Disclosure Report as at 31 December 2010

according to Section 26a of the
Geman Banking Act (KWG)

HSH NORDBANK

CONTENT

LIST OF TABLES

Due to rounding effects, slight differences may be present in the total figures shown in the tables.

LIST OF ABBREVIATIONS

ABCP	Asset-backed Commercial Paper
ABS	Asset-backed Securities
AktG	Aktiengesetz (German Stock Corporation Act)
ALCO	Asset Liability Committee
AöR	Anstalt öffentlichen Rechts (institution incorporated under public law)
ABSE	Ancillary banking services enterprises (Section 1(3c) German Banking Act)
Avg.	Average
BaFin	Bundesanstalt für Finanzdienstleistungsaufsicht (Federal Financial Supervisory Authority)
Basel II	Basel Framework Agreement
BU	Business Unit
CCF	Credit conversion factor
CDS	Credit default swaps
CEBS	Committee of European Banking Supervisors (since January 2011 EBA)
CI	Credit institution (Section 1 (1) German Banking Act)
CLD	Credit Loss Database
CLLP	Country-specific loan loss provisions
CRD	The Capital Requirements Directive
CRO	Chief Risk Officer
CRM	Credit Risk Management
CRSA	Credit Risk Standardised Approach
DakOR	Datenkonsortium operationelle Risiken (Operational risk data consortium)
DQM	Data quality management
DSGV	Deutscher Sparkassen- und Giroverband (German Association of Savings Banks and Giro Banks)
EaD	Exposure at default (gross loan volume at the date of default)
EBA	European Banking Authority (since January 2011, before CEBS)
ECB	European Central Bank
EL	Expected loss
FCR	Foreign currency rating
FE	Financial enterprise (Section 1(3) German Banking Act)
Fitch	Fitch Ratings
FSI	Financial services institution (Section 1(1a) German Banking Act)
GAS	German Accounting Standard
GLLP	General loan loss provisions
FVA	Fair value adjustments
GmbHG	GmbH-Gesetz (German Limited Liability Companies Act)
HGB	Handelsgesetzbuch (German Commercial Code)
IAA	Internal Assessment Approach
IAS	International Accounting Standards
ICAAP	Internal Capital Adequacy Assessment Process
IFRS	International Financial Reporting Standard
IMKS	Integrated market strategy and credit risk strategy
IRB	Internal Rating Based
IRBA	Internal Rating Based Approach
ISDA	International Swaps and Derivatives Association
KWG	Gesetz über das Kreditwesen/Kreditwesengesetz (German Banking Act)
LBO	Leveraged buyout
LCR	Local currency rating
LeDIS	Legal Database Information System

LGD	Loss given default
LLC	Limited liability company
LP	Limited partnership
Ltd	Limited
LVaR	Liquidity Value at Risk
M	Maturity
MaRisk	Mindestanforderungen an das Risikomanagement (Minimum Requirements for Risk Management)
Moody's	Moody's Investors Service
MaComp	Minimum Requirements for the Compliance Function
NPNM	New products – new markets
OECD	Organisation of Economic Cooperation and Development
OpRisk	Operational risk
OTC	Over the Counter
Oth	Other
PD	Probability of Default
P&L	Profit & Loss
PQC	Process quality controlling
RechKredV	Kreditinstituts-Rechnungslegungsverordnung (Ordinance on the Accounting System for Banks)
RSU	RSU Rating Service Unit GmbH & Co. KG
RW	Risk weight
RWA	Risk-weighted assets
SLLP	Specific loan loss provisions
SolvV	Solvabilitätsverordnung (German Solvency Regulation)
S & P	Standard & Poor's
SPC	Special purpose company
SPV	Special purpose vehicle
S Rating	S Rating Sparkassen Rating und Risikosysteme GmbH
TWR	Träger wirtschaftlichen Risikos (bearer of economic risk)
VaR	Value-at-Risk
VÖB	Bundesverband öffentlicher Banken Deutschlands (German Association of Public Sector Banks)

1 INTRODUCTION

The disclosure requirements[1] under the German Solvency Regulation (Solvabilitätsverordnung - SolvV)[2] and the third pillar of the Basel Framework Agreement supplement the minimum regulatory capital requirements (Pillar 1) and the regulatory monitoring process (Pillar 2). The objective is to strengthen the market discipline of credit institutions. This is to be achieved through a series of disclosure requirements which enable market participants to assess core information on the scope of application of the SolvV, equity, risk exposure, risk management procedures and, based on this information, the capital adequacy of the institution. In general, disclosures are on a Group level. Under Section 321 (1) SolvV, annual disclosures are required.

Changes to the German Banking Act (KWG) and the SolvV entered into effect on 31 December 2010 as part of the implementation of the amended Banking and Capital Adequacy Guidelines. Amongst other things, the new requirements relate to the recognition of hybrid equity components, expanded disclosure requirements and the treatment of life insurance as collateral. These changes have been appropriately taken into account in the preparation of this Disclosure Report. The issues, the majority of which are required to be implemented by 31 December 2011 as a result of CRD III, relate primarily to the capital adequacy requirements for the trading book and for re-securitisations. Additional regulatory changes resulting from Basel III are to be applied starting in 2013.

During the second quarter of 2009, HSH Nordbank implemented a capital increase funded by its shareholders, the German Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg. As a result of the capital increase, HSH Nordbank's capital base was strengthened by € 3 billion. In addition, the guarantee facility reduces risk-weighted assets, in that the Bank is protected from secondary losses in the guaranteed portfolios up to € 10 billion (the “risk shield”) as soon as the risks in the collateralised portfolios exceed the agreed first loss piece held by the Bank, which amounts to € 3.2 billion. A comprehensive presentation of the capital measures was part of the Disclosure Report as at 31 December 2009.

For reporting dates prior to 30 June 2010 HSH Nordbank backed the first loss piece as a risk-weighted position with equity. The first loss piece is deducted from equity starting with the 30 June 2010 reporting date. This means that the total amount of the first loss piece is taken into account in determining the modified available equity capital under Section 266 (1) SolvV and, therefore, no longer represents required regulatory capital. HSH Nordbank’s risk-weighted assets declined significantly during the 2010 financial year as a result of this change in accounting for the first loss piece, the portfolio wind-down and an improvement in portfolio quality which occurred in part during the second half of 2010.

The changes between 31 December 2009 and the reporting date in the values and capital requirements shown in the report are due essentially to the effects described above. Details of this are provided in the Consolidated Management Report in the 2010 HSH Nordbank Annual Report, in the Chapter “Underlying conditions and business overview”.

The capital ratios of HSH Nordbank have increased significantly during the reporting year. The Tier 1 capital ratio increased to 15.4% (31 December 2009: 9.5%) while the regulatory capital ratio rose to 22.4% (31 December 2009: 14.5%).

All representations in this report take the effects of the guarantee facility into account. To the extent it is useful with respect to individual representations or tables, an alternative calculation, which does not take the guarantee facility into account, is presented in the Notes for informational purposes.

The Disclosure Report will be published in accordance with Section 320 (1) SolvV on HSH Nordbank’s website under Investor Relations. The date and communication medium of publication will be communicated to the supervisory authorities and announced electronically in the Federal Gazette.

[1] Section 26a of the German Banking Act (KWG), in conjunction with Part 5 of SolvV, constitutes the national statutory basis of disclosure in Germany.

[2] Regulations governing the capital adequacy of institutions, groups of institutions and financial holding groups (Solvency Regulation - SolvV) as at 31 December 2010, Sections 319 to 337.

2 SCOPE OF APPLICATION

Consolidation

HSH Nordbank AG is the parent company of the HSH Nordbank group (hereafter HSH Nordbank) as defined in Section 1 (7a) KWG. The disclosures reflect those entities belonging to the Group which form part of the regulatory consolidation group pursuant to Section 10a (1) and (2) KWG. The consolidation group recognised for financial accounting/reporting purposes under International Financial Reporting Standards (IFRS) as described in the Annual Report of the HSH Nordbank Group for the financial year ending 31 December 2010 differs from the regulatory consolidation group.

In Table 45 (see Notes, Chapter 10) the consolidation principle pursuant to Section 323 (1) No. 2 SolvV as well as the difference between the regulatory and IFRS consolidations are described. All entities to be consolidated and their allocation to the regulatory and/or financial accounting consolidation group are listed. The entities are allocated to entity types for the purposes of the regulatory consolidation on the basis of the definitions set out in Section 1 KWG. Of the companies listed in Table 45 included in the consolidation group recognised for financial accounting purposes, 49 are fully consolidated and 2 are consolidated at-equity.

Those subsidiaries deducted from the equity capital of the HSH Nordbank Group are also shown in the table. The Bürgschaftsbank Schleswig-Holstein GmbH is the only subsidiary defined as a financial institution in accordance with Section 1 (1) KWG. With reference to Section 26a (2) KWG the Bürgschaftsbank is classified as immaterial.

Apart from the parent institution HSH Nordbank AG, the regulatory consolidation group includes 150 entities. The financial accounting consolidation group comprises 51 entities. 9 entities and/or portfolios are included in the financial accounting consolidation report but not in the regulatory consolidation group due to their business activities. These are taken into account as risk-weighted positions for regulatory purposes.

HSH Nordbank applies Section 31 (3) KWG to the entities listed below and does not include these in the consolidation under the exemption pursuant to Section 10a (6) to (12), Section 12a (1) Sentence 1 and Section 13b (3) and (4) KWG:

- HSH Immobilien Management GmbH, Kiel
- HSH N Real I GmbH, Kiel
- Verwaltungs- und Treuhandgesellschaft von 1963 mbH, Kiel

The concept underlying all qualitative and quantitative information to be disclosed is the regulatory group of institutions per Section 10a KWG. Exceptions to this are indicated at the relevant points in this report. The German Commercial Code ("Handelsgesetzbuch" or "HGB") is applied to determine the regulatory capital adequacy of HSH Nordbank and consequently is also applied to the disclosures.

With regard to the regulatory capital adequacy of subsidiaries in which there are other shareholders in addition to the HSH Nordbank Group, a change in capital and/or own funds requires the approval of the co-shareholders and their respective bodies.

In the case of subsidiaries which are also credit institutions, changes in capital must be approved where necessary by the appropriate banking supervisory authorities. This applies, for example, to subsidiaries in the USA in which the HSH Nordbank Group has an equity holding of more than 5% and which are subject to the regulations of the US banking supervisory authorities. Statutory restrictions such as, for example, the capital maintenance regulations as defined in the Limited Liability Companies Act (GmbHG) and the German Stock Corporation Act (AktG), under which it is difficult to transfer funds from a free capital reserve in the course of the fiscal year, must be adhered to by domestic subsidiaries.

With the exception of the above-mentioned restrictions as well as the statutory and regulatory requirements there are no other restrictions based on contractual agreements within the HSH Nordbank Group that have to be taken into account.

Principle of materiality

In accordance with Section 26a (2) KWG all information disclosed within this report is subject to the principle of materiality. Information which is legally protected and/or confidential and whose disclosure could harm HSH Nordbank's competitive position is not part of the Disclosure Report.

To the extent data from the accounting systems is presented in the Disclosure Report, this relates in particular to the risk provisions (Section 327 SolvV), HSH Nordbank has decided – with regard to the internal bank definition of group entities to be consolidated – to disclose material subsidiaries in addition to HSH Nordbank AG as the top-tier financial institution for the purposes of presentation in the Disclosure Report. These are HSH Nordbank Securities S.A., HSH Nordbank Private Banking S.A. and HSH Real Estate AG.

Waiver rule

Pursuant to Section 2a KWG the waiver rule is not currently being exercised. As at the reporting date there are no other domestic institutions within the regulatory consolidation group of the HSH Nordbank Group, apart from HSH Nordbank AG, that meet the conditions pursuant to Section 2a KWG.

3 REGULATORY CAPITAL AND REGULATORY CAPITAL REQUIREMENTS

3.1 GUARANTEE FACILITY

3.1.1 Provision of a guarantee facility

On 2 June 2009 the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg granted HSH Nordbank AG a guarantee facility in the amount of € 10 billion via the HSH Finanzfonds AöR in order to secure the future of the Bank. The agreement regarding the provision of the guarantee facility is subject to approval by the European Commission in line with the law regarding state aid.

The guarantor guarantees actual rating-related defaults on debt instruments selected based on certain defined criteria that form part of the assets of HSH Nordbank AG and certain subsidiaries. A first loss piece in the amount of € 3.2 billion remains with the Bank as the guarantee holder. HSH Nordbank AG and the guarantor can jointly agree to reduce the Bank's first loss piece.

Default on a specific commitment is determined by the outstanding amount, taking into account the existing specific loan loss provision as at 31 March 2009. The outstanding amount is at most the amount repayable as at 31 March 2009, plus all interest owed and other ancillary payments. Losses may only be allocated under the guarantee once the guarantee case has been examined and approved by the guarantor.

The guarantee expires when it 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 claim for the full amount. HSH Nordbank AG may reduce the guarantee to € 4 billion between 1 January 2010 and the end of 2013 through partial cancellations of no more than € 3 billion per year. The guarantee may be cancelled in full from 2014 onwards. Once reduced, the maximum amount cannot be increased again.

In exchange for the guarantee HSH Nordbank AG pays a contractual premium of 4% p. a. on the outstanding guarantee volume. The EU Commission is currently reviewing the appropriateness of the remuneration as part of the state aid proceedings.

The guarantee from the federal states is recognised in the consolidated financial statements as a financial guarantee contract in accordance with IAS 39.9. As at the balance sheet date, the financial guarantee had a security effect on the balance sheet for the covered portfolio for the first time. Portfolio valuation allowances, which relate to the covered portfolio, were reversed in part due to the hedging effect. A cash draw-down of the guarantee or an obligation on the part of the guarantor did not result from the security effect on the balance sheet as at the reporting date.

If during the restructuring and workout programme measures consistent with the guarantee are implemented in respect of hedged commitments that conflict with recognition of the hedging instrument in the financial statements as a financial guarantee under IAS 39.9, commitments may be transferred to a partial guarantee under the framework agreement that falls under the definition of a credit derivative under IFRS, subject to approval from a trustee appointed by the guarantor. The maximum guarantee amount is not altered by the creation of the partial guarantee, as the sum of the individual amounts remains the same.

Once the credit derivative has been created the guarantee premium is divided pro rata between the partial guarantees. The accounting treatment of the derivative is in accordance with the requirements of IAS 39. Since the acceptance of the guarantee first commitments notified to the guarantor have been transferred to the partial guarantee of the credit derivative without being disclosed on the face of the balance sheet.

As a result of the reduction of non-strategic portfolios, as well as an improved portfolio quality seen in particular during the second half of 2010, the gradual reduction of the second loss guarantee provided by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg at the outset of the strategic realignment is planned starting in 2011. In February 2011, HSH Nordbank initiated the first partial reduction of the guarantee by € 1 billion to € 9 billion. In March 2011 the Bank received the approval by the guarantor. Starting with the 31 March 2010 reporting date the Bank takes the adjustment into account.

3.1.2 Effects of the capital measures on the regulatory capital requirements

The HSH Finanzfonds AöR guarantee facility constitutes eligible credit protection in accordance with Section 162 et seqq. SolvV. As it possesses the necessary characteristics, such as for example division into tranches and ranking (waterfall), it is treated as a securitised position under the advanced IRB approach in accordance with Section 226 (1) and (5) SolvV. The risk weight of the senior tranche is determined using the Supervisory Formula Approach in accordance with Section 258 SolvV.

This secondary, loss-based, risk-shielding function of the guarantee facility is designated within HSH Nordbank as Sunrise or the Sunrise Transaction. This risk shield is structured as a synthetic securitisation transaction which is recognised by the supervisory authorities so that assets remain on HSH Nordbank's balance sheet.

Due to its structure, a corresponding easing of the strain on regulatory capital requirements may be achieved through the HSH Finanzfonds AöR guarantee facility starting on 30 June 2009.

Based on the securitisation regulations in SolvV, there is a choice for the first loss piece between a capital deduction and an allowance with a risk weight of 1,250%. For reporting dates prior to 30 June 2010 HSH Nordbank backed the first loss piece as a risk-weighted position with equity. The first loss piece is deducted from equity starting with the 30 June 2010 reporting date. This means that the total amount of the first loss piece is taken into account in determining the modified available equity capital under Section 266 (1) SolvV and, therefore, no longer represents required regulatory capital. The risk weight for the second loss piece is 0%. The risk weight for the senior tranche was 7% at the reporting date.

All representations in this report take the effects of the guarantee facility into account. Regulatory capital requirements continue to be determined without taking the guarantee facility into account, in the form of an alternative calculation, and are reported to the Federal Financial Supervisory Authority (BaFin) and the Deutsche Bundesbank in the form of an alternative presentation. To the extent it is useful, with respect to individual representations or tables contained in this report, the appropriate alternative calculations and/or presentations are contained in the Notes (Chapter 10) for informational purposes.

Additional information on the features of the Sunrise Transaction (e.g. treatment of currency mismatches) is set out in Chapter 5.7.

3.2 STRUCTURE OF REGULATORY CAPITAL

The following presentation of the capital structure is based on the KWG in the version that entered into effect on 31 December 2010 and is made in accordance with Section 10a KWG in conjunction with Section 10 KWG. In accordance with the foregoing, assets contributed by silent partners are to be stated under Other equity under Section 10 (2a) Sentence 1 No. 10 KWG. The consolidated regulatory capital of the group of institutions is determined using the aggregation method in accordance with Section 10a (6) KWG. The regulatory capital consists of core capital (Tier 1 capital), supplementary capital (Tier 2 capital) and subordinated capital (Tier 3 capital).

The components of Tier 1 capital within the meaning of Section 10 (2a) KWG are disclosed in detail in Table 1 in accordance with Section 324 (2) No. 1 SolvV.

HSH Nordbank's Tier 2 capital consists of longer-term subordinated liabilities, unallocated loss provisions under Section 340 f HGB and capital under Section 10 (5) KWG (profit participation capital).

Tier 3 funds comprise subordinated liabilities that cannot be classified as Tier 2 capital for regulatory purposes because Section 10 (2) Sentence 7 KWG stipulates a cap.

Changes in equity result primarily from a regularly scheduled capital increase in the balance sheet during the reporting year for which the owners of the Bank had subscribed for convertible bonds in 2008, from the recognition of a loss carryforward from 2009, as well as a change in the calculation of the first loss piece of the second loss guarantee provided by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg via the HSH Finanzfonds AöR at the start of the realignment (See Chapter 3.1). In addition, due to the re-classification of hybrid equity in accordance with Section 10 (2a) Sentence 1 No. 10 KWG, € 874 million was reclassified from paid-up capital to Other capital from 31 December 2010 (see Table 2).

Regulatory capital item	2010	2009
Subscribed capital	2,835	3,553
Reserves (capital reserve and other allocable reserves)	1,938	2,254
Capital under Section 10 (2a) Sentence 1 No. 8 KWG	1	-
Interim profit (or interim loss)	-	-
Special reserves for general banking risks in accordance with Section 340 g HGB	1,052	1,052
Other country-specific core capital components	1,952	12
Of which Other capital in accordance with Section 10 (2a) Sentence 1 No. 10 KWG	(1,937)	-
Of which positive difference in accordance with Section 10a (6) Sentences 9 and 10 KWG	(15)	(12)
less other positions to be deducted under Section 10 (2a) Sentence 2 KWG	-91	-48
Assets contributed by silent partners	-	2,036
Total core capital in accordance with Section 10 (2a) Sentences 1 and 2 Nos. 1-5 KWG	7,687	8,859
Total amount of Tier 2 capital in acc. with Section 10 (2b) Sentence 1 KWG and of Tier 3 funds as per Section 10 (2c) KWG	4,212	4,856
Total of the positions to be deducted in accordance with Section 10 (6) and (6a) KWG	-2,624	-542
of which value adjustment shortfalls and expected losses in accordance with Section 10 (6a) Nos. 1 and 2 KWG	(-785)	(-293)
Total amount of modified available capital in accordance with Section 10 (1d) Sentence 1 KWG and of allocable Tier 3 funds in accordance with Section 10 (2c) KWG	9,275	13,173

Table 1: Structure of regulatory capital in € m

3.3 TERMS AND CONDITIONS OF REGULATORY CAPITAL

As at the reporting date the regulatory capital instruments of the HSH Nordbank Group primarily comprise the following:

- The subscribed capital amounts to € 2,835 million. The entities to be consolidated in the regulatory consolidation group have different types of subscribed share capital depending on the legal form.
- The reserves of € 1,938 million consist of capital reserves (€ 1,911 million) and other allocable reserves (€ 27 million). Other capital in accordance with Section 10 (2a) Sentence 1 No. 10 KWG in conjunction with Section 10 (4) KWG (Silent participations) was allocated in the amount of € 1,937 million. An annual distribution is payable on assets contributed by silent partners, which, according to the structure of the agreement, is dependent either on the annual net income for the year or the distributable profit. In the year under review no distribution was made on silent participations as a result of the net loss for the year and insufficient distributable profit. Silent participations share in the net loss for the year (see the 2010 financial report of HSH Nordbank AG) of € 97 million. For the most part, the silent participations are for an indefinite period and cannot be terminated by the investors. HSH Nordbank regularly has the right to terminate after the expiry of an agreed minimum period of time that is subject to the approval of the Federal Financial Supervisory Authority.
- The Tier 2 capital amounts to € 3,956 million and comprises long-term subordinated liabilities, reserves allocated in accordance with Section 340 f of the HGB and capital in accordance with Section 10 (5) KWG (profit participation capital). Capital in accordance with Section 10 (5) KWG amounting to € 45 million, not including profit participation certificates not allocable under regulatory requirements, is allocated to Tier 2 capital. Holders of profit participation rights share in the net loss for the year to the extent of € 7 million, of which € 2 million is allocated to profit participation certificates allocable under regulatory requirements.
- Subordinated liabilities were issued in the form of loan Notes, registered or bearer bonds and are denominated in €, US Dollar and Japanese Yen. The original maturities range from five to 40 years. The interest rates payable are between 0.5% and 6.5% p.a. In total there are subordinated liabilities in the amount of € 5,048 million, of which € 3,843 million was included in supplementary capital as at the reporting date.
- Tier 3 funds in the amount of € 256 million consist solely of subordinated liabilities that were not taken into account for regulatory purposes.

