Bürgschaftsbank Schleswig-Holstein, Kiel	Supervisory Board Deputy Chairman
Matthias Müller	HSH Nordbank Private Banking S.A., Luxemburg	Supervisory Board Member
Christian Nieswandt	Aegean Baltic Bank S.A., Kifissia	Non-executive Member of the Management Board

(66) The Supervisory Board of HSH Nordbank AG

Hilmar Kopper, Rothenbach (from 1 July 2009) Chairman (from 3 July 2009)	Former Spokesperson of the Management Board, Deutsche Bank AG
Dr. Wolfgang Peiner, Hamburg Chairman (until 1 July 2009)	Auditor
Olaf Behm, Tangstedt Deputy chairman	Employee of HSH Nordbank AG
Sabine-Almut Auerbach, Lübeck	District secretary, ver.di Southern Holstein district
Astrid Balduin, Kiel	Employee of HSH Nordbank AG
Hans-Werner Blöcker, Helmstorf (from 1 July 2009)	Managing Director, Vereinigte Asphalt-Mischwerke GmbH & Co. KG
Berthold Bose, Hamburg	Regional financial services representative, ver.di- Hamburg district
Detlev Bremkamp, München (from 1 July 2009)	Former member of the Management Board, Allianz AG Holding
Prof. Dr. Hans-Heinrich Driftmann, Elmshorn (until 1 July 2009)	Managing Partner, Peter Kölln KGaA
Ronald Fitzau, Seevetal (until 1 July 2009)	Employee of HSH Facility Management Holding AG
J. Christopher Flowers, New York (until 1 July 2009)	Chairman of the Management Board, J.C. Flowers & Co. LLC
Dr. Michael Freytag, Hamburg (until 1 July 2009)	Senator and President of the Ministry of Finance of the Free and Hanseatic City of Hamburg
Jürgen Friedland, Kiel (from 1 July 2009)	Employee of HSH Nordbank AG
Jens-Peter Gotthardt, Moorrege	Employee of HSH Nordbank AG
Lothar Hay, Flensburg (until 1 July 2009)	Minister of the Inerior of the State of Schleswig-Holstein
Torsten Heick, Rellingen	Employee of HSH Nordbank AG
Reinhard Henseler, Schobüll (until 1 July 2009)	Chairman of the Management Board, Nord-Ostsee Sparkasse
Oke Heuer, Kiel (from 1 July 2009)	Deputy Head of Internal Audit, Savings Banks Association for Schleswig-Holstein
Jörg-Dietrich Kamischke, Selk (until 1 July 2009)	President of the Savings Banks Association for Schleswig-Holstein
Dr. Rainer Klemmt-Nissen, Hamburg (from 1 July 2009)	Managing Director, HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement GmbH
Lutz Koopmann, Altenholz (from 1 July 2009)	Chairman of the Management Board, Investitionsbank Schleswig-Holstein
Dr. Joachim Lemppenau, Korschenbroich (from 1 July 2009)	Former Chairman of the Management Board, Volksfürsorge Versicherung
Manfred Lener, Kiel (from 1 July 2009)	Employee of HSH Nordbank AG
Rieka Meetz-Schawaller, Kiel	Employee of HSH Nordbank AG
Dr. David Morgan, London (from 18 December 2009)	Managing Director, J.C. Flowers & Co. UK Ltd.
Alexander Otto, Hamburg (until 1 July 2009)	Managing Director, ECE Projektmanagement G.m.b.H. & Co. KG
Knut Pauker, Schnenefeld (until 1 July 2009)	Employee of Spielbank SH GmbH & Co. Casino Stadtzentrum Schenefeld KG
Dr. Hans Reckers, Bad Homburg (from 1 November 2009)	Former member of the Executive Board, Deutsche Bundesbank
Edda Redeker, Kiel	ver.di, Northern district
Ravi S. Sinha, London (until 1 December 2009)	Managing Director, J.C. Flowers & Co. UK Ltd.
Rainer Wiegard, Bargteheide (until 1 July 2009)	Minister of Finance of the State of Schleswig-Holstein
Bernd Wrede, Hamburg (from 1 July 2009)	Former Chairman of the Management Board, Hapag-Lloyd AG