More detailed information on the terms and conditions on the allocable components of equity capital are set out in Table 2.

Equity instruments	Allocable total amount in € million		Residual maturity < 5 years in € m		Residual maturity >= 5 years in € m		Avg. residual maturity in years		Avg. interest rate in %[1]	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Core capital										
Ordinary shares of HSH Nordbank AG	2,635	2,460	-	-	-	-	-	-	-	-
Allocable share capital of other entities included in the regulatory consolidation group	200	1,093	-	-	-	-	-	-	-	-
Other capital, convertible in a stress situation	-	-	-	-	-	-	-	-	-	-
Other capital, indefinite and without a payment trigger	1,024	708	-	-	-	-	-	-	-	-
Other capital, limited or with payment triggers	-	-	-	-	-	-	-	-	-	-
Core capital instruments with limited allocability, subject to transitional rules, indefinite and without payment triggers	793	1,185	-	-	-	-	-	-	-	-
Core capital instruments with limited allocability, subject to transitional rules, limited or with payment triggers)	120	143	99	118	21	25	4	5	-	-
Supplementary capital										
Preference shares	-	-	-	-	-	-	-	-	-	-
Profit participation certificates (capital in accordance with Section 10 (5) KWG	45	65	23	65	22	-	5	2	-	-
Subordinated liabilities (before utilisation of Section 10 (2) Sentence 7 KWG)	5,048	5,084	2,102	260	2,946	4,824	9	10	2.8	2.7

[1] Information on interest rates relate to interest payments actually made

Table 2: Terms and conditions of equity instruments

3.4 REGULATORY CAPITAL REQUIREMENTS

Since the beginning of 2008, HSH Nordbank has determined the amount of regulatory capital backing required for counterparty default, market and operational risks on the basis of SolvV. Following approval from the supervisory authority, the counterparty default risk positions are determined using the Advanced IRB Approach. Consequently the Bank is applying the same parameters already being used internally in risk management and counterparty default risk management for regulatory reporting.

The amounts allocated to market risk positions are determined in accordance with the Standardised Approach. Operational risk is taken into account under the Standardised Approach. For the procedures used to calculate the regulatory capital requirement for counterparty default risks see Chapter 3.4.1.

The total regulatory capital requirement of € 3,311 million is the sum of the amounts allocated to counterparty default, market and operational risks (see Table 3, pursuant to Section 325 (2) SolvV).

Counterparty default risk	Regulatory capital required 2010	2009
CSRA		
Central governments	0	0
Regional governments and local municipalities	0	0
Other public institutions	0	2
Multilateral development banks	0	0
International organisations	0	0
Institutions	2	3
Covered bonds issued by credit institutions	1	-
Companies	162	191
Retail banking	7	6
Positions secured by real estate	2	2
Investment certificates	5	17
Other positions	4	9
Past due positions	43	71
Advanced IRB Approach		
Central governments	13	12
Institutions	140	211
Retail banking	-	-
Companies	1,414	1,754
Other non-credit related assets	79	112
Risks from securitisation positions		
Securitisations under the CSRA	10	18
Securitisations under the Advanced IRB Approach	595	4,030
Risks arising on equity holdings		
Equity holdings based on the continued use of the old methodology/grandfathering (CRSA)	85	75
Equity holdings excluded from the IRBA on a permanent basis or for a limited period (CRSA)	0	0
Simple risk weight approach	48	42
Listed equity holdings	6	7
Not listed, but belonging to a sufficiently diversified portfolio	28	17
Other equity holdings	15	18
Equity holdings in accordance with the PD-LGD approach	35	25
Market risk		
Market risk in accordance with the		
Standardised Approach	358	411
Settlement risk		
Settlement risk	0	0
Operational risk		
Operational risk in accordance with the		
Standardised Approach	308	261
Total	3,311	7,252

Table 3: Regulatory capital requirements in € m

3.4.1 Credit risk

HSH Nordbank determines all the risk parameters required to calculate risk weight internally using the Advanced IRB Approach (see Chapter 5.9.1). However, as part of the temporary and/or permanent partial use, the Credit Risk Standardised Approach (CRSA) is applied to individual portfolios as well as to subsidiaries that are to be consolidated (see Chapter 2). For this reason, the information on the regulatory capital requirement for credit risk is broken down between the Advanced IRB Approach and the CRSA as well as into receivables classes in accordance with the approaches applied.

Due to the special treatment applied to equity holdings and securitisations, the regulatory capital requirements for these portfolios are separately disclosed. In the case of equity holdings, HSH Nordbank determines the regulatory capital backing using the PD-LGD approach and the simple risk weight method. Furthermore, the equity holdings already held prior to 1 January 2008 and consequently “grandfathered” (portfolio protection) pursuant to Section 338 (4) SolvV are excluded from the Advanced IRB Approach until 31 December 2017 and are treated in accordance with the rules applicable to the CRSA.

In total, the regulatory capital requirements for counterparty default risk declined significantly as at the reporting date compared to the prior year – from € 6,580 million to € 2,645 million. The causes of the decline included, in addition to the portfolio wind-down, improvements in portfolio quality in the second half of 2010 and a change in the calculation of the first loss piece of the second loss guarantee provided by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg via the HSH Finanzfonds AöR at the start of the realignment (see Chapter 3.1).

3.4.2 Market risk

HSH Nordbank currently applies the Standardised Approach for purposes of determining the regulatory capital requirement for market risk, pursuant to Section 294 et seqq. SolvV. The regulatory capital requirement for market risk amounts to € 358 million as at the reporting date (see Chapter 6.4).

3.4.3 Operational risk

HSH Nordbank applies the Standardised Approach pursuant to Section 272 et seqq. SolvV for purposes of determining the regulatory capital requirement for operational risk. In total, there is a regulatory capital requirement for the Group of € 308 million as at the reporting date (see Chapter 7.4).

3.5 ADEQUACY OF REGULATORY CAPITAL

Regulatory capital adequacy is determined on the basis of the equity structure described above and the risk-weighted assets (RWA). The regulatory capital ratio is defined in Section 3 (1) SolvV in conjunction with Section 2 (6) SolvV, and shows the ratio of regulatory capital (numerator) and the total for RWA of counterparty risk and amounts for market and operational risks (denominator), expressed as a percentage. The regulatory capital used in the calculation is the total of the modified available equity and Tier 3 capital used. The required minimum regulatory capital ratio is 8.0%. The Tier 1 capital ratio is the ratio between core capital (Section 10 (2a) KWG) and the total from RWA for counterparty risks and amounts for market and operational risks.

The regulatory capital ratios of both the HSH Nordbank Group as well as the subsidiaries (see Chapter 2), which are obligated to individually report the regulatory capital ratio in their respective national countries of domicile, were always in excess of the prescribed minimum-regulatory capital ratio.

In addition to the overall numbers for the Group the regulatory capital ratios are disclosed at the individual entity level in Table 4 pursuant to Section 325 (2) No. 5 SolvV for the following entities:

- HSH Nordbank AG, Hamburg/Kiel
- HSH Nordbank Securities S.A., Luxemburg
- HSH Nordbank Private Banking S.A., Luxemburg

The reasons for the rise in capital ratios for HSH Nordbank and HSH Nordbank AG during the reporting year relate to a change in accounting for the first loss piece, the portfolio wind-down and an improvement in portfolio quality – in part during the second half of 2010 (see Chapter 1). The decline in the capital ratios of HSH Nordbank Securities S.A. and of HSH Nordbank Private Banking S.A. resulted primarily from capital measures undertaken during the reporting year. Parts of the core capital of HSH Nordbank Securities S.A. were returned to HSH Nordbank AG. In addition, write-ups were conducted with regard to profit participation capital and silent participations. HSH Nordbank Private Banking S.A. returned profit participation capital and silent participations to HSH Nordbank AG. As a result, as at 31 December 2010, HSH Nordbank Private Banking S.A.’s equity consists solely of core capital.

Company	Regulatory capital ratio in %		Tier 1 capital ratio in %	
	2010	2009	2010	2009
HSH Nordbank Group	22.4	14.5	15.4	9.5
HSH Nordbank AG	20.6	13.7	14.2	9.0
HSH Nordbank Securities S.A.	22.1	43.8	11.1	39.3
HSH Nordbank Private Banking S.A.	19.5	28.8	19.5	26.7

Table 4: Capital ratios of the HSH Nordbank Group

The HSH Nordbank Group and HSH Nordbank AG refer to HGB data for the purposes of determining the overall capital requirements. However, pursuant to the provisions stipulated by the Luxembourg Supervisory Authority (Circulaire CSSF 06/251 – circular issued by the Luxembourg Financial Sector Supervisory Commission), HSH Nordbank Securities S.A. and HSH Private Banking S.A. must prepare their solvency ratios and reports on the basis of International Financial Reporting Standards (IFRS). For this reason the regulatory capital ratios and Tier 1 capital ratios of both these subsidiaries to be shown in the Interim Disclosure Report are also based on IFRS financial data.

4 RISK MANAGEMENT

4.1 STRATEGIES AND PROCESSES

The strategic realignment of HSH Nordbank makes an impact

HSH Nordbank has already initiated important steps on the path to becoming a stable and successful bank in the region on a sustainable basis. The strategic focus of the Core Bank was clearly placed on regional and sectoral business activities, and reductions in total assets through the reduction of risk positions bundled together in the Restructuring Unit have progressed faster than planned up to now. As part of the focussing of the business the number of employees and the network of locations of the Bank was further reduced. Furthermore the Bank has optimised numerous central processes and related organisational structures.

Winding down of risk positions ahead of plan

An important objective of the strategic realignment of HSH Nordbank is the winding down of transactions that no longer conform to the Core Bank strategy. The winding down process is managed by the internal Restructuring Unit, which operates as a separate segment of the Bank. Through reducing assets from € 77 billion to € 63 billion the Restructuring Unit has significantly exceeded the plan targets for 2010. The reduction in the portfolios has been driven by the Restructuring Unit on a risk-conscious and loss-minimising basis through targeted measures. Due to the improved risk situation the Restructuring Unit segment was able to report net income before restructuring in excess of forecast.

Reorganisation of key processes

Since 2009 HSH Nordbank has carried out as part of its realignment programme systematic analyses of its key processes and the related organisational structures. These are based on the weaknesses in the business organisation of the Bank identified as part of the follow up on the global financial crisis. The Bank regards the systematic implementation of process optimisations in central departments as an important contribution to establishing its new position for the future. The main focus is being placed on the risk management, accounting, compliance and internal audit areas. By the end of 2010 the Bank has implemented the highest priority measures. The reorganisation of the lending process and the internal control system were included among the largest cross-departmental projects in 2010.

Introduction of a risk-led lending process

In 2010 HSH Nordbank concentrated risk analysis completely in the back office departments and implemented increased specialisation of these back office functions as part of the implementation of a risk-oriented lending process. The new lending process has been in force since September 2010 and is aimed at ensuring a higher independence and quality of risk management in the Bank. At the same time a new, efficient allocation of work between the market and back office departments has been created. The market departments will be relieved of some of their functions and focus in future on customer service and sales activities. Further information on the lending process is set out in Chapter 5.1.

Reorganisation of the internal control system

The Bank has achieved important milestones in the reporting year in the reorganisation of its internal control system. The particular objective of this is to systematically analyse weaknesses and to ensure that stable processes are in place on a sustainable basis. Furthermore the processes will be systematically reviewed on a regular basis with regard to the appropriateness and effectiveness of the controls in place, thereby enabling the structure of the business processes to be continually enhanced.

The Bank has defined the major processes that have been gradually reorganised on a risk-oriented basis, documented them according to uniform criteria and provided them with adequate control mechanisms since 2010. In 2011 the restructuring of the internal control system for the remaining processes is to be completed and the systematic review of the processes included as a permanent activity.

Principles of risk management

Active risk management represents a core component of overall bank management at HSH Nordbank. Against this backdrop, the Bank has continued to develop its risk culture and the methods and procedures applied in risk management on a systematic basis.

HSH Nordbank defines risk as the threat that unfavourable future developments may adversely affect the Bank's earnings and liquidity situation. Material risks for the Bank are classified as default risk, market risk, operational risk, liquidity risk and strategic risk. The individual elements of risk management constitute a system in their entirety that ensures that risks are identified, analysed, evaluated, managed, monitored continuously and reported on.

There are clear rules in the Bank concerning responsibilities within the risk management framework. The overall responsibility for risk management in the Bank lies with the Management Board. This also includes the methods and procedures to be applied for measuring, managing and monitoring risk. By taking all types of material risk into account the risk strategy reflects the organisational and strategic orientation of risk management. It includes the planned development of all material business activities from a strategic risk perspective and taking particular account of the risk-bearing capacity.

The methods and instruments used in the risk management process are documented in a risk manual that is published throughout the Bank. The Management Board and the Risk Committee of the Supervisory Board are informed of the risk situation of the Group by means of a comprehensive quarterly risk report. As an internal but independent winding down unit for the Management Board of the Bank, the Restructuring Unit is fully integrated into the Group's risk management process. The risk methods and processes of the Core Bank apply accordingly to the Restructuring Unit.

Systematic enhancement of the lending process

In the year under review the Bank has made systematic progress on the enhancement of the lending process started in 2009 for the purposes of strengthening the backoffice functions and the effectiveness of the lending decision process.

In 2010 significant changes were made to the Bank's organisational structure and processes. For instance, the cooperation between the market and back office divisions was structured on a much more efficient basis by defining clear responsibilities. In addition, the functions of credit risk analysis as well as loan and collateral management were successfully integrated into the back office. The independent status and the quality of the back office were thereby increased decisively. As a result, the lending decision process previously shaped by the market divisions was replaced by a much more risk-oriented approach. This ensures that there is a balance between risk and return targets in the assessment, particularly in the case of cyclical transactions. Overall, the measures implemented have made a significant contribution to the further enhancement of the Bank's risk culture and risk management.

Risk strategy

Taking into account all material risk categories, the risk strategy represents the organisational 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. This is reviewed at least annually and adjusted as needed. The basis for the risk strategy is the business strategy adopted by the Management Board.

The Management Board as a whole sets the Bank's risk strategy annually as part of its overall responsibilities, and discusses this with the Risk Committee formed by the Supervisory Board. The contents of the risk strategy are subsequently communicated as required within the Bank, as the strategy is a framework for the actions of the employees.

The risk strategy is a key instrument in the Bank's risk culture. For detailed descriptions of procedural and methodological regulations, the risk strategy is augmented by the Credit and Risk Manual. The guiding principle of the risk strategy is ensuring risk-bearing capacity. HSH Nordbank has integrated the task of ensuring risk-bearing capacity into its internal risk management system. The components required in the ICAAP (Internal Capital Adequacy Assessment Process) have been implemented in a bank-wide limit system.

Risk-bearing capacity

HSH Nordbank has integrated a capital adequacy process (ICAAP) into its risk management pursuant to MaRisk in order to monitor and safeguard its risk-bearing capacity on a sustained basis. Risk-bearing capacity is managed in conjunction with equity capital and value added.

The economic capital required to cover unexpected losses (overall risk) is regularly compared to the available amount of economic risk coverage potential. This comparison is made within an integrated limit system that forms the basis of Group-wide economic risk limits on all types of risk. HSH Nordbank analyses its risk-bearing capacity comprehensively on a quarterly basis, as well as within the framework of its annual planning process.

Economic risk coverage potential is determined using the net asset value approach. In addition to equity capital for economic purposes (including changes in the net asset value) the net asset value approach takes into account, amongst other things, unrealised gains and losses arising on securities, equity holdings and the lending business as well as effects from the second loss guarantee provided by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein (total of economic markups/mark-downs).

Since the second quarter 2009, the risk coverage potential has been reduced by the second loss guarantee provided by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein by the amount retained by HSH Nordbank of € 3.2 billion. At the same time, the total economic capital required for default risk has declined, as no economic capital has been required since June 2009 for positions that fall under the guarantee.

The calculation of the risk-bearing capacity changed as at 31 December 2010. On the one hand total economic mark-ups / mark-downs decreased by the deduction of deferred taxes now carried out. On the other hand the economic capital required for default risk has increased due to the change in the recognition of concentration parameters in the risk-bearing capacity.

The risk tolerance of HSH Nordbank is determined as part of the annual preparation of the risk strategy. Amongst other things, this includes the level of the buffer between the risk coverage potential and the maximum accepted overall risk (global limit). The buffer serves to cover, in particular, risks resulting from special stress scenarios and risks not yet quantifiable. The global limit is broken down into limits for individual risk types within the framework of the risk strategy.

The overall risk takes into account default risk, market risk, operational risk as well as the liquidity maturity transformation risk as an element of liquidity risk. Economic capital required is an expression of unexpected losses and is determined monthly for default, liquidity and market risks in a methodical manner with a confidence level of 99.9% and a risk horizon of one year. In order to do so, market risks are scaled up to this one year horizon based on the daily value-at-risk. Operational risks are determined in accordance with the standardised approach as defined in the German Solvency Regulation (SolvV). The economic capital requirements for the individual risk types are aggregated to an overall economic risk. In doing so, no riskreducing correlations are utilised.

We regularly conduct a stress test across all risk types in order to be in a better position to estimate the expected effects of potential crises on the overall risk situation of HSH Nordbank in addition to the assessment of the utilisation of the risk coverage potential as at the reporting date. For this purpose, we simulate the increase in the economic capital required that would arise on special scenarios for default, market and liquidity risks, which assume a massive deterioration in the risk parameters compared to the current situation and consequently go beyond the negative developments assumed within the framework of the CEBS stress test carried out in June 2010. The risk-bearing capacity of the Bank would have been maintained during the financial year 2010, even in this economic stress case.

HSH Nordbank uses recognised risk management instruments for the management of both regulatory and economic risk. For example, the Bank was one of the first institutions to receive approval from the supervisory authority to calculate the regulatory capital backing for default risk on the basis of internally determined ratings (so-called advanced IRB approach).

As part of the scenario analysis HSH Nordbank determines the changes in the risk parameters for the customer lending portfolios. The PD and LGD are analysed for the respective portfolios on the basis of market expectations specific to segments. Furthermore, the credit investment portfolio is reviewed by internal and external experts on the basis of an analysis of carrying values, market values and unrealised losses.

HSH Nordbank successfully participated in the EU-wide regulatory stress test conducted by the Committee of European Banking Supervisors (CEBS) – since 2011, the EBA – in the second quarter of 2010. As a result of the economic downswing assumed in the stress scenario in connection with a negative development of the financial markets, HSH Nordbank would report a Tier 1 capital ratio (including market risk positions) of 9.9% in 2011 – compared to 10.5% established for the 2009 annual financial statement. An additional simulated increase in the risk premium for government bonds would affect the Tier 1 capital ratio by an additional 0.2 percentage points. HSH Nordbank thus considerably exceeds the minimum value of 6% required by CEBS, even in the most severe scenario. Detailed results of the stress test may be viewed on our website, www.hsh-nordbank.de, under “Investor Relations”.

4.2 STRUCTURE AND ORGANISATION

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

The Management Board adopts the risk strategy of the Bank on an annual basis as part of its overall responsibilities. As a member of the Management Board, the Chief Risk Officer (CRO) is responsible for risk controlling, including risk monitoring, as well as for the back office functions of the Core Bank. He is responsible for the divisions Group Risk Management, Credit Risk Management, Loan and Collateral Management and Restructuring. The tasks of the independent back office are integrated into each of these divisions. Among the tasks of Credit Risk Management are the preparation of the risk analysis, including the determination of the internal rating and the drawing up of the credit application as well as the structuring of the processes and regulations for the lending business. Since September 2010 the new separate division Restructuring has been responsible for restructuring cases within the Core Bank. This function was previously assigned to Group Risk Management.

The member of the Management Board in charge of the

Restructuring Unit takes responsibility for the internal winding down department, which has been set up from a organisational and process-related perspective as a back-office department. The Restructuring Unit decides whether to wind down positions which have been transferred to it. By the end of 2010, a second assessment had been made here by Credit Risk Management on non-problem and intensive care cases, in addition to the assessment made by the Restructuring Unit independently of the market divisions. Since the beginning of 2011, the relevant decisions have in principle been made solely within the Restructuring Unit under the dual control principle. The Restructuring Unit processes and manages the restructuring cases for positions for which it is responsible, mainly on an independent basis.

The CRO and the board member responsible for the Restructuring Unit make decisions independently of the members of the Management Board responsible for the market or trading divisions. In this way the separation of functions required under the regulatory rules between the market and trading divisions on the one hand and risk controlling, settlement and control as well as back office activities on the other is taken into account at all levels from an organisational perspective. The CRO provides the Management Board as well as the Risk Committee, a committee of the Supervisory Board, with information on the risk situation of the Group.

Central risk controlling in Group Risk Management develops the methods and instruments for measuring, managing and monitoring risks. In doing so, it ensures that the material risks of the Group are transparent and manageable. Trading transactions are settled and controlled in the Operations, Group Risk Management and IT divisions.

Active risk management for the Core Bank is performed in particular in the market and trading divisions, which are directly responsible for risks and profitability within the scope of their business activities. At the same time the risks are analysed and monitored decentrally by portfolio managers at the level of the respective division.

The Restructuring Unit created in December 2009 is responsible for positions of business areas no longer considered strategic and special risk positions. Central responsibility for the risk-oriented and loss-minimising winding down of the Credit Investment Portfolio is also included among its tasks.

In the year under review, the Management Board was directly responsible for the management of the strategic positions of the overall Bank, the management of the risk-bearing capacity throughout the year and capital measures. At the beginning of 2011, the ongoing portfolio management function was transferred to the newly formed Asset Liability Committee (ALCO). It comprises the Management Board as well as the heads of the Group Treasury, Group Risk Management and Finance divisions.

For lending decisions above a certain amount the vote of a cross-division committee, which manages all the liquidity outflows on the asset side required for the business, is also taken into account. The composition of this committee was adjusted in February 2011, when the heads of Group Risk Management, Group Treasury and Finance became permanent members. The existing scope of the criteria catalogue was also expanded, e. g. to include profitability aspects.

Internal Audit reviews the effectiveness and appropriateness of risk management and the internal control system from a risk-oriented and process-independent perspective as well as the correctness in principle of all activities and processes. It includes the Core Bank, the Restructuring Unit, outsourcing and equity holdings in its audit scope. It plays an accompanying role in important projects while maintaining its independence and avoiding any conflicts of interest.

The Legal division monitors the legal risks of the Bank as an independent department. The Compliance function monitors compliance with the requirements of the Bank with respect to securities compliance, anti money laundering, financial sanctions and fraud prevention. The Compliance reports to the Management Board on the results of its control and monitoring activities on a semi-annual basis and to the responsible committee of the Supervisory Board on an annual basis.

Business segments are managed in line with worldwide standards on the basis of a global head principle. In this instance, the global heads – mainly heads of divisions – are responsible on a worldwide basis for the management of the business segments, administrative functions and services assigned to them. The global head principle also applies to risk controlling to ensure that a Group-wide coordinated risk controlling process is in place.

The Bank has stipulated rules under which formalised audit processes are gone through prior to entering into transactions in new products or new markets. This should ensure that the products are properly considered under risk aspects in the relevant systems and reflected in the relevant processes and that such transactions are only entered into with the approval of the Management Board.

As part of the Group-wide risk management process the material subsidiaries are also taken into account in the management and controlling of the individual risk types.

4.3 BASIC PRINCIPLES REGARDING THE HEDGING OR REDUCTION OF RISK

At HSH Nordbank the assumption of risk is subject to the overriding principle of risk-bearing capacity (see above). The hedging or reduction of risk as well as the continuous monitoring of measures taken to hedge or reduce risk are managed at the individual risk type level. Details on the measures taken for each relevant risk type are set out in the following chapters.

4.4 RISK REPORTING

The manner and scope of risk reporting is geared to the risk strategy and follows a uniform concept that is applied to all reports. This overall concept creates conditions under which reporting is aimed at the recipient. In this manner it is ensured that resources are utilised optimally, and inefficiencies and any overlapping in reporting as well as management errors caused by inconsistent data are avoided.

Reports are produced at different intervals. Reports produced monthly enable information relevant to the management process to be forwarded promptly to the recipients. Reports produced quarterly and annually support the management, planning processes and the strategy. BUs Group Risk Management and Finance are responsible for the content and dissemination of the reports on the overall risk and the individual risk types as well.

In Table 5 reports on overall risk taking into account the relevant subsidiaries pursuant to the requirements of MaRisk, ICAAP and SolvV are listed. The recipients of the Group-wide risk reports are as a rule the Management Board and the Risk Committee as well as, to a restricted extent, the Heads of the BUs and the Supervisory Board. The reports are supplemented by specialised, internal reports.

The risk report constitutes the core element of risk reporting in particular to the Management Board and the Risk Committee. It is prepared quarterly and shows the overall risk position of HSH Nordbank together with detailed information on the default, market, operational and liquidity risk types. Furthermore, as part of MaRisk-compliant reporting it contains, amongst others, statements on the development of the loan portfolio, the available risk coverage potential as well as the degree of utilisation of economic and regulatory capital in both regular and stress cases, the scope and development of new business as well as the movement in the loan loss provisions.

In addition to reports on the overall risk there are reporting tools based on the risk type, which are described in the following chapters.

Report	Recipient	Interval	Content	Objective
Risk Strategy	Management Board, Supervisory Board/ Risk Committee overall bank	Annually	Overall bank perspective of all types	Description of the organisational and strategic direction of risk management; presentation of the planned development of all material business activities from a risk strategy perspective and taking into account the risk-bearing capacity in particular.
Risk Report in the Annual Report	The public, (potential) investors, rating agencies	Annually	Risk management system; risk-bearing capacity; methods, processes, key ratios for the material risk types	Presentation of the risk situation of the Bank and the adequacy of its management; gradual, quantitative expansion as part of the enhancement of the Risk Report for the Risk Committee; compliance with the requirements under GAS, IFRS and HGB.
Risk Report	Management Board, Supervisory Board/ Risk Committee	Quarterly	View of the overall bank Default risk Market risk Liquidity risk Operational risk	Core element of the reporting of risk to the Management Board and the Risk Committee; reporting medium for adhering to the risk strategy, also contains analyses of individual risks in addition to portfolio analyses; consolidated presentation of contents relevant for the management process which are derived from the internal and external reporting objectives (e.g. utilisation of the global limit and the Principle I ratio); ongoing enhancement of the internal management process in line with the requirements of the capital markets
Risk Report in the Interim Report	The public, (potential) investors, rating agencies	Quarterly	The risk situation of the Bank	Presentation of the material changes to the risk position of the Bank and the adequacy of its management compared to the last report.
Finance and Risk Report	Management Board	Monthly	The earnings, liquidity and risk situation of the Bank	Summarised current presentation of the Bank's overall situation regarding earnings, liquidity and risk, with the separate goal of reporting the state of implementation of the restructuring.
NPNM MaRisk Report	Management Board	Monthly	Total NPNM portfolio processes for existing and new business, status and information regarding MaRisk violations (NPNM), transactions from BU Operations subject to a MaRisk reporting obligation	Presentation of status and processing of NPNM MaRisk violations and forwarding of information to the Management Board Management Board has delegated the product approval competence and is informed of the results via the report
Profit centre calculation	BUs' customer units, BU Heads, decentralised controllers	Monthly	Important management information	Management of the BUs

Table 5: Significant reports on the overall risk

5 DEFAULT RISK

In view of HSH Nordbank's strong orientation towards the lending business, entering into, managing and limiting default risks are among the Bank's core competencies. The default risk is broken down into credit, country, equity holding and settlement risk. In addition to the traditional credit risk, credit risk also includes counterparty and issuer risk. Settlement risk consists of clearing risk and advance performance risk. Clearing risk arises in the case of possible loss of value if delivery or acceptance claims pertaining to a transaction that is already due have not been met by both parties. Advance performance risk arises where the Bank has performed its contractual obligations but consideration from the contracting party is still outstanding. All elements of default risk referred to are taken into account within the context of the management of equity capital. For risk concentrations (in particular at borrower / country level) and equity holding risks, additional management measures are in place.

The organisation of and methods applied in default risk management are being constantly improved in order to reflect changes in market conditions and new regulatory requirements. The organisational and procedural changes made during the reporting year, which have led to a strengthening of back office functions, were already addressed in Chapter 4. Please refer to the following Chapter for further details.

5.1 ORGANISATION OF DEFAULT RISK MANAGEMENT

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

As part of the measures implemented by the Bank during the financial market crisis, the previous lending processes and structures of the loan divisions were subject to an intensive analysis, which was developed into an approach essentially based on risk. As a consequence, the credit analysis, loan management and collateral management functions, which were previously assigned organisationally to the market divisions, were integrated into the back office.

Through the restructuring of the back office departments, the tasks of Credit Risk Management have also changed significantly. By assuming the task of credit analysis originally performed by the market divisions, the preparation and setting of the internal rating and the drafting of the credit applications are now part of the tasks of risk analysis. As a result, the independence of risk analysis from the market divisions is further increased. Excluded from this new structure is the risk analysis for the highly structured business of the Core Bank. This remains within the market division, but the back office divisions are to be closely involved. Furthermore, the organisation of the processes and regulations for the lending business, including the corresponding process responsibility, is among the tasks of the Credit Risk Management division. Collateral values are determined in the newly formed Loan and Collateral Management division, the development and operation of an early warning system and segment risk analysis in the Group Risk Management division.

At the same time as the reorganisation of the back office, new competence guidelines were established to reflect the new structures. Lending decisions in the Core Bank are made jointly by the market and back office departments. Assessment and decision-making occur at the same time. A decision contrary to that of the back office is not permitted. In the restructuring division, lending decisions are made under the dual control principle. The competence levels are based on nominal amounts and the internal rating category.

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

The principles and regulations contained in the Credit Manual of HSH Nordbank, in particular on lending competencies, the determination of the rating, the treatment of collateral and loan monitoring, form the basis of the operating activities within the lending business. Credit risks, which fall under the broader definition of the term loan as set out in section 19 (1) of the KWG are considered and treated differently based on collateral, loan type, rating category and type of credit risk. The basis is the Bank's aggregate exposure per borrower unit in accordance with Section 19 (2) of the KWG, whereby the bearer of the economic risk (TWR) is always to be regarded as the relevant borrower.

The Bank has defined valuable collateral in order to differentiate between collateralised and non-collateralised loans. The focus is placed on meeting the requirements of the SolvV (e. g. availability of a market value, realisation options, non-correlation to the collateralised loan, legal enforceability, maturity match). The range of approved collateral can be expanded following an assessment carried out by a team independent of the market divisions consisting of specialists from the Credit Risk Management, Group Risk Management and Legal divisions.

Credit risk management for single risks is supplemented in particular by instructions on loan monitoring and early identification of risks.

The Group Risk Management division is responsible for the independent monitoring of risks at the portfolio level, independent reporting and the management of country risk for both the Core Bank and the Restructuring Unit. As part of the introduction of a risk-oriented lending process the organisational structure of the independent portfolio management function within Group Risk Management was specified and a separate portfolio management unit established. For this purpose, the previous monitoring unit was organisationally transferred from the Credit Risk Management division into Group Risk Management. Portfolio management is responsible for ensuring the transparency of the portfolio, independent segment risk analysis and the operation of an early warning system for identifying at an early stage borrowers that are beginning to show signs of increased risk. In addition, the Bank is planning to further expand portfolio management with regard to processes, systems and instruments.

As part of the restructuring of the lending decision process, an integrated market strategy and credit risk strategy (IMKS) was developed in 2009 for the individual divisions as a component of the consolidated credit risk strategy for HSH Nordbank Group. The IMKS combines the assessment of risks and opportunities in the respective markets. Furthermore, it defines a comprehensive, binding and exclusive framework, within which lending business may be carried out in the strategic business fields of the Bank. Taking into account both market and risk perspectives ensures that the guidelines for granting loans ("credit standards") are consistent with the developments currently observed in the market and the position of HSH Nordbank within this market. The Group Risk Management division coordinates the development of the IMKS, in which the market divisions as well as the Corporate Development, Credit Risk Management and Group Risk Management divisions are involved.

The expertise for winding down the portfolios is consolidated in the Restructuring Unit, which was set up as a back office unit from an organisational and processing perspective. The Restructuring Unit makes the decision to reduce positions which are transferred to it. By the end of 2010, a second assessment had been made here by Credit Risk Management on non-problem and intensive care cases in addition to the assessment of the Restructuring Unit. Since the adjustment of the competence guidelines at the beginning of 2011, the relevant decisions have been made solely based on the assessment of the Restructuring Unit under the dual control principle.

In principle, the Restructuring Unit processes and manages restructuring cases for positions for which it is responsible on an independent basis. Furthermore, it is responsible for processing and decision-making on workout cases both for its own positions and those of the Core Bank.

The relevant subsidiaries – HSH Nordbank Securities S.A., HSH Real Estate AG and HSH Nordbank Private Banking S.A. – are especially included in the risk reporting in order to ensure that default risk is controlled throughout the Group.

5.2 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 for their analysis, assessment and proactive management.

Stress tests

HSH Nordbank carries out regular stress tests to determine the economic capital required for default risk. For this, the risk parameters used to calculate the economic capital required are varied, e. g. by changing the expected probability of default and the default ratios. An assessment is made as to whether the budgeted risk limit for the default risks is still adhered to given the specific stress scenarios. The same stress tests are applied to the regulatory capital required to meet the requirements under the SolvV.

Early warning system

HSH Nordbank has a market-independent system for the early recognition of potential changes in counterparty risk in all significant segments of the Bank. This system covers not only borrowers listed on the capital markets but also unlisted borrowers. Changes in credit rating are monitored on the basis of both quantitative and qualitative risk parameters.

The operational management and continual development of the early warning system is performed by BU Group Risk Management. The analysis of triggers and the definition of risk assessment measures in relation to individual counterparties are made by BU Credit Risk Management as part of the prescribed monitoring and decision-making process.

Risk concentrations

Effective limitation of risk concentrations is necessary for economic reasons, as well as from a regulatory perspective. Corresponding limits for economic capital are set in order to effectively manage and monitor risk concentrations at the borrower level (borrower entities) and country level. Limits are also applied to high risk countries, which are described in the “Country risk” section. Limits were derived from the risk coverage potential, taking into account portfolio granularity. At least once a year, the limits are reviewed on the basis of risk bearing capacity and set by the Management Board in line with the Bank’s risk strategy. The decision on each new lending transaction which could result in a limit being exceeded is made by the Management Board. The Management Board and the Risk Committee are informed in the quarterly risk report of all cases where a limit has been exceeded on new and existing lending transactions and of the status of the key measures introduced.

Risk concentrations with respect to sectors and rating categories are monitored in the framework of an integrated limit system. This enables early identification of adverse developments and the implementation of relevant countermeasures.

Additional limits for risk concentration are set at the level of regulatory borrower entities (in accordance with Section 19 [2] KWG) as part of the internal large risk management. The large risk management procedure ensures compliance with the regulatory limits for large exposures at both HSH Nordbank AG and the HSH Nordbank Group level and places the Bank in a position to identify large exposures at an early stage, which could exceed the applicable limit after taking account of the amounts to be applied to it, and to introduce countermeasures before they actually occur. In addition, there are limits on classic lending and trading transactions.

Country risk

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

Country risk limitation is an additional management dimension within the management of risk concentrations. The risks involved in foreign lending activity are managed using the economic capital required. Among other things, the rating and the LGD of the specific economic risk country are included in the country risk measurement as the main risk drivers. Country ratings and country LGDs are based on a methodology that was developed as part of the joint project of the Landesbanks and the RSU. In addition, portfolio granularity is taken into account in order to provide a true portrayal of cluster effects.

The risk concentrations for all countries at Group level are limited in principle by the country limits for economic capital required as derived from the risk-bearing capacity. In addition, limits at global head level are set by the Management Board based on the strategic importance of countries where the Bank conducts its core activities. Utilisation of the limits is monitored continuously by the country risk management.

In view of the global financial crisis, country risk management has identified high risk countries which are likely to be particularly affected by the negative macroeconomic effects of the crisis. Narrow limits have been set for these high risk countries and are monitored continuously. The country risk concept for these limits comprises all country risks and thus goes beyond observation of the transfer risk described above. Because of the deterioration in their fiscal data, a number of countries in the eurozone are subject to increased monitoring. Since 2009, additional limits have been established for this purpose, which at the end of 2010 affect Ireland, Greece, Portugal and Spain and since January 2011 also Italy and Belgium.

Equity holding risk

The equity holding risk is the danger of financial loss due to impairment of equity holdings. The risks and opportunities associated with an equity holding are analysed extensively prior to the conclusion of the transaction. Equity holdings are only acquired if they meet the strategic objectives of the Bank.

The Bank’s equity holding portfolio is described in detail in Chapter 5.8.

5.3 REPORTS ON DEFAULT RISK

In general, reporting of HSH Nordbank on default risk is integrated in the reports on the overall exposure of the Bank (see Chapter 4.4). In addition HSH Nordbank uses different regular reporting tools to report exclusively on counterparty default risks (see Table 6). These reports are supplemented with information on the monitoring and management of country risk (see Table 7).

Report	Recipient	Interval	Content	Objective
Workout-loans	Management Board, BU Corporate Clients and BU Real Estate Clients	Half-yearly	Case descriptions, tables on specific case groups or risk-oriented overview of the portfolios processed in the workout, presentation of key individual cases	Information to recipients on nonperforming loans
Problem loan report	Management Board, selected BUs	Quarterly	Comprehensive information on the problem loan portfolio	Comprehensive information on the development of intensive, restructuring and wind-down cases within the problem loan portfolio
Status of Basel II capital adequacy under SolvV	CRO	Quarterly	Presentation and commentary on SolvV ratios and their changes	Information to CRO on regulatory ratios
Stress test report	CRO	Quarterly	Stress test; short review of the scenarios developed; results at overall bank level; sensitivity tests	Evaluation of risk-bearing capacity and observance of the global limit for individual stress scenarios
Validation reports (RSU rating modules, LGD and CCF)	Rating multipliers, Supervisory Authority	Annually	Default risks	Information for recipients and fulfilment of requirements of the Supervisory Board
Basel II data quality management	Management Board	Quarterly	Presentation on selected data quality issues with SolvV relevance	Information for Management Board on data quality

Table 6: Significant reports on default risk

Report	Recipient	Interval	Content	Objective
Country Risk Update	Management Board, Market BUs, BU heads (Version A), Staff BUs and operative level (Version B)	Quarterly	Country Risk Monitor; Country Risk Ticker; HSH Nordbank Foreign Exposure	Current information on specific country risk and cross-border commitment of HSH Nordbank
Country Risk Watchlist	BU CRM (risk assessment)	Monthly	Country risks	Condensed practical guidelines for high-risk countries/countries with special limits
Country limit list	Management Board, Market BUs, Staff BUs	Weekly	Utilisation of country limits	Information for Market BUs, limit monitoring tool
Review high-risk country limitation	Management Board, Market BU's, Administrative BU's	Quarterly	Utilisation of new business limits for high-risk countries, communication of the limitation requirements for each high-risk country	Informing the Market BU's and Administrative BU's, Monitoring instrument for monitoring high-risk country limits

Table 7: Significant reports on country risk

5.4 COUNTERPARTY DEFAULT RISK: GENERAL DISCLOSURE REQUIREMENTS FOR ALL FINANCIAL INSTITUTIONS

5.4.1 Exposure values of receivables sorted by risk-bearing instruments

Exposure values of the portfolio of the HSH Nordbank Group are presented below, divided into the main types of receivables (risk-bearing instruments), main regions, main sectors and contractual terms to maturity, in accordance with Section 327 (2) No. 1 to 4 of the SolvV. The residual maturity of “1 day” includes all transactions due within one day, which also means transactions callable daily with indefinite maturity. Receivables which generally do not have fixed terms to maturity, like investment certificates, are included in the last maturity range with a flat residual maturity of 10 years.

The exposure values are calculated after the application of CCFs in accordance with Sections 48 and 99 SolvV. However, with respect to the requirements stipulated in Section 327 (2) No. 1 SolvV, in Table 8 to Table 11 credit risk minimisation techniques are not included in the calculation. The credit equivalent value is shown for derivative instruments. IRBA and KSA exposure values are combined. The division does not include equity holdings and securitisations. Securitisations and shareholdings are presented separately; securitisations in Chapter 5.7 and equity holdings in Chapter 5.8.