(a) Members of the Risk Committee

Dr. Hans Reckers	Chairman (from 1 November 2009)
Dr. David Morgan	Deputy Chairman (from 19 January 2010) (from 19 January 2010)
Ravi S. Sinha	Chairman (until 3 July 2009), Deputy Chairman (from 3 July 2009 to 1 December 2009)
Astrid Balduin	
Olaf Behm	
Jürgen Friedland	(from 20 October 2009)
Jens-Peter Gotthardt	(until 3 July 2009)
Torsten Heick	
Jörg-Dietrich Kamischke	(until 1 July 2009)
Dr. Rainer Klemmt-Nissen	(from 3 July 2009)
Hilmar Kopper	(from 3 July 2009)
Manfred Lener	(from 3 July 2009)
Dr. Wolfgang Peiner	(until 1 July 2009)
Rainer Wiegard	(until 1 July 2009)
Bernd Wrede	(from 20 October 2009)

b) Members of the Audit Committee

Dr. Joachim Lemppenau	Chairman (from 3 July 2009)
Jörg-Dietrich Kamischke	Chairman (until 1 July 2009)
Lutz Koopmann	Deputy Chairman (from 3 July 2009)
Ravi S. Sinha	Deputy Chairman (until 3 July 2009)
Astrid Balduin	(until 3 July 2009)
Olaf Behm	
Jürgen Friedland	(from 3 July 2009)
Jens-Peter Gotthardt	
Oke Heuer	(from 3 July 2009)
Hilmar Kopper	(from 3 July 2009)
Rieka Meetz-Schawaller	
Dr. Wolfgang Peiner	(until 1 July 2009)
Rainer Wiegard	(until 1 July 2009)

(c) Members of the Executive Committee

Hilmar Kopper	Chairman (from 3 July 2009)
Dr. Wolfgang Peiner	Chairman (until 1 July 2009)
Rainer Wiegard	Deputy Chairman (until 1 July 2009)
Astrid Balduin	(until 1 July 2009)
Olaf Behm	
J. Christopher Flowers	(until 1 July 2009)
Dr. Michael Freytag	(until 1 July 2009)
Oke Heuer	(from 3 July 2009)
Jörg-Dietrich Kamischke	(until 1 July 2009)
Dr. Rainer Klemmt-Nissen	(from 3 July 2009)
Lutz Koopmann	(from 3 July 2009)
Rieka Meetz-Schawaller	(from 3 July 2009)
Dr. David Morgan	(from 19 January 2010)
Ravi S. Sinha	(from 3 July to 1 December 2009)

d) Members of the Mediation Committee

Hilmar Kopper	Chairman (from 3 July 2009)
Rainer Wiegard	Chairman (until 1 July 2009)
Dr. Wolfgang Peiner	(until 1 July 2009)
Olaf Behm	
Torsten Heick	(until 1 July 2009)
Dr. Rainer Klemmt-Nissen	(from 3 July 2009)
Manfred Lener	(from 3 July 2009)