As at the reporting date, exposure values from risk-bearing instruments amount to € 40.5 billion. In addition, there are receivables from miscellaneous assets amounting to € 0.5 billion. These cannot be allocated to risk-bearing instruments and are therefore not presented in the following tables.

Changes in the exposure values between 31 December 2009 and the reporting date result primarily from continued portfolio wind-down of transactions with no further strategic relevance as part of the strategic realignment. Details of this are given in the Consolidated Management Report in the 2010 HSH Nordbank Annual Report, in the section "Underlying conditions and business overview".

For informational purposes, the exposure values of the following tables without taking into account the guarantee facility are presented in the Notes (Tables 46 through 49).

	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Exposure value (total)	22,574	26,722	2,014	2,382	1,086	2,347	6,856	5,510	7,997	8,796

Table 8: Exposure values by risk-bearing instruments in € m

	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
Main region	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Western Europe	18,226	22,176	1,903	2,121	976	1,898	6,437	5,002	6,236	6,933
North America	2,132	3,146	43	171	64	82	342	418	1,338	1,522
Asia Pacific Region	935	633	14	14	23	345	5	11	145	91
Latin America	53	45	8	25	1	2	11	59	5	7
Central and Eastern Europe	522	282	12	45	18	18	6	5	168	151
Middle East	200	92	5	2	3	4	0	0	105	93
African countries	28	38	29	0	0	0	3	0	-	0
Int. Organisations	125	0	0	0	-	0	52	10	-	0
Other	354	310	-	3	-	0	-	4	-	0
Total	22,574	26,722	2,014	2,382	1,086	2,347	6,856	5,510	7,997	8,796

Table 9: Exposure values by main regions in € m

	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
Main sector	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Credit institutions	3,824	5,043	63	90	49	682	3,276	2,065	2,497	3,296
Other financial institutions	853	1,698	60	80	182	494	788	1,220	649	373
Public sector	3,198	5,406	83	150	43	45	2,064	1,375	357	343
Private households	665	287	51	28	8	3	-	0	50	52
Properties and flats	2,271	2,125	160	226	94	97	-	0	1,017	918
Shipping	5,330	3,445	247	300	56	83	524	562	1,424	1,407
Industry	2,791	3,411	521	805	471	623	1	6	498	539
Trade and transport	1,735	1,593	385	295	125	244	14	1	506	577
Other service activities	1,768	3,511	203	408	56	75	189	282	986	1,274
Other	139	203	241	0	1	0	2	0	11	18
Total	22,574	26,722	2,014	2,382	1,086	2,347	6,856	5,510	7,997	8,796

Table 10: Exposure values by main sectors in € m

Contractual residual term	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
≤ 1 day	3,342	4,775	129	206	2	10	76	123	0	0
> 1 day ≤ 3 months	2,401	4,365	182	199	132	240	1,121	1,152	91	100
> 3 months ≤ 6 months	409	826	54	136	6	25	60	77	55	52
> 6 months ≤ 1 year	1,241	1,317	322	391	209	201	597	112	301	215
> 1 year ≤ 5 years	4,434	5,167	700	740	327	766	2,981	2,205	1,748	1,902
> 5 years	10,748	10,272	627	711	411	1,105	2,021	1,842	5,802	6,527
Total	22,574	26,722	2,014	2,382	1,086	2,347	6,856	5,510	7,997	8,796

Table 11: Exposure values by contractual residual terms in € m

5.4.2 Procedure for creating loan loss provisions for the purposes of financial reporting

As part of the risk monitoring process of HSH Nordbank risk provisions for loan commitments are created in accordance with Group-wide standards through specific loan loss provisions (SLLP) for receivables and allowances for contingent receivables and irrevocable loan commitments to the sum of the potential default. Furthermore, the Bank takes general loan loss provisions (GLLP) and country-specific loan loss provisions (CLLP) into account.

As part of ongoing credit monitoring the units with customer responsibility identify whether the creation of new SLLPs is necessary. With regard to borrowers listed on the restructuring or wind-down list, the necessity of the creation of a new risk provision, a change of the risk provision or an assessment of the risk provision as being stable must be documented at least as part of the quarterly credit risk provisioning process. Notification and recording of the creation or modification of risk provisions is performed immediately on identification of the pertinent events. Determination and recording of risk provisions are performed at the transactional, i.e. account, level.

The Bank must assess as at the end of every quarter / every reporting date whether there is “objective evidence” that a financial asset is impaired. Sustained impairment of the receivable is a precondition for the creation of risk provisions. Objective proof for impairment must be provided. Criteria for impairment are generally considerable financial difficulties of the borrower and indications based on current information that future capital service will not be possible, with no improvement foreseeable in the economic situation. The initiation of, or application for, bankruptcy, insolvency or composition proceedings are, for example, the triggers for a review of the value of a financial instrument. In the same manner, disruptions to performance or a delay in payment in the standardised business of more than 90 days and/or in the individual business without fixed thresholds could be indicators for a potential impairment.

Recognisable risks in the lending business are allowed for by creating SLLP for the corresponding receivable. To calculate the sum of the SLLP the net present value of the expected cash flows for the receivable, i.e. the recoverable amount, is compared to the carrying amount of the receivable. Estimated future cash flows are composed of principal and/or interest payments as well as cash inflows from liquidating collateral less costs for obtaining and selling the collateral. If the carrying amount is higher than the recoverable amount, an SLLP is created for the difference.

Provisions for the lending business are reported in the balance sheet for expected defaults on off-balance sheet transactions. The amount of the allowances is the difference between the expected payment obligations of HSH Nordbank and the incoming payments expected from the borrower without discounting.

In contrast to SLLPs, GLLPs are not created for specific, but for contingent credit risk. Contingent credit risk is where receivables considered recoverable on the balance sheet date already contain risks which cannot be identified until later and which result in default. General loan loss provisions are created on that part of the loan portfolio which does not meet the requirements for specific loan loss provisions. These loans are also written down to their lower fair value based on the principle of prudence. Since allocation to particular receivables is not possible, general loan loss provisions are created. HSH Nordbank is therefore complying with the circular from the Federal Ministry of Finance dated 10 January 1994.

Provisions for country risks are generalised SLLPs. They are measured subject to the political and economic conditions of a country and created based on the overall credit commitment of the Bank in that country. The internal country rating of HSH Nordbank is the basis for the general CLLP. For all countries classified from 6 to 18 according to the rating of HSH Nordbank (see Table 32) a country-specific general loan loss provision is created. All receivables (including those not reported in the balance sheet) from debtors domiciled outside of Germany may generally be considered, whereby, amongst others, collateral assets or receivables in offshore countries are deducted. Increasing loan loss provisions are applied to the remaining sum according to the risk category. The loan loss provisions start at 5% for rating category 6 and increase by 5 percentage points per rating category to 50% for rating category 15. For rating categories 16 to 18 a 100% country-specific general loan loss provision is used as a result of the heightened probability of default.

Non-recoverable receivables are written off directly in profit or loss.

The appropriateness of specific loan loss provisions and of general loan loss provisions is monitored as part of problem loan processing. The expected need for risk provisioning for the financial year resulting from this process is determined on a quarterly basis and reported to the Management Board. The country-specific general loan loss provisions are determined at the end of the respective year.

5.4.3 Definition of "non-performing" and "defaulting" for financial reporting purposes"

According to the German Commercial Code, both current assets and the receivables portfolio of the Bank must be written down to fair value if lower than the carrying amount. The fair value of a receivable is determined by assessing the creditworthiness of the borrower, i.e. the ability to comply with the contractual terms for the receivable, together with interest and principal repayments. The loans are then divided into the following categories depending on the creditworthiness of the borrower:

No SLLP or allowances created	Loans without identifiable default risks. As at the reporting date these loans do not show any risk; no SLLPs are created for these credits, only GLLPs.	
	Earmarked loans (higher risk loans). These loans contain higher latent and/or not finally assessable risks and need to be monitored closely. SLLP is not required. GLLP is sufficient.	defaulting
Creation of SLLPs or allowances and/or direct write-off	Non-performing loans On the basis of objective criteria, for these loans (partial) default is expected; hence the creation of an adequate SLLP is required. No (additional) GLLP are created for these loans. Non-recoverable loans Such receivables can no longer be collected. No recoverable collateral available. These loans need to be written-off.	non-performing

Table 12: Division of receivables into *non-performing* and *defaulting*

A borrower is considered to have defaulted:

- if it is more than 90 consecutive calendar days in arrears with a significant part of its overall liability to the Bank from loans granted (90 days in arrears). The delayed payment is considered to be significant if the overall liability exceeds the current limits reported by more than 2.5%;
- if the Bank assumes that there is a high degree of probability that the borrower will not be able to meet its obligations in full, without the need for recourse to such actions as the realisation of collateral (unlikeliness to pay). This basic assumption should be made when certain circumstances occur (e.g. restructuring) which are specified exactly in the Credit Manual.

5.4.4 Development of risk provisions in the lending business

Consistent with Section 327 (2) No. 6 SolvV, Table 13 lists the overall portfolio as well as the changes in risk provision types in the reporting year in accordance with HGB accounting regulations. Additions, changes due to exchange rate fluctuations as well as other changes to impairments were disclosed separately. The provisions existing at the end of the 2009 reporting period include other provisions in the amount of € 48 million created for transactions not allocable to the lending business. These are no longer published in the figures for this reporting period pursuant to Section 327 (2) No. 6 SolvV.

The overall global financial stabilisation had a positive effect on the need for risk provisioning and on the quality of HSH Nordbank's loan portfolios during 2010. After trends in risk provisions were characterised by high net allocations through the end of 2009 as a result of the economic and financial crisis, following the recovery in the economy a noticeably reduced net change has been observable since the start of 2010. This applies especially for the shipping markets which are of particular importance to HSH Nordbank. SLLP and provisions totalled € 4,473 million at the reporting date. € 2,786 million relate to the Sunrise Transaction. This represents loan loss provisions (including use) for the Sunrise Transaction reference portfolio formed after 31 March 2009. Resulting actual defaults are allocated to the financial guarantee as described in Chapter 3.1.

Loan loss provision	SLLP 2010	SLLP 2009	Allowances 2010	Allowances 2009	GLLP 2010	GLLP 2009	CLLP 2010	CLLP 2009
Portfolio at the beginning of the reporting year	3,807	2,560	523	444	213	198	95	163
Addition	2,641	2,881	406	569	4	18	11	33
Reversal	1,533	1,054	569	386	0	4	0	102
Utlisation	772	460	2	47	-	-	-	-
Interest income	179	112	-	-	-	-	-	-
Changes due to exchange rate fluctuations and other changes	137	-8	15	-9	-	-	-	-
Portfolio at the closing date	4,100	3,807	373	571	216	213	105	95

Table 13: Development of loan loss provisions in € m

5.4.5 Non-performing and defaulting receivables in the lending business by main sectors and main regions

Subsequently the non-performing and defaulting receivables are listed broken down by the main region and main sector consistent with Section 327 (2) No. 5 SolvV. Table 14 and Table 15 show values taken from HGB data.

As at the reporting date, receivables from non-performing loans (needing value adjustments, i.e. individual value allowances or loan loss provisions) totalled € 11,637 million, and receivables on loans in arrears (not needing value adjustments) totalled € 3,330 million. Of this, € 9,148 million and € 2,776 million respectively come within the Sunrise Transaction reference portfolio.

												2010
					Portfolio	Net additions/reversals of						
Main sector	Non-performing[1]	SLLP	GLLP	CLLP	Allow.	SLLP	GLLP	CLLP	Allow.	DW[2]	Receipts[3]	in default[4]
Credit institutions	212	185			-	-21			-			5
Other financial institutions	1,067	329			9	42			-102			73
Public sector	111	55			2	22			-20			148
Private households	170	87			0	15			-3			95
Properties and flats	2,930	844			23	312			-15			452
Shipping	2,938	814			159	43			-110			1,838
Industry	2,061	871			156	402			90			475
Trade and transport	1,096	418			15	175			-1			21
Other services	1,047	491			9	119			-4			223
Other	5	5			-	-			-			-
Total	11,637	4,100	216	105	373	1,108	4	10	-163	8	81	3,330

												2009
					Portfolio	Net additions/reversals of						
Main sector	Non-performing[1]	SLLP	GLLP	CLLP	Allow.	SLLP	GLLP	CLLP	Allow.	DW[2]	Receipts[3]	in default[4]
Credit institutions	355	301			-	37			-			9
Other financial institutions	2,004	695			103	-73			63			158
Public sector	132	41			21	10			12			185
Private households	190	86			3	9			-7			136
Properties and flats	2,167	628			86	307			34			619
Shipping	2,735	805			258	824			21			1,370
Industry	1,686	537			66	345			37			353
Trade and transport	697	289			18	146			17			158
Other services	1,255	421			14	218			6			242
Other	5	5			-	5			-			-
Total	11,226	3,807	213	95	571	1,827	15	-69	183	35	4	3,230

[1] Non-performing loans (with need for loan loss provisions) [2] Direct write-offs [3] Recoveries on receivables written off

[4] Defaulting loans (without need for loan loss provisions)

Table 14: Non-performing or defaulting receivables by main sector in € m

	Non-performing[1]		SLLP portfolio		GLLP portfolio		CLLP portfolio		Allowances portfolio		in default[2]	
Main region	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Western Europe	8,121	8,831	3,089	2,989			8	23	322	555	3,037	3,028
North America	1,812	1,532	537	477			-	-	41	13	108	76
Asia Pacific Region	222	157	95	66			53	6	1	1	127	40
Latin America	172	161	85	45			4	7	2	0	3	13
Central and Eastern Europe	396	222	80	68			41	57	6	1	54	28
Middle East	905	315	213	162			-	1	1	-	-	43
African countries	8	9	1	1			-	1	-	-	2	4
Int. Organisations	-	-	-	-			-	-	-	-	-	-
Other	-	-	-	-			-	-	-	-	-	-
Total	11,637	11,226	4,100	3,807	216	213	105	95	373	571	3,330	3,230

[1] Non-performing loans (with need for loan loss provisions) [2] Defaulting loans (without need for loan loss provisions)

Table 15: Non-performing or defaulting receivables by main region in € m

5.5 COUNTERPARTY DEFAULT RISK: CRSA AND/OR IRBA RECEIVALBLE CLASSES

5.5.1 Names of nominated rating agencies

Under CRSA the required risk weight for the calculation of regulatory capital backing is stipulated by the supervisory authority. The risk weight depends on the type of receivable, its external rating and any collateral. If external ratings are being used, HSH Nordbank takes only those into account which are issued by agencies approved by the Supervisory Board (Section 44 SolvV). Different rating or export insurance agencies can be appointed for each category of receivable. The CRSA or IRBA receivables category for securitisations allows rating agencies to be appointed at the transaction level; for all other CRSA exposures they are appointed per receivables category related to credit assessment.

If an external rating from a recognised rating agency is used this external rating must be converted to a rating on the rating master scale. A check should be made for each of the recognised rating agencies if an external rating is available. If there is more than one external rating available, of the two ratings leading to the lowest CRSA risk weights, the rating with the higher CRSA risk weight is decisive. The issuer rating should always be used, except for ABS transactions where the external rating for the transaction is used

HSH Nordbank has appointed the following rating agencies.

Receivables category	Receivables class	Rating agency
States	Central governments Regional governments Other public sector entities Institutions Covered bonds issued by banks	Fitch Moody's S & P
Banks	Multilateral development banks	External ratings not used
Companies	Companies	External ratings not used
Investment certificates	Investment certificates	External ratings not used
Securitisations	IRBA exposures in acc. with Section 85 (6) 1 No. 1 SolvV CRSA securitisation exposures IRBA securitisation exposures	Fitch Moody's S & P

Table 16: Rating agencies by receivables category

5.5.2 Transfer of ratings from issues to receivables

Issuer ratings are necessary to determine the CRSA and IRBA risk weight for securitisations as well as the amounts of eligible collateral for CRSA and IRBA exposures. In addition, issuer ratings may have to be provided for the receivables class Investment certificates. The emission ratings employed in HSH Nordbank are taken from the rating agencies Fitch, Moody's and S & P. The listed rating agencies were specifically nominated to the regulatory authorities by HSH Nordbank. Generally, the ratings for the corresponding positions are maintained in the internal IT systems.

HSH Nordbank does not use the creditworthiness assessment via comparable exposures and borrower creditworthiness due to the minor relevance of the low exposure.

5.5.3 CRSA and IRBA exposure values when applying regulatory risk weight

In order to determine the equity capital requirements, both the CRSA and the Advanced IRB Approach require risk-weighted exposure values (the product of risk weight and exposure value) to be created. For CRSA the risk weights are set globally by the supervisory authority by receivables category and external rating. Table 17 shows the CRSA exposure values before and after credit risk reduction measures in accordance with Section 328 (2) SolvV. Substitution effects mean that exposure values with risk weights that were originally higher are replaced with those with a lower risk weight.

In contrast, the Advanced IRB Approach always calculates the risk weights using parameters assessed internally. The IRBA receivables class Equity holdings and IRBA Special Financing positions are exceptions. In these cases it is possible to determine risk weight using the "simple risk weight". Risk weighting is set by the supervisory authorities depending on fixed criteria. However, within the HSH Nordbank Group the simple risk weight approach is only used partially for equity holdings at present. Depending on whether the equity holding exposure is not quoted on the stock exchange but diversified sufficiently, is quoted on the stock exchange or is another equity holding exposure, it is assigned a risk weight of 190%, 290% and/or 370%. These exposure values are also listed in Table 17 in accordance with Section 329 (2) SolvV. This classification does not include securitisations since they are separately disclosed in Chapter 5.7.

The figures in the following table take into account the Sunrise Transaction. The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 50).

	CRSA before credit risk reduction		CRSA after credit risk reduction		Advanced IRBA	
Risk weight in %	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
0	111	167	111	167	-	-
10	86	-	86	-	-	-
20	115	161	117	277	-	-
35	-	-	60	63	-	-
50	0	0	2	107	-	-
70	-	-	-	-	-	-
75	167	167	108	100	-	-
90	-	-	-	-	-	-
100	3,108	3,637	3,113	3,414	-	-
115	-	-	-	-	-	-
150	351	586	309	574	-	-
190	-	-	-	-	185	112
200	-	-	-	-	-	-
250	17	-	13	-	-	-
290	-	-	-	-	25	30
350	-	-	-	-	-	-
370	-	-	-	-	49	61
1,250	2	-	2	-	-	-
Capital deduction [1]	15	15	15	15	0	0
Other risk weights	323	580	325	580	-	-
Total	4,293	5,312	4,261	5,297	259	203

[1] The figures as at 31 December 2009 have been corrected

Table 17: CRSA/IRBA exposure values by regulatory risk weight in € m

5.6 DERIVATIVE COUNTERPARTY DEFAULT RISKS

5.6.1 Nominal value of derivative transactions

Derivative financial instruments have been implemented to a considerable extent to ensure efficient risk hedging, exploit market opportunities and cover specific financing needs of customers.

The nominal volume of derivative transactions amounted to € 538 billion as at the balance sheet date (previous year: € 656 billion). The reduction in 2010 is due to a decrease in the positive market value of derivatives. Around 80% of nominal volume involves banks with their registered office in an OECD country.

5.6.2 Internal capital allocation and assignment of upper limits for credits to counterparties

The usual credit approval procedures must be complied with when creating derivative counterparty default risk exposures. The risk classification, limitation and monitoring processes of the classic lending business apply accordingly (see Chapter 4.1) supplemented by the daily monitoring of derivative exposures in accordance with MaRisk requirements. The eligible sums for derivative counterparty default risk exposures are included in the Bank-wide economic management, capital allocation and limitation together with the other exposures subject to credit risk.

5.6.3 Procedure for receiving collateral

Derivative transactions for hedging interest rate, foreign exchange and other similar risks are generally concluded with single counterparties and governed by existing master agreements. A differentiation should be made between the German Master Agreement for Financial Transactions and the international Master Agreement of the International Swaps and Derivatives Association (ISDA).

In addition, collateral agreements supplementing a number of Master Agreements were concluded, mostly with major banks in Germany and abroad, but also with other companies in individual instances. For the German Master Agreement, this involves the schedule, and for the ISDA Master Agreement it involves the ISDA Credit Support Annex (Transfer – English Law). The following information applies equally to both Master Agreements and the associated collateral agreements.

The collateral agreements include agreements on thresholds which are unsecured, eligible collateral, other collateral arrangements and the scope of the collateral agreement. The agreed collateral is generally cash, plus in several cases interest-bearing securities from G10 nations or other EU nations with good ratings, which are received or delivered through (generally daily) margining.

Cash collateral amount in convertible and freely transferable currencies (normally Euro or US dollars).

The Master Agreements and the collateral agreements are entered in the Legal Database Information System (LeDIS). LeDIS checks legal opinions on collateralisation and eligibility for netting under supervisory law.

5.6.4 Evaluation of derivates and creation of loan loss provisions

Counterparty risk is calculated using the market valuation method in accordance with Section 18 et seqq. SolvV.

Derivatives are recognised and measured in accordance with German commercial law. Internal transactions are required to comply with uniformly determined conditions. In particular, they must be conducted on arms-length terms. To the extent purchased / written options are assigned to the non-trading portfolio, the option premium paid / received is stated on the balance sheet under other assets / other liabilities. 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. If purchased / written options are assigned to the trading portfolio, the fair value less VaR discount are stated under trading portfolio assets / liabilities. To the extent that a margin system is applied in the case of innovative financial instruments not assigned to the trading portfolio, the margin payments are recognised as assets and liabilities as appropriate. We comply with the recognition-of-loss principle by setting up provisions as necessary. Margin payments related to financial instruments assigned to the trading portfolio are recognised in realised gain or loss. For further information on recognition and measurement of derivatives, see the 2010 Annual Report, Chapter 8 “Accounting policies”.

5.6.5 Dealing with correlations of market and counterparty risk

The management of derivative counterparty default risks includes determining both market and counterparty risks and providing capital backing. A reduction due to correlations of both these types of risks is not applied at present.

5.6.6 Effect of the collateral amount which the Bank must provide when the rating is downgraded

HSH Nordbank has entered into individually negotiated Master Agreements with its counterparties. These agreements are based on netting agreements recognised under supervisory law. The collateral agreements to these Master Agreements include individual clauses which could require the HSH Nordbank to supply collateral or additional collateral in the event that an external rating of the Bank is downgraded. As at the reporting date, a downgrade by the rating agencies Moody’s or Fitch would have resulted in additional collateral of € 35.6 million, which would not have affected HSH Nordbank’s risk-bearing capacity.

5.6.7 Positive net replacement costs before and after application of credit risk reduction

Table 18 shows to what extent HSH Nordbank Group is committed to different types of counterparty as defined by Section 326 (2) No. 1 SolvV and to what extent derivative netting agreements and collateral netting is used. The counterparty default risk according to the approach used (regulatory market assessment approach) is given in Table 19 in accordance with Section 326 (2) No. 2 SolvV. Derivatives forming part of securitisations are not shown in the following table as they are described separately in the next Chapter.

	Positive replacement value *before* netting and collateral		Netting options		Nettable collateral		Positive replacement value *after* Netting and collateral	
	2010	2009	2010	2009	2010	2009	2010	2009
Interest-related contracts	10,094	15,158						
Currency-related contracts	596	756						
Securities/index-related contracts	139	194						
Loan derivatives	87	55						
Goods-related contracts	150	180						
Other contracts	386	0						
Total	11,451	16,343	5,142	10,414	855	1,064	5,454	4,865

Table 18: Positive replacement costs in € m

	Market assessment method	
	2010	2009
Counterparty default risk item	7,891	8,795

Table 19: Counterparty default risk in € m

5.6.8 Credit derivatives

Credit derivates purchased to hedge the loan portfolio of HSH Nordbank Group are shown in accordance with Section 326 (2) No. 3 SolvV in Table 20. As at the 2010 reporting date, HSH Nordbank did not hold any derivatives eligible for collateral. Credit derivatives forming part of securitisations are not shown in the following table as they are described in the next Chapter separately.

	Nominal value of collateral	
	2010	2009
Credit derivatives (secured party)	0	563

Table 20: Nominal value of credit derivatives eligible for collateral in € m

HSH Nordbank Group acts as both buyer and seller of credit derivatives (see Table 21 in accordance with Section 326 (2) No. 4 SolvV). There were no brokerage transactions as at the reporting date.

	Use for own credit portfolio protection buyer		Use for own credit portfolio protection seller		Brokerage activity	
	2010	2009	2010	2009	2010	2009
Credit Default Swaps	1,178	2,585	580	2,204	-	-
Credit Linked Notes	-	-	-	-	-	-
Total Return Swaps	-	-	-	-	-	-
Credit Options	-	-	-	-	-	-
Other contracts	-	-	-	-	-	-
Total	1,178	2,585	580	2,204	-	-

Table 21: Nominal values of credit derivatives in € m

5.7 SECURITISATION

5.7.1 Aims, functions and scope of securitisation activities

Securitisations are an important instrument for banks in refinancing, capital relief and risk management. Banks can play different roles in a securitisation transaction, transferring credit risk themselves as originators, managing the portfolio to be securitised as sponsors, or acquiring securities from the securitisation as investors. HSH Nordbank is involved in various activities which have securitisation structures. In the process, the Bank plays the role of originator, investor and sponsor.

Securitisation transactions in which HSH Nordbank acts as originator are used for risk management and to reduce credit risk. Overall risk is managed through strategic sales of selected receivables (traditional or true sale securitisation) by eliminating or reducing cluster risk.

In addition to its role as originator, HSH Nordbank acts as investor in securitisations sponsored by third parties by investing in tranches of securitisations issued by third parties (e.g. residential mortgage backed securities , commercial mortgage backed securities, collateralised debt obligations) or by providing liquidity or credit enhancement.

Part of the securitisation transactions as at the reporting date 31 December 2010 are hedged by the Sunrise Transaction. As a result, these are not recognised separately. For information purposes, the quantitative information in this Chapter is presented in the Notes (Tables 51-53) as an alternative presentation excluding the effect of the guarantee.

In calculating the figures in this Chapter, credit risk minimisation techniques involving substitution are ignored. As a result, the figures include the second loss piece of € 10 billion in the Sunrise Transaction. In the course of credit risk minimisation, the second loss piece as a financial guarantee is substituted in the IRBA central government class.

The securitised portfolio which underlies the Sunrise Transaction includes foreign currency positions with a share of around 50% in the total portfolio. This means that there is a mismatch in currencies between the guarantee in euro and part of the hedged portfolio. A change in how such currency mismatches are taken into account was carried out during the reporting year. Prior to this conversion, the second loss piece was not measured in terms of the nominal value of the guarantee (€ 10.0 billion) but in terms of the value adjusted for the currency mismatches. The amount of the difference was allocated to the senior tranche. Since the date of the conversion, the currency fluctuation factor has been applied to the entire Sunrise Transaction in accordance with Section 189 SolvV and the second loss piece is again measured based on the nominal value of the guarantee. As at the reporting date the Sunrise Transaction has a value of € 117.3 billion. This is divided into the senior tranche (€ 104.1 billion), the second loss piece (€ 10 billion) and the first loss piece (€ 3.2 billion).

Overall, the CRSA and IRBA value of all securitisation positions retained or sold by HSH Nordbank (including Sunrise) as at the reporting date total € 118.4 billion.

5.7.2 Determination of risk-weighted exposure for securitisation transaction to be considered

The methods to be used in calculating the regulatory capital for securitisation positions are stated in SolvV. Under the IRB securitisation rules, HSH Nordbank uses the ratings-based approach, if ratings by external providers are available in the market. The Bank uses the external ratings from S&P, Moody's or Fitch. For securities positions which do not have an eligible external rating HSH Nordbank applies the alternative approaches established in SolvV (Section 243 (2-4) SolvV for CRSA securitisation positions and Sections 255-260 SolvV for IRBA securitisation positions).

In accordance with Section 266 (1) SolvV, there is the option for CRSA or IRBA securitisation positions for which a risk weight of 1,250% has been calculated of making a capital deduction or applying this risk weight to determine the total counterparty risk capital charge. In the context of the Sunrise Transaction this option is particularly important for the treatment of the first loss piece and calculating capital ratios.

For reporting dates prior to 30 June 2010 HSH Nordbank backed the first loss piece as a risk-weighted position with equity. The first loss piece is deducted from equity starting with the 30 June 2010 reporting date. This means that the total amount of the first loss piece is taken into account in determining the modified available equity capital under Section 266 (1) SolvV and, therefore, no longer represents required regulatory capital. An internal assessment approach (IAA) in accordance with Section 259 SolvV for the determination of risk weights for exposures from asset backed commercial papers programmes is not applied by HSH Nordbank at present.

The Carrera transaction is a conduit that issues asset backed commercial papers (ABCP). The programme is based on ABSs. During the course of the reporting year, the measurement approach with regard to Carrera was converted to the supervisory formula approach.

ABCP are likewise issued via the Poseidon conduit. The ABCP are used to refinance Notes acquired by Poseidon through the Rasmus 5 and Rasmus 9 acquisition companies. Capital requirements are calculated at the level of the acquisition companies (under Section 249 SolvV to determine the maximum risk weighted CSRA position value).

Profit participation rights / liabilities to Scandinavian regional banks are securitised via the transactions Prime 2006 -1 and Scandinotes II through V. The risk-weighted exposure values are determined by external ratings.

Smartfact comprises securitised trading receivables which are risk-weighted in KSA using the look-trough approach on the basis of external ratings.

As at the reporting date, all securitisation transactions – other than Poseidon, Smartfact and parts of Scandinotes III – are hedged by Sunrise.

Securitisation activity	Type of securitisation	Approach	Procedure to determine the risk-weighted exposure
Carrera (ABCP-Programm)[2]	Traditional securitisation	IRBA	Formula approach under supervisory law acc. to Sect. 258 SolvV
Poseidon (ABCP-Programm)	Traditional securitisation	CRSA	Cap-regularisation
Rasmus 5	Traditional securitisation	CRSA	CRSA look-through approach
Rasmus 9	Traditional securitisation	CRSA	CRSA look-through approach
Prime 2006-1[2]	Traditional securitisation	CRSA	Risk weight in line with external rating
Scandinotes II[2]	Traditional securitisation	IRBA	Risk weight in line with external rating
Scandinotes III[1]	Traditional securitisation	IRBA	Risk weight in line with external rating
Scandinotes IV[2]	Traditional securitisation	IRBA	Risk weight in line with external rating
Scandinotes V[2]	Traditional securitisation	IRBA	Risk weight in line with external rating
Smartfact	Traditional securitisation	CRSA	CRSA look-through approach
Sunrise	Synthetic securitisation	IRBA	Formula approach under supervisory law acc. to Sect. 258 SolvV

[1] Partly hedged as part of the Sunrise Transaction. [2] Fully hedged as part of the Sunrise Transaction.

Table 22: Determination of risk-weighted exposure for securitisation transactions

5.7.3 Accounting policies for securitisations

Acquired securitisation positions which meet the definition of securities in the German Ordinance on the Accounting System for Banks (RechKredV) are recognised and measured in accordance with the standard methods for securities.

Primary receivables of HSH Nordbank AG which the Bank allocates to synthetic securitisations without a significant transfer of risk or with regard to which a transfer is made to Special Purpose Vehicles (SPV) still included in the consolidated financial statements, continue to be reported under the original receivables class. Assumption of risks by third parties is taken into account as collateral when calculating impairments. If the risk has not been transferred through securitisation or if the guarantee is impaired, the receivable is written down.

Receivables transferred under true sale securitisations are shown as disposals. Risks retained by the Bank are still recognised and measured here in accordance with the standard methods for receivables.

As HSH Nordbank prepares parent company financial statements under HGB and consolidated financial statements under IFRS, Table 23 shows the effects of both sets of accounting standards. Only securitisation transactions not hedged by the Sunrise Transaction are taken into account.

			IFRS		HGB
Securitisation transaction	True sale Yes/No	Approach	Disposal Yes/No	Consolidation Yes/No	Disposal Yes/No
Poseidon	Yes	CRSA	-	No	-
Scandinotes III[1]	Yes	IRBA	Yes	No	Yes
Smartfact	No	CRSA	-	No	-
Sunrise	No	IRBA	No	-	-

[1] Partly hedged as part of the Sunrise Transaction.

Table 23: Accounting policies for receivables securitised as originators

5.7.4 Rating agencies used for securitisations

The securitisations issued by the HSH Nordbank Group were externally rated. The rating agencies used and the type of receivables underlying the securitisation portfolio are shown in Table 24 in accordance with Section 334 (1) No. 6 SolvV. The rating agencies used for investment in third party securitisation transactions are shown in Table 16.

Securitisation transaction	Type of securitisation	Type of receivable	Rating agency
Carrera (ABCP-Programm)[2]	Traditional securitisation	ABS	Fitch, Moody's, S & P
Poseidon (ABCP-Programm)	Traditional securitisation	ABS, leasing claims	Moody's
Prime 2006-1[2]	Traditional securitisation	Profit participation rights	Fitch, Moody's, S & P
Scandinotes II[2]	Traditional securitisation	Receivables from Danish regional banks	Moody's
Scandinotes III[1]	Traditional securitisation	Receivables from Scandinavian regional banks	Moody's
Scandinotes IV[2]	Traditional securitisation	Receivables from Danish regional banks	Moody's
Scandinotes V[2]	Traditional securitisation	Receivables from Danish regional banks	Moody's

[1] Partly hedged as part of the Sunrise Transaction. [2] Fully hedged as part of the Sunrise Transaction.

Table 24: Securitisation transactions initiated by HSH Nordbank

5.7.5 Exposure values of securitised receivables

For securitisations, a distinction must be made between securitisations with transfer of receivables (traditional or true sale securitisations) and securitisations without transfer of receivables (synthetic securitisations). Depending on the nature of the securitised receivables, securitisations are also allocated to different product classes, which have the characteristics of specific receivables.

In accordance with section 334 (2) No. 1 SolvV, Table 25 shows the value at the reporting date of the securitised receivables at HSH Nordbank, broken down by securitisation transaction with or without transfer of receivables and the nature of the securitised receivables.

The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 51).

	Exposure value	
Securitisation portfolio	2010	2009
Traditional securitisations		
Real estate	93	-
Ships	-	-
Retail banking	150	315
ABS	1	1,221
Other	129	98
Sub-total	373	1,634
Synthetic securitisations		
Real estate	-	-
Ships	-	-
Retail banking	-	-
ABS	-	-
Other	-	-
Sunrise	117,255	136,579
Sub-total	117,255	136,579
Total	117,628	138,213

Table 25: Exposure values of securitised receivables in € m

5.7.6 Exposure values of retained or purchased securitisation exposures

In accordance with Section 334 (2) No. 3 SolvV, Table 26 shows a list of the securitisation positions held by the Bank. This includes retained tranches from the Bank's own securitisation transactions (e.g. for the purpose of credit enhancement), liquidity facilities provided by the Bank for securitisation transactions and investments in third party securitisation transactions.

The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 52).

Securitisation items	CRSA exposure value 2010	CRSA exposure value 2009	IRBA exposure value 2010	IRBA exposure value 2009
Balance-sheet items				
Credit enhancements[1]	-	160	-	-
Participations in ABS transactions	229	620	795	2,390
Other balance-sheet items	129	-	-	98
Sunrise	-	-	117,255	136,579
Sub-total	358	779	118,050	139,068
Off-balance sheet items				
Liquidity facilities	3	-	8	-
Derivates	-	-	-	-
Other off-balance sheet items	-	-	-	-
Sub-total	3	-	8	-
Total	361	779	118,058	139,068

[1] Measures to improve credit quality

Table 26: Exposure values of retained or purchased securitisation exposures in € m

5.7.7 Risk weight ranges and exposure values of securitisation

In accordance with Section 334 (2) No. 4 SolvV, Table 27 shows the Bank's individual securitisation positions (see Table 26) allocated to risk weight bands, and the resulting capital requirements. As of the reporting date, all securitisation transactions with a risk weight of 1,250% are deducted from equity in accordance with Section 266 (1) SolvV. These positions accordingly do not constitute a capital requirement. As at the 31 December 2009 reporting date, the first loss piece of the Sunrise Transaction and of the Carrera securitisation transaction, as well as the Omega 52 and 55 securitisation transactions reversed under Section 255 (1) Sentence 2 SolvV, were calculated using a risk-weighting of 1,250%.

The figures excluding the effect of the guarantee facility are shown for information purposes in the Notes (Table 53).

	Securitised items retained/purchased							
	CRSA exposure value		IRBA exposure value		CRSA capital requirement		IRBA capital requirement	
Risk weight range in %	2010	2009	2010	2009	2010	2009	2010	2009
0 ≤ 10	74	-	114,316	134,015	-	-	583	698
> 10 ≤ 20	0	501	129	1,281	0	6	2	4
> 20 ≤ 50	154	166	52	32	4	7	2	1
> 50 ≤100	72	30	20	24	5	2	1	3
> 100 ≤ 350	0	49	3	217	0	4	0	12
> 350% ≤ 650	0	-	14	22	-	-	5	8
> 650 < 1,250	0	-	0	-	-	-	-	-
1,250 or capital deduction	60	35	3,524	3,478	-	-	-	3.303
Total	361	779	118,058	139,068	10	18	595	4,030

Table 27: Exposure values and capital requirements for retained or purchased securitisation items acc. to risk weight ranges in € m

5.7.8 Non-performing and delayed securitisations and actual losses

In accordance with Section 334 (2) No. 2 SolvV, Table 28 shows those parts of securitised receivables which are non-performing or in default and the actual losses in the period under review. The securitisation positions shown are those for which HSH Nordbank acts as originator. To ensure comparability of data, the definitions of receivables and actual losses are based on those for general recognition of non-performing and delayed receivables (see Chapters 5.4.4, 5.4.5) and actual losses (see Chapter 5.9.8).

The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 54).

	Total non-performing or in-arrears[1]		Actual losses	
Securitisation portfolio	**2010**	**2009**	**2010**	**2009**
Real estate	-	-	-	-
Ships	-	-	-	-
Retail banking	-	-	-	-
ABS	-	-	-	-
Other	5	5	-	-
Sunrise[2]	11,924	10,586	20	2
Total	11,929	10,591	20	2

[1] Total non-performing receivables (needing value adjustment) or delayed receivables (not needing value adjustment)

[2] The actual losses in the Sunrise Transaction are loss allocations under the guarantee which have already been reported to the guarantor for review and approval or have already been settled. The value of the actual losses of the Sunrise Transaction for the year 2009 was corrected compared to the report for the previous year as loan loss provisions were reported in addition to actual losses.

Table 28: Non-performing and delayed securitisations, actual losses on securitised receivables in €

5.7.9 Securitisation activities in the reporting year

HSH Nordbank carried out the Plato No. 1 S.A. securitisation transaction during the reporting period. In addition, Smartfact was classified as a regulatory securitisation during the reporting period. Smartfact is a securitisation company formed under the laws of Luxembourg. It purchases non-interest bearing trade receivables of various receivables traders. The transaction Plato did not achieve any regulatory securitisation benefit under Section 232 SolvV as a result of the lack of significant risk transfer.

In the course of the strategic realignment, HSH Nordbank has decided that financing special purpose entities and the loan replacement business are not part of its core business. HSH Nordbank terminated its investment in the transactions Omega 52 and 55 in January 2010. With the termination of Omega 52 and 55, HSH Nordbank took advantage of the recent recovery in the credit and capital markets and, at the same time, continued to wind-down the credit investment portfolio.

For the year 2011, the only securitisation transactions planned are those in which HSH Nordbank is the investor.

5.8 LONG-TERM EQUITY HOLDING PORTFOLIO

The regulatory authorities state that equity holdings must be consolidated, deducted from equity or backed with equity capital in the asset class Equity Holdings. In this context regulatory law considers equity holding risk to be a sub-class of the counterparty default risk. The equity holdings from the banking book are explained below.

5.8.1 Objectives of equity holdings

The equity holding portfolio of the HSH Nordbank Group is divided essentially into five sub-portfolios. Each sub-portfolio has a different objective.

a) Strategic equity holdings

Strategic equity holdings are all those which have a strategic importance for the Group and/or promote the economic interests of the region.

b) Equity holdings to support business segments

Equity holdings to support business segments are oriented towards expanding existing customer relationships or creating new ones.

c) Investment-related equity holdings

Investment-related equity holdings comprise private equity commitments for profit and diversification of risks.

d) Other equity holdings

In contrast to the regulations of the German Commercial Code all items that contain a subordinated residual claim to the assets or income of the issuer are classified as equity holding under supervisory law. Equity holdings which are considered as a equity holding under supervisory aspects (in accordance with SolvV) but mostly are allocated to the item “Shares and other non-fixed-income securities” (in accordance with the German Commercial Code) do not therefore belong to the divisions of strategic, business field-related or investment-oriented equity holdings and instead are treated as other equity holdings.

e) Equity holdings contained in investment funds or certificates

Special funds of domestic or foreign banks and certificates which under HGB must be recognised under the heading “Bonds and other fixed-interest securities” can also include equity holdings within the meaning of SolvV under supervisory law. If these equity holdings have to be allocated to the banking book, they come under the separate sub-portfolio “Equity holdings contained in investment funds or certificates”

5.8.2 Accounting principles for equity holdings

An important instrument for monitoring and managing equity holding risk for strategic, business field-related and investment-oriented equity holdings is regular company assessment. The processes have been designed to ensure that the recoverability of all HSH Nordbank’s direct equity holdings and relevant indirect equity holding are assessed at least once a year. Significant equity holdings are subject to a detailed assessment using the relevant standards of the Institute of Public Auditors in Germany (“Institut der Wirtschaftsprüfer”). The assessment of fund holdings and similar constructs is performed using a net asset value approach which also assesses the current year reports and financial statement of the investment companies. All other equity holdings undergo a risk-oriented assessment.