(67) The Management Board of HSH Nordbank AG

Prof. Dr. Dirk Jens Nonnenmacher Chairman Born in 1963	Responsible for the following divisions: Corporate Communications Corporate Development/Management Corporate Office and Marketing Legal and Group Compliance Also responsible from 28 April 2009 for: Internal Audit Human Resources, IT/Organisation*), Transaction Services*) Also responsible on a temporary basis for: Taxes, Finance *) since 1 December only organisational and disciplinary allocation
Dr. Martin van Gemmeren (since 1 November 2009) Born in 1970	Responsible for: Restructuring Unit with the corporate divisions Wind-down Loans Special Loans Divestments
Bernhard Visker Born in 1966	Responsible for the following divisions: Corporate Clients Private Banking Savings Banks Real Estate Clients Also responsible on a temporary basis from 11 November 2009 for: Energy, Shipping, Transport, Group Treasury*), Asset and Investment Management*), Capital Markets Clients*), Capital Markets Structuring & Trading*), Capital Markets Credit*) *) organisational/disciplinary assignment responsibility is shared by the full Management Board
Constantin von Oesterreich (since 1 November 2009) Born in 1953	Responsible for: Credit Risk Management Group Risk Management
Peter Rieck (until 10 November 2009) Deputy chairman Born in 1952	Responsible for the following divisions: Energy Shipping Transportation
Joachim Friedrich (until 10 November 2009) Born in 1964	Responsible for the following divisions: Group Treasury Asset and Investment Management Capital Markets Clients Capital Markets Credit Capital Markets Structuring & Trading
Frank Roth (until 27 April 2009) Born in 1959	Responsible for the following divisions: IT/Organisation Human Resources Internal Audit Transaction Services

With effect from 1 December 2009 Mr Ulrich Voss was appointed Chief Operating Officer of the Bank. In this capacity he is responsible as a General Agent (Generalbevollmächtigter) for the Transaction Services and IT/Organisation divisions.

Hamburg/Kiel, 12 March 2010

Nonnenmacher

van Gemmeren

von Oesterreich

Visker

AUDITOR'S REPORT

We have audited the annual financial statements, comprising the balance sheet, the income statement and the notes to the financial statements, together with the bookkeeping system, and the management report of the HSH Nordbank AG for the business year from 1 January to 31 December 2009. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law (and supplementary provisions of the shareholder agreement/articles of incorporation) are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

We conducted our audit of the annual financial statements in accordance with § 317 HGB [„Handelsgesetzbuch“: „German Commercial Code“] and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the annual financial statements in accordance with [German] principles of proper accounting and in the management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the books and records, the annual financial statements and the management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the annual financial statements and management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the annual financial statements comply with the legal requirements (and supplementary provisions of the shareholder agreement/ articles of incorporation) and give a true and fair view of the net assets, financial position and results of operations of the Company in accordance with [German] principles of proper accounting. The management report is consistent with the annual financial statements and as a whole provides a suitable view of the Company's position and suitably presents the opportunities and risks of future development.

Without qualifying this opinion, we refer to the discussion in the management report in the paragraph „EU Beihilfeverfahren“ (EU subsidy proceedings) as well as to Note 1 to the consolidated financial statements. Therein it is disclosed that the continued existence of HSH Nordbank AG as a going concern depends on whether the European Commission approves the stabilization measures implemented by the Free and Hanseatic Ctiy of Hamburg and the Federal State of Schleswig-Holstein on a permanent basis. It is also necessary that the approval should only be tied to requirements

- which can be implemented within the framework of reasonable business plan, and,
- in particular, which will not conflict the effect of the stabilization measures that relieve the regulatory capital.

The Auditor's Report was issued in German language and refers to the consolidated financial statements that were issued in German language. Only the German version of the Auditor's Report is legally binding.

Hamburg, 12 March 2010

KPMG AG
Wirtschaftsprüfungsgesellschaft

Krall
Wirtschaftsprüfer

Madsen
Wirtschaftsprüfer

Responsibility statement by the Management Board

We hereby affirm that to the best of our knowledge the financial statements have been prepared in accordance with the applicable accounting principles and give a true and fair view of the assets, liabilities, financial position and results of operations of HSH Nordbank AG and that the management report presents the course of business, including the results of the business and HSH Nordbank AG's situation, in such a manner that it gives a true and fair view and describes the main opportunities and risks for HSH Nordbank Group AG's likely performance.

Hamburg/Kiel, 12 March 2010

Nonnenmacher van Gemmeren

von Oesterreich Visker