Equity holdings which are allocated to the sub-portfolios “Other equity holdings” and “Equity holdings contained in investment funds or certificates” also represent a long-term commitment due to their allocation to the Bank’s investment portfolio. Hence these partial portfolios are also assessed on the moderate lower of cost or market principle and the corresponding exposures are reported with their historical costs. This means that reporting of P&L volatilities, which would not be economically justified due to the short-term nature of the underlying fluctuations in value, is avoided. If long-term reductions in value are foreseeable – generally related to creditworthiness – write-downs are made to the lower share price, market price or fair value.

5.8.3 Overview of equity holdings in the banking book

The equity holding portfolio of the banking book of HSH Nordbank Group is shown in Table 29.

	Carrying amount		Fair value		Stock market value	
Equity holding portfolio	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
Strategic equity holdings	408	422	408	422	-	-
Items traded on the stock exchange	-	-	-	-	-	-
Not listed on the stock exchange but belonging to a sufficiently diversified equity holding portfolio	-	422	-	422	-	-
Other equity holding exposures	408	-	408	-	-	-
Business field-related equity holdings	481	380	491	375	-	-
Items traded on the stock exchange	93	17	102	13	102	13
Not listed on the stock exchange but belonging to a sufficiently diversified equity holding portfolio	389	363	389	363	-	-
Other equity holding exposures	-	-	-	-	-	-
Investment-related equity holdings	343	129	343	129	-	-
Items traded on the stock exchange	-	-	-	-	-	-
Not listed on the stock exchange but belonging to a sufficiently diversified equity holding portfolio	343	129	343	129	-	-
Other equity holding exposures	-	-	-	-	-	-
Other equity holdings[1]	309	260	307	108	-	-
Items traded on the stock exchange	40	46	39	30	39	30
Not listed on the stock exchange but belonging to a sufficiently diversified equity holding portfolio	0	213	0	79	-	-
Other equity holding exposures	269	0	269	0	-	-
Investment exposures contained in investment funds or listed certificates or exposures treated as equity holdings	17	81	18	92	-	-
Total	1,558	1,273	1,567	1,126	-	-

Table 29: Valuation of equity holding instruments in € m

5.8.4 Realised profits and losses and hidden revaluation gains for equity holdings

Table 30 shows in accordance with Section 332 No. 2c SolvV the accumulated gains from sales. It also shows in accordance with Section 332 No. 2d SolvV the amount of hidden revaluation gains (or losses); these hidden gains (or losses) are not recognised in the statement of financial position or statement of comprehensive income. They are also not included in Tier 1 or Tier 2 capital.

	Realised gains or losses from sales and workout		Hidden revaluation gains/losses			
			Overall		of which amounts included in Tier 1 or Tier 2 capital	
	2010	2009	2010	2009	2010	2009
Equity holding items	3	-1	8	-156	-	-
Equity holding items contained in investment funds or listed certificates or exposures treated as equity holdings	-1	-3	1	11	-	-
Total	2	-4	9	-145	-	-

Table 30: Realised/hidden gains and losses from equity holding instruments in € m

5.9 RISK MEASUREMENT FOR IRBA PORTFOLIOS

5.9.1 Procedures and transition rules permitted by the Federal Financial Supervisory Authority as part of IRBA

HSH Nordbank determines all parameters required to determine the risk-weighted exposure value internally, i.e. probability of default (PD), loss given default (LGD), exposure at default (EaD), credit conversion factor (CCF) and maturity (M), and hence complies with the requirements of the Advanced IRB Approach of the German Solvency Regulation.

Since the first quarter of 2009, the advanced IRBA has also been used to calculate capital requirements for LBO financing. The aircraft financing rating module was also in the regulatory approval process in 2009. Approval for single airline financing was given in January of the year under review.

There is a detailed description of the approved rating module used by HSH Nordbank in Table 31.

The regulatory reference point of 80% indicates the degree of coverage of the positions with internal rating systems which must be achieved by the middle of the maximum five-year term for an institution approved for the advanced IRB approach. As at the relevant reporting date of 30 June 2010, HSH Nordbank had significantly exceeded this degree of coverage. At this point in time, the different degrees of coverage in accordance with Section 67 SolvV amounted to over 85% in each case. The Bank is striving to achieve the regulatory benchmark, i.e. degree of coverage of at least 92%, by the end of 2012 at the latest.

The current strategic realignment of HSH Nordbank also influences which positions will remain permanently or temporarily in partial use or will not be included in determining the degree of coverage, as they belong to business units which will not be continued. This process will only be complete on the conclusion of the realignment.

HSH Nordbank Group applies the following transitional rules in accordance with Sections 338 and 339 SolvV::

- The Bank excludes equity holdings held before 1 January 2008 from application of the Advanced IRBA, using CRSA instead to determine the capital requirement (grandfathering).
- For investment certificates in accordance with Section 294 (6) Sentences 1-8 SolvV, HSH Nordbank Group is waiving prorated treatment in line with the actual foreign currency composition until 31 December 2011, provided that the share of the special fund denominated in foreign currency or gold does not exceed 10% of the total value of the special fund.

5.9.2 Structure of internal rating systems and internal allocation of exposures or borrowers to rating classes or risk pools and external credit ratings

In a cooperation project with nine Landesbanks rating procedures based on scorecards and simulations were developed at an early stage for the individual portfolio segments. This cooperation between the Landesbanks led in 2003 to the founding of RSU Rating Service Unit GmbH & Co. KG (RSU). Since 2004 this company has assumed responsibility for the methodical maintenance and development of the rating systems. The individual Landesbanks provide their expertise in the form of competence or support centres. Currently 13 of the rating modules developed by the participating banks are provided by RSU. In addition, RSU has integrated two rating modules from S Rating und Risikosysteme GmbH (S Rating), a subsidiary of Deutscher Sparkassen- und Giroverband (DSGV), into the central LB-Rating application. With a single exception (rating of funds), these rating modules are all rating procedures recognised at HSH Nordbank for the purposes of reporting under SolvV.

In addition, during the year 2009 the LGD and CCF methodology developed by HSH Nordbank and approved by the supervisory authorities was transferred to RSU. HSH Nordbank now plays the role of centre of competence.

Rating methods

The rating procedures distinguish between scorecard and cash flow approaches. The scorecard approach identifies characteristics and factors that are able to differentiate between good and bad borrowers. Their validity is first verified with a single factor model. Subsequently, several characteristics, which each have high significance in a single factor model, are combined to create a multi-factor model. The scores determined using the multi-factor model are translated to default probabilities. A precondition for the application of a scorecard approach is that a sufficient number of relatively homogeneous borrowers is available.

The cashflow approach simulates cashflows of the asset in various scenarios. These vary depending on macro-economic and sector-based conditions. A simulation engine (SimEngine) is used to create numerous scenarios which differ according to macro-economic conditions before the data enter the corresponding rating modules. A sector-based model uses these scenarios to calculate scenarios for future changes in sector-related factors such as rents, vacancies or charter rates. The values are then fed into the calculation of scenarios for the cashflow of the corresponding asset. Subsequently scenarios are selected where the borrower must be considered to be defaulting. The default probability is calculated as a ratio from the number of scenarios where a default was recorded to the total number of scenarios.

Both the scorecard and the cash flow approaches include quantitative as well as qualitative factors. Once these factors have been taken into consideration, warning signals and the company background are examined. There are also regular override opportunities, allowing ratings to be moved up to a limited extent and down to an unlimited extent. The result of the rating process, the local currency rating or LCR, is only finalised once all these aspects have been taken into consideration. As a result, an individual PD is obtained for each borrower, enabling assignment to a specific credit rating class. When measuring borrower risk, the risk of foreign currency transfer restrictions has to be considered, as well as default risk.

The rating result is calibrated on a standard rating master scale. This master scale is the DSGV master scale which contains 22 live and 3 default categories. Each rating class on the rating master scale is assigned a one-year default probability. This standard rating scale allows for immediate comparison of exiting ratings separately from the portfolio segment. The scale also includes mapping of external ratings to the internal categories.

The rating modules and methods used at HSH Nordbank Group at the reporting date for the purposes of reporting under SolvV are shown in Table 31. Capital backing is calculated using the advanced IRB approach.

Borrower, bearer of economic risk (TWR), asset or project	Rating module	Rating method
Companies	Corporates Sparkassen-StandardRating	Scorecard
Real estate	Sparkassen-ImmobiliengeschäftsRating Internationale Immobilienfinanzierungen	Cashflow
Ships	Ship financing	Cashflow
Banks	Banks	Scorecard
Insurance companies	Insurance companies	Scorecard
International regional authorities	International regional authorities	Scorecard
Leasing companies SPC real estate leasing	Leasing	Scorecard with cash flow component
Projects	Project financing	Cashflow
Single-airline financing	Aircraft financing	Cashflow
LBO financing	Leveraged finance	Scorecard
Individuals, self-employed, craftsmen, corporate clients	Sparkassen-StandardRating or Sparkassen-ImmobiliengeschäftsRating (depending on the primary origin of capital)	Scorecard or cashflow
States	Country and transfer risk	Scorecard
DSGV guarantee system	DSGV guarantee system	Scorecard with simulation part

Table 31: Rating modules of HSH Nordbank Group approved by the supervisory authorities

The Landesbanks participating in the development of rating procedures are divided into competence and support centres and participants. The competence centre bank assumes the lead for the development and maintenance of modules where it can offer special expertise. It is supported by experts from the support banks while the remaining banks act as participants (collaborating indirectly). HSH Nordbank has the main responsibility for the rating modules ships and leveraged finance and is also co-responsible for the modules international real estate financing and country and transfer risk. HSH Nordbank collaborated in the development of a rating module for loan financing for funds in 2008 within the RSU group. The module was implemented at HSH Nordbank in 2009 for internal management purposes. Since January 2011, HSH Nordbank has additionally assumed the Competence Centre function for the aircraft financing module.

Rating classification per the masterscale rating	Moody's	S & P	Fitch
1(AAAA)	-	-	-
1(AAA)	Aaa, Aa1	AAA, AA+	AAA
1(AA+)	Aa2, Aa3	AA, AA-	AA+, AA
1(AA)	A1	A+	AA-
1(AA-)	-	-	-
1(A+)	A2	A	A+
1(A)	A3	A-	A
1(A-)	-	-	-
2	Baa1	BBB+	A-
3	Baa2	BBB	BBB+
4	Baa3	-	BBB
5	-	BBB-	-
6	Ba1	BB+	BBB-
7	Ba2	BB	BB+
8	-	-	BB
9	Ba3	BB-	BB-
10	B1	B+	-
11	-	-	B+
12	B2	B	B
13	-	-	-
14	B3	B-	B-
15	Caa1 – Caa3	CCC+ - C	CCC+ - C
16 – 18	Default rating	Default rating	Default rating

Table 32: Internal allocation of exposures and borrowers to rating classifications and external ratings

LGD method

The LGD calculation method was developed successively by HSH Nordbank for each rating segments, and is continuously reviewed and refined in the course of the annual validation process. Since the transition to the RSU Association in 2009, validation has been was done jointly with other Landesbanks. The results were estimation methods for recovery rates regarding specific collateral and specific borrowers (proceeds of the assets in bankruptcy). LGD calculation takes into account the current data in the legacy systems.

When determining LGD (overall LGD) three possible default scenarios are considered. In addition to processing, restructuring of the defaulted commitment is possible. In the best case scenario recovery is possible. LGD estimation is based on observation of the workout. In order to draw up a forecast for the loss ratio, the proceeds of the sale of collateral (the product of the market value of the collateral asset and a recovery rate specific to that asset) and proceeds from the bankruptcy estate (the product of non-collateralised exposure and a borrower-specific recovery rate) are used.

Modelling is based on historical losses, which are collected together with other Landesbanks and analysed using statistical and econometric techniques. For data capture, HSH Nordbank uses the Credit Loss Database (CLD). Historical loss data is used to identify macroeconomic and microeconomic factors influencing LGDs, which in turn are used to create models for predicting LGDs in future loss events. In accordance with Section 132 (3) Sentence 1 SolvV, the effects of an economic downturn were taken into account, and "downturn LGDs" calculated. Information from external studies was also used as a benchmark.

CCF methods

In contrast to assets on the balance sheet, where future exposure can be calculated from the loan agreements, receivables from the classic off-balance-sheet business must have the exposure at default (EaD) calculated using a credit conversion factor (CCF). This is assessed annually on a joint basis as part of the RSU association together with other Landesbanks. Analogously with the LGD method, a downturn CCF is calculated here as well. For transactions with unlimited future absorption, different product categories - and hence varying estimation procedures for the CCF - are used.

5.9.3 Internal process for allocation of exposures or borrowers to rating classes or risk pools divided according to receivables categories

The rating process is divided into creation and determination processes. The BUs Credit Risk Management or Group Risk Management are responsible for approving the rating.

The rating guidelines in the Credit Manual specify for all classes (except the retail portfolio and risks with total lending of € 750,000 per borrower unit or € 75,000 at business partner level) that internal rating methods recognised under supervisory law must be used. An individual rating must be prepared:

- for borrowers, bearers of economic risk (TWR), rating issuers (for special financing projects: for the item or the project). This applies also to the purchase of receivables without recourse;
- for persons who act exclusively as support in the rating modules;
- as a precondition in order to include specific collateral (e.g. personal collateral) provided as a risk reduction to the benefit of HSH Nordbank.

Each borrower subject to rating is given only one rating for local currency rating (LCR) and, if need be, foreign currency rating (FCR). The LCR determines the counterparty default risk without considering a foreign currency transfer risk. The foreign currency transfer risk is incorporated when the FCR is determined.

The exact triggers for the rating are also specified in the Credit Manual. Each rating must be updated according to risk aspects – but at the latest within twelve months – and verified and confirmed by the back office unit. Special risk aspects which require updating before the end of the 12 month period are specifically:

- significant expansion of the counterparty default risk,
- knowledge of significant new risk-related information,
- commitments where a currency transfer risk exists if the risk country migrates to rating class 9 or worse,
- defaults and recoveries.

The Working Instruction in the Credit Manual explains the requirements for creating a rating unit. It sets out when the rating of the legal borrower is waived as part of the rating and the loan decision process and the rating of the TWR and/or the rating donor is to be applied instead.

Positions which have not been rated using a recognised IRBA rating method but have an internal expert rating are treated as CRSA (Chapter 5.5.1).

To ensure comprehensive rating for the exposure for which risk classification is required by SolvV, the Bank has process quality controlling (PQC) and data quality management (DQM).

Assignment of borrowers requiring a rating to the rating methods is done on the basis of the module-specific rating process instructions in the Credit Manual, taking into account the module-specific applications manuals and expert rating manuals.

IRBA exposures and borrowers are allocated to IRBA receivables categories or IRBA exceptions based on a customer systematic key in accordance with Section 70 (1) SolvV. The customer system classifies business partners according to various characteristics. The most important are: entity groups (banks/public authorities/companies and organisations), location of the entity (domestic or foreign according to the country list of the Deutsche Bundesbank, industry and legal form and differentiation between economically independent and economically dependent entities.

Specific models are developed for the various rating segments in order to determine the collateral-specific recovery rate for the non-collateralised part of the EaD. Therefore the allocation of an borrower to the various partial LGD models is based on the allocation performed as part of a rating procedure. The CCF is selected according to the product so that an allocation to rating systems is not required

Retail banking

Within HSH Nordbank Group receivables from retail banking are handled in the CRSA.

Equity holding exposures

For equity holdings covered by the grandfathering provisions of Section 338 (4) SolvV, which are given a risk weight of 100% in CRSA, no rating is required under supervisory law before 31 December 2017. However, ratings are required for positions entered into since 1 January 2008. The rating methods are used for these default risks. If none of the rating modules recognised under supervisory law can be used for an equity holding, the simple risk weighting method is used, i.e. the risk weight specified in supervisory law is assigned.

For investments in funds and the underlying risk of near-fund listed certificates in the banking book the risk weight and expected loss is determined using the "look-through treatment" as described in Section 83 SolvV. If this is not possible, an assessment of the underlying assets, does HSH Nordbank use a risk weight of 370%.

5.9.4 Control mechanisms for reviewing the rating system

A validation of all rating modules and of the LGD and CCF models of HSH Nordbank is performed annually within the meaning of Section 106 No. 5 and Section 147 SolvV. Validation of a rating module means a verification of the accuracy of forecasts and the selectivity of the rating module. This includes the following steps:

- analysis of portfolio and market performance (e.g. description of the portfolio according to region and relevant customer types)
- analysis of rating distributions
- backtesting (comparison with actual default rates) and/or benchmarking (comparison with external ratings)
- calibration (verification of the extent of allocated default probabilities)
- examination of selectivity (ability of the rating module to differentiate between good and bad borrowers)
- review of the model structure and design (e.g. significance and weighting of individual factors and partial models, inclusion of supporters, analysis of the frequency with which data were overwritten and the reasons for this, inclusion of the transfer risk)
- examination of the application of ratings (e.g. analysis of data quality, verification of standard application by carrying out duplicate analyses)

The process of validation involves three steps:

- The first step involves validation based on the pooled data of all Landesbanks and/or Landesbanks and savings banks under the lead management of RSU and S Rating. Data are pooled specifically to create the largest possible and hence statistically most significant database. In cooperation with the relevant competence centre and support centre, RSU performs the validation and, if necessary, the recalibration and further development of the modules on the basis of the pooled data. For the modules of S Rating, pooling is carried out on the basis of data from participating savings banks and participating Landesbanks. Updates are made by S Rating.
- As the validation is done on the basis of the pooled data, it is necessary to demonstrate that the results can also be applied to HSH Nordbank Group. This is done in a second step in cooperation with RSU and/or S Rating.
- In a last step further internal analyses to complete the validation and proof that the rating modules are suitable for use at HSH Nordbank are performed.

The role of HSH Nordbank during the updating phase on the basis of the pooled data depends on whether it has assumed one of the functions of competence and/or support centre in respect of the module in question.

The LGD and CCF methods are also validated annually in accordance with the provisions of the German Solvency Regulation, similar to validation of the rating modules. Until 2008 the validation procedures were carried out internally. With the transition of the methods to the RSU Association, since 2009 validation has been done jointly with other Landesbanks.

A similar procedure exists for S Rating modules in collaboration with S Rating.

5.9.5 Utilisation of internal estimates for purposes other than determination of risk weighted exposure in accordance with IRBA

HSH Nordbank Group uses parameters determined internally in many areas of the Group. For example, all risk parameters EaD, PD, LGD and CCF are used actively for the overall management of the Bank. The risk parameters in particular are embedded into risk-adjusted pricing of loan applications, the procedure to create loan loss provisions and determination of expected risk costs and limitation. With their inception the rating systems and the corresponding risk parameters are used in the following steering systems of the Bank:

- loan approval procedures/determination of competences
- a priori and ex-post calculation of individual transactions
- limit setting
- reporting
- commitment monitoring
- intensified loan management/restructuring

In addition the parameters are used for ongoing scenario calculations and in the planning and strategy process.

5.9.6 Exposure values according to rating ranges (excluding retails banking) under IRBA

The rating results determined using the rating modules described above are calibrated to a standard rating scale, whereby rating classes 16 to 18 represent default classes. The individual rating classes are summarised in seven Rating ranges for greater clarity. As most of the receivables have a good rating and there are relatively few receivables in the poorer rating ranges, the assignment of rating ranges for better grades has been refined.

Table 33 shows the breakdown as at the reporting date in accordance with Section 335 (2) nos 1 and 2 SolvV. Tables 33-35 do not include securitisations, which are shown separately (see section 5.7). In the case of equity holdings, only equity holdings under the PD-LGD approach are shown. The overall long-term equity holding portfolio is described in more detail in section 5.8.

The following table shows the figures in accordance with Section 99 SolvV allowing for credit risk reduction techniques. It also shows the average probability of default (average PD), average LGD and average risk weight within a rating range for the individual receivables classes. All presentations in accordance with Section 335 (2) SolvV are based on the figures in the reports in accordance with Bundesbank Circular B 40-5 / B 410-1 65.2.229.13.

The figures in the following table take into account the Sunrise Transaction. In the course of credit risk minimisation, the second loss piece as a financial guarantee is substituted in the IRBA central government class. As a result, the figures include the second loss piece totalling € 10.0 billion of the Sunrise Transaction, but exclude the first loss piece and senior tranche. The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 55).

IRBA receivable class	Average PD in % 2010	Average PD in % 2009	Average LGD in % 2010	Average LGD in % 2009	Average RW in % 2010	Average RW in % 2009	Exposure value 2010	Exposure value 2009
Rating range 1: 1(AAAA) – 1(AA+)								
Central governments	0.0	0.0	21.3	24.9	0.2	0.2	14,939	16,213
Institutions	-	-	-	-	-	-	-	-
Companies	-	-	-	-	-	-	-	-
Equity holding exposures[1]	-	-	-	-	-	-	-	-
Subtotal	0.0	0.0	21.3	24.9	0.2	0.2	14,939	16,213
Rating range 2: 1(AA) – 1(A-)								
Central governments	0.0	0.0	23.2	44.9	14.6	27.9	310	37
Institutions	0.0	0.0	31.1	32.9	14.1	14.6	8,554	9,155
Companies	0.1	0.0	40.7	36.7	24.5	20.0	4,613	4,808
Equity holding exposures[1]	-	-	-	-	-	-	-	-
Subtotal	0.0	0.0	34.2	34.2	17.7	16.5	13,478	14,000
Rating range 3: 2 – 5								
Central governments	0.3	0.1	91.7	32.0	155.5	46.0	13	61
Institutions	0.2	0.2	22.4	30.6	24.9	24.1	696	1,580
Companies	0.3	0.2	45.0	44.7	58.6	53.5	5,401	4,864
Equity holding exposures[1]	0.4	0.4	90.0	90.0	166.7	176.1	85	5
Subtotal	0.3	0.2	43.2	41.2	56.5	46.4	6,195	6,509
Rating range 4: 6 - 9								
Central governments	0.6	2.0	20.0	50.0	49.4	100.0	50	0
Institutions	1.7	1.7	31.4	44.2	65.0	136.1	146	89
Companies	1.1	1.2	38.5	39.8	81.2	91.0	4,074	5,012
Equity holding exposures[1]	1.3	1.5	90.0	79.1	279.2	230.5	28	47
Subtotal	1.1	1.2	38.4	40.2	81.6	93.1	4,298	5,148
Rating range 5: 10 - 12								
Central governments	-	3.0	-	20.0	-	74.9	-	71
Institutions	5.2	3.2	62.1	32.7	206.9	86.9	13	15
Companies	4.7	4.7	43.0	51.0	150.6	179.0	1,538	2,300
Equity holding exposures[1]	4.6	4.2	90.0	81.9	372.2	324.7	29	41
Subtotal	4.7	4.6	44.0	50.5	155.2	177.9	1,581	2,426
Rating range 6: 13 - 15								
Central governments	20.0	20.0	18.9	27.7	117.4	162.5	7	12
Institutions	20.0	20.0	0.0	34.8	0.0	200.1	0	228
Companies	16.6	15.7	42.4	52.4	226.1	273.3	1,889	2,509
Equity holding exposures[1]	10.0	15.0	90.0	90.0	470.6	527.8	1	7
Subtotal	16.6	16.1	42.4	50.9	225.7	267.4	1,897	2,755
Rating range 7 (Default): 16 - 18								
Central governments	100.0	100.0	23.9	23.0	39.0	37.5	96	28
Institutions	100.0	100.0	86.9	58.3	141.6	95.1	178	351
Companies	100.0	100.0	49.8	53.6	81.2	87.5	4,283	3,236
Equity holding exposures[1]	100.0	100.0	66.6	65.0	108.7	106.0	94	29
Subtotal	100.0	100.0	51.0	54.0	83.2	88.0	4,651	3,644
Total (without default)								
Central governments	0.0	0.0	21.4	24.9	0.8	0.9	15,320	16,393
Institutions	0.1	0.5	30.5	32.7	16.0	20.9	9,410	11,066
Companies	2.6	3.0	41.9	43.2	81.0	98.0	17,516	19,492
Equity holding exposures[1]	1.5	3.4	90.0	81.5	232.4	286.0	143	100
Total	1.1	1.4	32.1	34.4	38.1	46.4	42,388	47,052

[1] Only equity holdings under the PD-LGD approach; with regulatory LGD of 65% or 90%; CCF = 100%

Table 33: Average PD, average LGD, average RW and exposure values in € m by rating ranges

5.9.7 Undrawn loan commitments and average exposure values under IRBA

Based on the rating ranges described above the assessment basis for undrawn loan commitments and the average exposure values weighted by commitment for each portfolio are given in Table 34.

The figures in the following table take into account the Sunrise Transaction. The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 56).

IRBA receivable class	Central governments 2010	Central governments 2009	Institutions 2010	Institutions 2009	Companies 2010	Companies 2009	Equity holding exposures[1] 2010	Equity holding exposures[1] 2009	Total 2010	Total 2009
Rating range 1: 1(AAAA) – 1(AA+)										
Basis for evaluation of loan commitments	621	665	-	-	-	-	-	-	621	665
Basis for evaluation of non-derivative assets not reported	8	6	-	-	-	-	-	-	8	6
Avg. exposure value of loan commitments	29	33	-	-	-	-	-	-	29	33
Avg. exposure value of non-derivative assets not reported	5	6	-	-	-	-	-	-	5	6
Rating range 2: 1(AA) – 1(A-)										
Basis for evaluation of loan commitments	-	-	354	519	986	817	-	-	1,340	1,335
Basis for evaluation of non-derivative assets not reported	16	16	75	648	137	205	-	-	229	868
Avg. exposure value of loan commitments	-	-	1	2	6	4	-	-	5	3
Avg. exposure value of non-derivative assets not reported	14	14	6	59	9	10	-	-	8	47
Rating range 3: 2 - 5										
Basis for evaluation of loan commitments	0	-	0	56	2,089	2,724	-	-	2,089	2,780
Basis for evaluation of non-derivative assets not reported	0	0	8	143	658	632	-	-	666	776
Avg. exposure value of loan commitments	0	-	0	9	15	7	-	-	15	7
Avg. exposure value of non-derivative assets not reported	0	0	5	37	14	13	-	-	14	17
Rating range 4: 6 - 9										
Basis for evaluation of loan commitments	-	-	75	0	1,436	1,639	-	-	1,511	1,639
Basis for evaluation of non-derivative assets not reported	-	-	4	2	528	830	-	-	532	832
Avg. exposure value of loan commitments	-	-	46	0	7	15	-	-	9	15
Avg. exposure value of non-derivative assets not reported	-	-	1	1	3	12	-	-	3	12
Rating range 5: 10 – 12										
Basis for evaluation of loan commitments	-	-	0	0	300	432	-	-	300	432
Basis for evaluation of non-derivative assets not reported	-	-	-	2	154	165	-	-	154	167
Avg. exposure value of loan commitments	-	-	0	0	12	5	-	-	12	5
Avg. exposure value of non-derivative assets not reported	-	-	-	0	5	6	-	-	5	5
Rating range 6: 13 – 15										
Basis for evaluation of loan commitments	-	-	-	0	318	420	-	-	318	420
Basis for evaluation of non-derivative assets not reported	0	-	0	3	280	254	-	-	281	257
Avg. exposure value of loan commitments	-	-	-	0	10	9	-	-	10	9
Avg. exposure value of non-derivative assets not reported	0	-	0	0	3	4	-	-	3	4
Rating range 7 (Default): 16 - 18										
Basis for evaluation of loan commitments	-	-	6	0	244	484	-	-	250	484
Basis for evaluation of non-derivative assets not reported	-	-	-	0	107	231	-	-	107	231
Avg. exposure value of loan commitments	-	-	0	0	4	10	-	-	4	10
Avg. exposure value of non-derivative assets not reported	-	-	-	0	2	13	-	-	2	13
Total										
Basis for evaluation of loan commitments	621	665	435	575	5,372	6,516	-	-	6,428	7,755
Basis for evaluation of non-derivative assets not reported	24	22	88	798	1,864	2,316	-	-	1,976	3,136
Avg. exposure value of loan commitments	29	33	9	3	10	9	-	-	12	11
Avg. exposure value of non-derivative assets not reported	11	12	6	54	8	11	-	-	8	22

[1] Only equity holdings under the PD-LGD approach; with regulatory LGD of 65% or 90%; CCF = 100%

Table 34: Assessment basis in € m and average exposure value of undrawn loan commitments and of non-derivative off-balance sheet assets

In the case of investment funds and certificates purchased by HSH Nordbank Group and included under the advanced IRB approach using the look-through approach (Section 83 (4) SolvV), an average risk weight is determined mostly based on information provided on a regular basis by the fund management companies. It is not possible to include this in the rating ranges, therefore disclosure of equity holding exposures contained in investment funds or certificates is made by means of Table 35.

	Exposure value		Regulatory capital requirements under IRBA	
Risk weight range in %	**2010**	**2009**	**2010**	**2009**
0 ≤ 10	-	-	-	-
>10 ≤ 20	-	-	-	-
>20 ≤ 50	-	-	-	-
>50 ≤ 100	-	-	-	-
>100 ≤ 350	17	27	4	6
>350 ≤ 650	0	55	0	16
>650 > 1,250	-	-	-	-
1,250	-	-	-	-
Capital deduction	-	-	-	-
Total	17	81	4	22

Table 35: Exposure values and capital requirements for investment funds in € m

5.9.8 Loss estimates and actual losses in the lending business (IRBA)

Table 36 shows a comparison of loss estimates with actual losses in the lending business in accordance with Section 335 (2) No. 6 SolvV. Loss estimates correspond to the expected loss (EL) after minimisation of the credit risk. The EL for non-defaulting risk assets in the traditional lending business is shown (e.g. excluding securities in the banking book and derivatives). Actual loss is defined as follows:

Utilisation of SSLP (for balance sheet transactions)

\+ Utilisation of allowances (for loan commitments and off-balance sheet assets)

\+ direct write-offs

\- recoveries on receivables written off

= actual loss in the lending business

The figures in the following table take into account the Sunrise Transaction. For this reason EL from this transaction and actual losses which have been reported to the guarantor for review and approval or already have been settled are not included in the figures. The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 57).

	2010		2009	
	Expected loss (EL)	Actual loss	Expected loss (EL)	Actual loss
Receivables class	**as at 31.12.2010**	**01.01.2010 to 31.12.2010**	**as at 31.12.2009**	**01.01.2009 to 31.12.2009**
Central governments	0	0	0	-
Institutions	2	72	2	-
Companies	138	228	215	250
Equity holding exposures[1]	2	-	2	4
Total	142	300	219	255

[1] Only equity holdings under the PD-LGD approach; with regulatory LGD of 65% or 90%; CCF = 100%

Table 36: Expected losses and actual losses in the lending business in € m

5.10 CREDIT RISK MITIGATION TECHNIQUES

5.10.1 Strategy, procedures and scope of balance sheet and off-balance sheet netting agreements

Banks are able to utilise netting agreements when determining their required equity capital which lead to a reduction in the evaluation basis and hence the equity capital required.

In contrast to balance sheet netting which is not used by HSH Nordbank, off-balance sheet netting within the framework of netting agreements for derivatives is applied (see Chapter 5.6.7). The market assessment method is used to determine the required net assessment basis. As at the reporting date HSH Nordbank Group recorded a counterparty default risk exposure to the amount of € 7.9 billion (see Table 19).

5.10.2 Processes for management and approval of credit risk mitigation techniques

The Collateral and LGD Guideline issued by the Management Board defines the collateral approved by HSH Nordbank as recoverable and hence minimising default risk as well as the qualitative requirements for such collateral. Hence it also defines the benchmarks for collateral management within HSH Nordbank Group and is supplemented by detailed instructions in the process regulations for the lending business in order to ensure comprehensive collateral management. The provisions of SolvV are an integral part of the Collateral Guideline.

Qualitative requirements for collateral are in particular legal enforceability (especially for foreign collateral), the absence of a correlation between the creditworthiness of the borrower and the value of the collateral, matching maturities of loan and collateral agreement and the existence of an objective market value.

For this collateral the Bank has identified collateral-specific recovery values based on historical recovery cases, which are used with recognised collateral in calculating the LGD. In 2009 the LGD method was transferred to the RSU Association, and since then recovery rates have been validated there together with other Landesbanks (see Chapter 5.9.2). The collateral guidelines establish what assets (e.g. real estate, moveable assets, receivables) and – particularly for foreign jurisdictions – which collateral instruments (e.g. mortgage, land charge, assignment) are recognised. In addition, the responsible front office division must ensure on a case by case basis that the individual collateral and associated collateral agreement meet requirements in terms of enforceability and recoverability. In the risk-relevant lending business, the recoverability of the individual collateral is reviewed for plausibility as part of the loan decision process.

The decision whether an asset or collateral instrument can be recognised as minimising risk is taken by a team of specialists from the BUs Credit Risk Management, Group Risk Management and Legal department.

5.10.3 Strategy and procedures for assessing and managing collateral

Valuation and administration of collateral is integrated into the process of managing and recognising credit risk reduction techniques. As SolvV is the basis for the collateral guidelines, collateral is only treated as reducing risk for the purpose of calculating capital requirements if all SolvV requirements are satisfied.

For each item of collateral to be offset against risk, an objective market value is determined. This is done on the basis of HSH Nordbank Group's Valuation Guideline through a process of review and determination by market-independent appraisers or a market-independent entity. The recoverability of an item of collateral is ensured by recognising it as reducing risk only up to the specific recovery rate for that collateral. The legal validity and enforceability of the collateral is ensured in the loan and collateral agreements. There is a standard instruction on regular monitoring and revaluation of collateral. Besides the annual review of collateral, there is a review and revaluation of the market value of the individual items of collateral every three years. The results of the annual monitoring can lead to a direct revaluation of the individual collateral in individual cases or for a segment. For certain types of collateral, there is an annual review and revaluation of the value (e.g. ships). Recognised collateral is documented and maintained in a central collateral system. This enables regular reporting to monitor and evaluate collateral. The recoverability of and options for realising an item of collateral are regularly reviewed as part of the regular credit monitoring process, and more frequently in the event of wide fluctuations in market value.

In the event of permanent impairment of collateral rights, e.g. impairment in value or a change in the legal position, additional collateral is sought and/or a monitoring file may be opened in accordance with the guidelines for exposure monitoring. In the event of a borrower's default, all collateral and possibly further collateral of a borrower unit involved are revalued. All relevant information on an item of collateral is documented and updated in the IT system. Only collateral which is recognised as compliant with the guidelines and accordingly maintained is retained in the HSH Nordbank management system.

Back office specialists are available for prompt and competent realisation of security in the event of a borrower's default. Experience with realising security is incorporated into optimising collateral management.

5.10.4 Material collateral

HSH Nordbank takes into account all the forms of collateral listed in SolvV (financial collateral, guarantees, physical collateral, other IRBA collateral) and netting agreements. Based on the portfolio and customer structure, essentially the following types of collateral are held by HSH Nordbank.

- Real estate and movable assets, e.g. ships, aircraft, railway wagons
- Receivables and rights
- Guarantees

In addition, securities, shareholder rights, gold and some credit derivatives serve as collateral. Collateral can only be taken into account in calculating LGD if its risk-reducing effect has not been taken into account in establishing a rating (PD). This means, for example, that a guarantee or assigned receivable which has already been taken into account in a rating tool or through the rating of the guarantor as the bearer of economic risk cannot in addition be netted against risk as collateral.

5.10.5 Guarantors and counterparties for credit derivatives and their rating

For a guarantee (or credit derivative) to be recognised as reducing risk there must be a current internal rating for the guarantor comparable with at least a Fitch or S&P BB- or Moody's Ba3.

Within HSH Nordbank Group, the main types of guarantors under these internal rules are guarantees by central governments, German local and regional administrative authorities, banks and parent companies with first class ratings. The main counterparties for credit derivatives are internationally active banks.

5.10.6 Market or credit cluster risk within collateral instruments

Management of potential cluster risks from eligible collaterals is done for portfolios at the level of the Bank as a whole, e.g. by reporting and monitoring these risks in the risk report. In addition, it is integrated into strategic planning and limiting by adding a further limit on the collateral typically associated with the business areas involved to the planning and limiting for typical business area related collateral (specifically tangible assets e.g. ships).

5.10.7 Total amount of secured CRSA and IRBA positions

The two following tables in accordance with Section 336 (1) No. 2 SolvV show the credit risk reduction techniques for CRSA and advanced IRBA, broken down by class of receivables. Securitisations are omitted as they are shown separately (see Chapter 5.7). In the case of CRSA, both financial and tangible security and guarantees are taken into account. Under advanced IRBA financial, tangible and other collateral is included in LGD calculation. Guarantees and credit derivatives can be taken into account either in LGD calculation or through PD substitution. Here, the secured part of the receivables is given the guarantor's PD. However, collateral taken into account in calculating the PD is not shown here. Due to the changes related to CRD II, life insurance is stated separately since the reporting date 31 December 2010. Life insurance is accounted for in accordance with Section 170 SolvV.

The figures in the following tables take into account the Sunrise Transaction. The figures excluding the effect of the guarantee are shown for information purposes in the Notes (Table 58 and Table 59).

Receivables class CRSA	Financial collateral 2010	Financial collateral 2009	Other and physical collateral 2010	Other and physical collateral 2009	Guarantees/derivatives 2010	Guarantees/derivatives 2009	Life insurance 2010	Life insurance 2009
Central governments	-	-	-	-	-	-	-	-
Regional governments	-	-	-	-	-	-	-	-
Other public sector entities	-	0	-	-	0	0	-	-
Multilateral development banks	-	-	-	-	-	-	-	-
International organisations	-	-	-	-	-	-	-	-
Banks	-	-	-	-	-	0	-	-
Collateralised Notes issued by banks	-	-	-	-	-		-	-
Companies	5	8	-	-	0	216	4	-
Retail banking	3	3	-	-	0	0	5	-
Items collateralised by real estate	-	-	61	70	-	-	-	-
Investment certificates	-	-	-	-	-	-	-	-
Equity holdings	-	-	-	-	-	-	-	-
Other items	-	-	-	-	-	-	-	-
Overdue items	25	4	24	9	-	-	1	-
Total	32	15	85	78	0	216	9	-

Table 37: Total amount of collateralised CRSA exposure values (without securitisations) in € m

Receivables class IRBA	Financial collateral 2010	Financial collateral 2009	Other and physical collateral 2010	Other and physical collateral 2009	Guarantees/derivatives 2010	Guarantees/derivatives 2009	Life insurance 2010	Life insurance 2009
Central governments	-	-	-	-	-	-	-	-
Banks	-	35	98	87	176	98	-	-
Retail banking	-	-	-	-	-	-	-	-
Equity holdings	-	-	-	-	-	-	-	-
Companies	316	425	5,448	3,833	265	326	8	-
Other assets not related to loans	-	-	-	-	-	-	-	-
Total	316	460	5,546	3,920	441	423	8	-

Table 38: Total amount of collateralised IRBA exposure values (without securitisations) in € m

6 MARKET RISK INCLUDING INTEREST RATE RISK

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

6.1 ORGANISATION OF MARKET RISK MANAGEMENT

The Management Board determines the methods and processes for measuring, limiting and steering market risk and budgets for an overall global limit percentage for market risks. Against the background of this upper loss limit, the risks of all business bearing market risk are limited by a dynamic system of loss and risk limits.

Market risk is actively managed directly in the Capital Markets Structuring & Trading and Group Treasury divisions. The Management Board was directly responsible in the year under review for selected, strategic positions. At the beginning of 2011, this overriding portfolio management function was transferred to the newly formed Asset-Liability Committee (ALCO). The market positions of the Restructuring Unit are also restricted through limits and monitored on a daily basis. Daily market risk reports regularly keep the Management Board and the trading divisions informed on the extent of existing market risks and current utilisation of limits.

An organisational division between market risk controlling, settlement and control on the one hand and the trading divisions responsible for the positions on the other is ensured at all levels in accordance with MaRisk. All major methodological and operative tasks for risk measurement and monitoring are consolidated in the Group Risk Management division.

Settlement and control, financial controlling and risk controlling for the Core Bank and the Restructuring Unit are managed by the corresponding divisions of the overall bank. The Restructuring Unit processes the positions allocated to it from the capital markets and credit investment businesses.

HSH Nordbank Securities S.A. was identified as a subsidiary to be included within the Group-wide market risk management. Risk limits are set and risks monitored centrally by HSH Nordbank AG.

6.2 MARKET RISK MANAGEMENT

Market risk measurement and limitation

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

The VaR is determined by the Bank using the historical simulation method. It is calculated for the entire Group based on a confidence level of 99.0% and a holding period of one day for a historical observation period of 250 equally weighted trading days.

The main market risks at HSH Nordbank are interest rate risk (including credit spread risk) and foreign exchange risk. In addition to these risk types, the VaR of HSH Nordbank also covers equity and commodity risk for both the trading book and the banking book. The individual market risk types are not restricted by separate limits. Limitation is applied within the VaR limit for the overall market risk of the Bank. Limits are set for the VaR for the different reporting entities for the purposes of managing market risk, whereas losses incurred are restricted through stop loss limits. There are clearly defined processes for limit adjustment and breach.

Where necessary, HSH Nordbank enters into hedging transactions to manage or reduce market risk in order to offset the impact of unfavourable market movements (e. g. with regard to interest rates, exchange rates) on its own positions. Derivative financial instruments in particular, such as interest rate swaps, are used as hedging instruments.

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

Market risk measurement enhanced

In the year under review, the risk measurement for credit spread risk was enhanced to complement the existing VaR methodology. The credit spread of a bond is a premium payable for the default risk of an issuer. The credit spread risk represents the risk that the value of a position will rise or fall due to a change in the spread. During the third quarter of 2010, credit spread risk on securitisation transactions, for which an approximate monthly calculation had been made since the end of 2009, was integrated into the daily VaR measurement and thus into the determination of economic capital required. Furthermore, the risk measurement for government bonds and Pfandbriefe was refined in June 2010. Differentiated spread curves are now applied in the calculation of the VaR and the profit and loss by country or collateral category respectively.

As part of the regular process for identifying basis risk, the Bank again analysed the overall portfolio in the year under review with regard to importance for the Bank. No significant changes were identified compared to the previous year. The swap positions in particular contain interest rate basis risk. The interest rate basis risk is defined as the potential loss of value that results from different payment frequencies and / or reference interest rates on the variable side of swaps. As part of the integration of interest rate basis risk into the daily measurement of market risk, the remaining professional work for the secondary currencies of HSH Nordbank (DKK, SEK) was completed in the reporting year. Technical implementation is planned for 2011.

At the end of 2010, work was commenced to incorporate into the internal management process the fair value adjustments (FVA), which have been calculated for financial statement purposes for several years. As a first step, the change in counterparty default adjustments, i. e. the measurement of counterparty risk on derivatives, was included in the calculation of the economic profit and loss. Other types of FVA are to follow in 2011.

Since the end of the year under review, we have also been measuring the market risk that arises on derivative positions from the change in the market's assessment of the creditworthiness of the counterparties. This is particularly relevant for very positive market values on derivatives. An appropriate measurement method was established in the course of the year 2010.

The incorporation into the market risk calculation of so-called smiles for volatilities is planned for 2011. For ease of simplification volatilities independent of the interest rate strike price have been assumed up to now for the risk calculation. The calculation will be based on volatility surfaces in the future. The improvement of the consideration of the right to cancel bonds in the market risk systems is an additional focus of the enhancement measures.

The VaR model used and constantly enhanced by the Bank contains all of the Bank's significant market risks in an adequate form.

Backtesting

The Bank performs daily backtests to verify the appropriateness of our VaR forecasts. On the assumption of unchanged positions, the daily profit and loss achieved in theory due to the market developments observed are compared with the VaR values of the previous day, which were forecasted using historical simulation. Based on the assumption of the confidence level of 99% applied by the Bank, up to four outliers indicate that the forecasting quality for market risks is satisfactory. With a total of four outliers in the year under review, the market risk model of the Bank is validated accordingly. The results of backtesting are taken into account in the ongoing development of our VaR methodology.

Stress tests

In addition to the limit-based management of the daily VaR, at least weekly stress tests are performed that analyse the effects of unusual market fluctuations on the present value of the Bank's positions. In doing so, the stress scenarios based on the risks specific to the economy, the Bank and the Bank's portfolios are varied.

The bank differentiates between historical/standardised and hypothetical stress scenarios on the one hand and risk-type specific and risk-type overlapping stress scenarios on the other. While the historical / standardised scenarios are constant and take into account correlations that actually occurred in the past in the case of risk-type overlapping stress tests, the hypothetical scenarios represent notional changes in the risk factors.

As part of the risk stress test a change in the risk factors is simulated under extremely unusual market conditions, e. g. by shifting or rotating the interest rate curve in the interest rate risk stress test. For special analyses of the interest rate risk of the banking book positions, the change in present value on interest rate shocks of +130 and − 190 basis points is continually determined. In doing so, the supervisory requirements for the determination of the effects of a sudden and unexpected interest rate change to positions held in the banking book are fulfilled (see Chapter 6.5).

Furthermore separate stress tests are performed for credit spreads, currencies, securities, commodities and volatilities, whereby standard shifts are used as a basis for the respective positions.

6.3 REPORTS ON MARKET RISK

Reporting on market risk of HSH Nordbank is integrated in the reports on overall risk (see Chapter 4.4). These are supplemented by special market risk reports (see Table 39).

Report	Recipient	Interval	Content	Objective
Monthly market risk report	CRO	Monthly	Market risk changes, analysis of market risks acc. to banking book/trading book, stress tests, back-testing, limit monitoring	Market risk reporting to the Management Board (where required with recommendations for action)
Market Risk Report to the Management Board	Management Board and Financial Market divisions	Daily	Market risk changes, analysis of market risks acc. to banking book/trading book, stress tests, back-testing, limit monitoring	Information of Management Board and trade, overview of risk and profit/loss, limit utilisation

Table 39: Reports on market risk

6.4 REGULATORY CAPITAL REQUIREMENTS FOR MARKET RISK

HSH Nordbank uses the prescribed Standard Approach for determining the required regulatory capital for market risk. The regulatory capital required as a result of transactions in the trading book on the reporting date is listed in Table 40.

	Regulatory capital required	
Market risk	2010	2009
Interest rate risk	273	348
Equity price risk	2	4
Currency risk	63	54
Commodity price risk	20	5
Other risk	-	-
Total	358	411

Table 40: Regulatory capital requirements for market risks in € m

6.5 INTEREST RATE RISK IN THE BANKING BOOK

Management of the interest rate risk in the banking book is part of market risk management. Interest rate risk is the potential loss of an open interest rate position as a result of a possible change in market or net present value of a stream of payments due to a potential change in yields or discount factors. Discount factors are taken from the corresponding interest rate curve. For single name bonds and CDS, credit spreads are also taken into account.

The interest rate risk in the banking book is modelled from the strategic holdings in the HSH Nordbank bank book without using model assumptions. There is no modelling of early loan repayments due to special repayment or termination rights or investor behaviour with deposits from customers. Where loans are agreed with optional components, existing termination rights are reported by the front office to Group Treasury for entry in the trading system. Risk measurement and stress testing are done by Group Risk Management based on the transactions entered in the trading and inventory systems.

In addition there is the special feature for interest rate risk in the banking book that management is handled by two units. The overall Managing board is responsible for the bank's ALCO – Portfolio and adjusts the strategic amount of interest rate risk at regular intervals. The interest rate risk for the bank book arising out of the Bank's client business (excluding Capital Markets Structuring & Trading clients) is managed by Group Treasury. Among other tasks it is responsible bundling interest rate risks and possibly transferring them for strategic reasons to Capital Markets Structuring & Trading to close the corresponding position.

The interest rate risks on the banking book are measured daily. Risk controlling has shown the interest rate risks in the banking book in the VaR histories since the start of 2007 separately. To calculate the VaR, a confidence level of 99%, a holding period of one day and a data history of 250 trading days are used.

Besides daily calculation of the interest rate risk in the course of the VaR calculation, HSH Nordbank also measures the interest rate risk for the group as a whole in the event of an interest rate shock. For the specific analysis of interest rate risks on banking book positions, the Bank uses net present value analysis, i.e. the net present value change due to defined changes in interest rates. HSH Nordbank does a substantial share of its transactions in foreign currencies, so that a breakdown by currency is relevant. The interest rate shocks for the major currencies are carried out and presented separately. Other currencies are immaterial for both the statement of financial position and the present value analysis, so they are not shown individually. The figures for the year under review have shown that HSH Nordbank Group would always lose significantly less than 20% of liable capital in the event of an interest rate shock of +130 and -190 basis points.

The effects of an interest rate shock of +130 and -190 basis points as at 31 December 2010 in accordance with Section 333 (2) SolvV are shown in Table 41.

The total amount of € 89 million / € -226 million represents the balance of changes in present value from the interest rate shocks in the case of the parallel move in yield curves in all currencies.

The present value effects of interest shocks determined in 2010 are not comparable to those of the previous year. They are not primarily due to changes in holdings, but rather to a revaluation of interest rate products which where migrated to a state of the art risk management system in order to correct previous weaknesses in valuation.

	Change in net present value			
	Interest rate shock +130 base points		Interest rate shock -190 base points	
Currency	**2010**	**2009**	**2010**	**2009**
€	79	-61	-228	99
USD	13	-14	5	57
CHF	0	7	0	5
JPY	5	1	-8	-1
GBP	3	-2	-11	0
DKK	-3	-4	3	5
Other	-8	-1	13	1
Total	**89**	**-74**	**-226**	**166**

Table 41: Interest rate risks in the banking book in € m

7 OPERATIONAL RISK

HSH Nordbank defines operational risk (OpRisk) as the risk of direct or indirect losses caused by the inappropriateness or failure of the internal infrastructure, internal procedures or staff or as a result of external factors (risk categories). This definition includes legal risk, reputation risk and compliance risk. Strategic risk is not included in operational risk.

HSH Nordbank considers operational risk controlling and the promotion of an appropriate risk awareness in the Group as an integral component of its management systems. This is particularly relevant given the dynamic business environment, the ongoing restructuring measures of the Bank, the limited options for transferring risk, together with the increased requirements of rating agencies and other market players.

In the year under review, a training session was held for employees of HSH Nordbank AG and selected subsidiaries by means of an E-Learning program to further increase the alertness of employees with regard to operational risk.

The internal splitting of the Bank into a Core Bank and a Restructuring Unit has no influence on the management of operational risk. The individual divisions within the Restructuring Unit are integrated into the Group-wide processes and methods for managing operational risk in the same way as are all relevant divisions in the Core Bank.

7.1 ORGANISATION OF OPERATIONAL RISK MANAGEMENT

HSH Nordbank has set up an independent central controlling unit to identify, analyse, evaluate and monitor operational risk. It is responsible for developing and supporting controlling instruments, providing expertise and advice on operational risk and the promotion of the risk awareness throughout the Group. Central risk controlling is also responsible for the independent reporting to the management units of the Bank that are responsible for managing risk.

Central controlling of operational risks is backed by a local network of experts. All divisions have OpRisk officers and OpRisk assistants who are responsible for maintaining the controlling instruments and who act as an interface between central risk controlling and the respective divisions. The OpRisk officers and OpRisk assistants receive training on their duties from central risk controlling.

All methods and procedures for controlling operational risk are also employed at the Bank's foreign branches.

The subsidiaries HSH Nordbank Securities S.A., HSH Real Estate Group, HSH Nordbank Private Banking S.A. and HSH Facility Management Holding AG have been identified as relevant and have been integrated in the Groupwide assessment of operational risk.

7.2 OPERATIONAL RISK MANAGEMENT

Operational risk can affect all products, processes and organisational units. For this reason, a functioning risk awareness is of central importance in order to be able to utilise the expertise of employees to identify operational risk.

As part of the realignment of the Bank, a substantial reduction in the number of employees is planned in addition to the associated staff restructuring under which employees were affected in 2010, particularly by organisational restructuring and job changes. The reduction in headcount planned for 2009 and 2010 was slightly exceeded in the year under review. As a result, there is the danger in some divisions that the upcoming tasks can only be performed with the required diligence to a limited extent. In order to counter the resultant operational risk, the Bank has introduced measures to curb high staff fluctuation, to manage the internal job market and to intensify external recruiting. This ensured that the positions relevant for meeting the regulatory and legal requirements and other key positions critical to the success of the realignment and risk management of the Bank, particularly in the Credit Risk Management, Group Risk Management, Restructuring, Compliance, Guarantee Management, NPNM and Internal Audit divisions, were filled in good time. In addition, the specific measures initiated in 2009 for improving the personnel situation with regard to the management of intensive and restructuring cases, both in the Core Bank and the Restructuring Unit, were also continued in the year under review.

Loss event database

The loss events arising from operational risk are consolidated into a central loss event database for the Bank and relevant subsidiaries. The loss events are recorded locally by the divisions affected and forwarded to central risk controlling. The central risk controlling unit checks the data, consolidates losses into collective losses, if applicable, and prepares analyses and reports. The results of the analyses of actual loss events allow us to derive preventative measures.

The central loss event database includes all loss events with a gross loss of at least € 2,500. A gross loss is the sum of losses that involve a cash outflow, lost earnings and consumption of internal resources. Furthermore unexpected income arising from operational risk from an amount of € 2,500 is also recorded in the loss event database, as loss events with a positive income for the Bank can also provide indications of, for example, procedural weaknesses. Classification of loss events leads to systematically analyse the causes of losses and therefore contributes indirectly to the identification of operational loss events.

HSH Nordbank participates in the exchange of operational loss event data 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.

Based on the experience of the participating institutions, a catalogue of risk categories of banking risk scenarios was developed and adopted in 2010. The scenario catalogue has already been implemented by HSH Nordbank as a basis for risk assessment in the annual risk inventory. Since 2011 the participating banks have also allocated all loss events involving a certain minimum amount of gross loss to a specific risk scenario. Thus, HSH Nordbank perspectively obtains an improved data base for the evaluation of risk scenarios and external comparisons.

Risk inventory

Since 2005, HSH Nordbank has carried out a risk inventory each year for the whole Group. Based on information about the risk situation of the divisions gained from this inventory, the reporting of operational risk to the management units is supplemented by forward-looking risk estimates to encourage the proactive management and monitoring of operational risk. The scenario catalogue developed by DakOR was expanded by HSH Nordbank to include internal scenarios and is now being used for the bottom-up collection of potential loss events. The individual scenarios are consolidated in core topics, e. g. reorganisation and outsourcing, and supplemented by a top-down analysis across divisions. Based on the risk inventory, scenario analyses are to be performed in individual cases for the purposes of assessing the danger presented by particularly serious operational risk events that are of particular importance with regard to establishing suitable measures.

Legal risk

In accordance with the SolvV, legal risk also falls under operational risk. The Legal division is responsible for managing these risks. In order to reduce, limit or prevent risk all divisions are given comprehensive legal advice by regularly trained staff. A structured process with clear requirements and responsibilities serves to ensure that the Bank's contracts and agreements are kept up-to-date.

Compliance risk

Compliance risk comprises legal and regulatory sanctions or financial losses caused by non-compliance with certain laws, regulations and guidelines, as well as organisational standards and codes of conduct. The Compliance department at HSH Nordbank is responsible for managing risks with regard to the German Securities Trading Act and related standards, fraud prevention, anti money laundering and international financial sanctions.

There has been a further increase in the compliance requirements on financial institutions. This is due firstly to new legal and regulatory requirements and secondly to compliance loss events in the area of international financial services. HSH Nordbank has responded to this by continuously developing its compliance system and taking current market standards into account.

The Code of Conduct summarises all behavioural requirements for compliance, which are set out in detail in internal instructions. It applies to all employees, managers and the Management Board of HSH Nordbank AG and is a mandatory part of the agreement of personal goals. By March 2010 all members of the Management Board, managers and employees had attended a Bank-wide training programme on the Code of Conduct. Special training sessions were standardised and expanded.

In 2010, the Bank received notification of suspicious cases of misconduct from the so-called "whistleblowing office" and forwarded these to the relevant internal and external units. Furthermore, the whistleblowing office is staffed by independent ombudsmen from BDO Deutsche Warentreuhand Aktiengesellschaft Wirtschaftsprüfungsgesellschaft and enables anonymous reporting of suspicious cases.

During the year under review, several enhancements were made with regard to the individual compliance topics. These include the gradual review of the older existing portfolio of HSH Nordbank with regard to any money laundering risk. This was continued and specific high risk cases were submitted to the Management Boards for their decision. The new requirements with regard to financial sanctions, investor protection and investment consulting have been implemented in good time. The implementation of the Minimum Requirements for the Compliance Function (MaComp) issued by the supervisory authority in June 2010 was monitored as part of a project.

7.3 REPORTS ON OPERATIONAL RISK

Reporting on operational risk of HSH Nordbank is integrated in the reports on overall risk (see Chapter 4.4). Furthermore the management level is provided with special reports on operational risk and loss events on a regular basis. These are listed in Table 42.

Report	Recipient	Interval	Contents	Objective
Report on risk inventory	Overall Management Board as as well as BU heads, heads of foreign branches and subsidiaries	Annually	Information on identified potential loss incl. the management steps decided on	Identification of operational potential loss and information on management steps decided on
Report to persons responsible for interdepartmental issues	BU HR, IT, Legal as well as HSH Facility Management Holding AG	Quarterly	Description of all loss events and management measures decided for the pertinent interdepartmental issues: e.g. BU HR will receive all information on losses incurred in relation to employees	Creation of transparency, raised risk awareness and information to implement measures to reduce and avoid risk
Report on operational risks	BU heads, heads of foreign branches and subsidiaries	Quarterly	Description of all loss events reported by the field of responsibility incl. the management measures decided on	Creation of transparency, explicit confirmation of adressees regarding the comprehensiveness of all recorded loss events, raised risk awareness and information to implement measures to reduce and avoid risk
Report of operational loss events to the members of the Management Board	Board members	Monthly	Description of all loss events reported in the relevant field of responsibility incl. the management measures decided on	Creation of transparency, raised risk awareness and information to implement measures to reduce and avoid risk

Table 42: Reports on operational risk

7.4 REGULATORY CAPITAL REQUIRED FOR OPERATIONAL RISK

HSH Nordbank applies the Standardised Approach in order to determine the regulatory capital required for operational risk. .On the date of reporting the Group had a regulatory capital requirement to the amount of € 308 million.

Operational risk	Regulatory capital required 2010	Regulatory capital required 2009
According to Standardised Approach	308	261
Total	**308**	**261**

Table 43: Regulatory capital requirements for operational risk in € m

8 LIQUIDITY RISK

HSH Nordbank divides its liquidity risk into insolvency risk and liquidity maturity transformation risk. The 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 extent desired. Liquidity maturity transformation risk refers to the risk that a loss will result from a mismatch in the contractual maturities of assets and liabilities, the so-called liquidity maturity transformation position, and from the change in the Bank's refinancing surcharge. Liquidity maturity transformation risk is also a component of our risk-bearing capacity concept. The Bank uses various instruments to measure, manage and limit its liquidity risk.

8.1 ORGANISATION OF LIQUIDITY RISK MANAGEMENT

Liquidity management is the responsibility of the Group Treasury division which assumes this task as a cross-divisional banking function. The splitting of the Bank into a Core Bank and a Restructuring Unit has no impact on the management of liquidity risk. The individual divisions within the Restructuring Unit are integrated into the processes and methods for managing liquidity risk in the same way as are all relevant divisions in the Core Bank. The objective of liquidity management is to ensure the solvency of the Bank at all times, in all locations and in all currencies. Group Treasury is also responsible for funding and marketing. The Group Risk Management division is responsible for the methods used to measure and limit liquidity risk within the Group. In addition it measures risk and monitors limits as part of the daily reporting of liquidity risk. This supports Group Treasury in managing liquidity for all time buckets and enables it to counter possible risks at an early stage.

HSH Nordbank Securities S.A. as well as, since the end of 2010, HSH Nordbank Private Banking S.A. and the HSH Real Estate Group are integrated as relevant subsidiaries into the Group-wide examination of liquidity risk.

The Bank has a contingency plan which contains a catalogue of measures and regulated procedures and responsibilities should a liquidity crisis occur. We have now also incorporated early warning indicators as part of the enhancement of the contingency plan.

Our Liquidity Policy defines the basic parameters of the Group in dealing with liquidity and the associated risks. For example, responsibilities and processes are defined in this policy, the measurement, monitoring and management of liquidity risk described and the risk tolerance of the Bank for dealing with liquidity risk specified.

8.2 LIQUIDITY RISK MANAGEMENT

Measurement of liquidity risk

The transactions of the Bank impacting liquidity are converted into cash flows and the inflows and outflows allocated to time buckets (liquidity development report) for the purposes of measuring insolvency risk or funding requirements. The difference between inflows and outflows represents a liquidity surplus or deficit (gap) in the relevant time buckets. As a measure of insolvency risk the individual gaps for 1 to 14 days are used to show concentrations of outflows and the cumulative gaps from 1 day to 12 months to consider future liquidity requirements. They are compared to the liquidity potential which is applied to close the cumulative gaps of the individual time buckets and consequently represents the limit for insolvency risk.

Liquidity development reports are prepared daily at the level of the Group, Overall Bank, foreign branches and relevant subsidiaries. In addition to the total business recorded in the statement of financial position, loan commitments already granted, guarantees, pre-value dated transactions and other off-balance sheet transactions are incorporated in the report. In order to better consider economic maturities flow scenarios are used for some items. In so doing any possible residual amounts from deposits and current accounts as well as the time to liquidate assets and the amounts, for example, are modelled conservatively as a matter of principle. These liquidity development reports reflect the current market situation as a base scenario (normal case assessment). In addition to calculating the liquidity development report in euro equivalents, a separate liquidity development report is prepared daily for all US dollar transactions. This ensures that our US dollar position is adequately managed.

In addition to the normal case liquidity development report, which is compiled on the assumption of business developments in a normal market environment, the Bank also compiles the results of a market liquidity stress test on a daily basis in the form of a stressed liquidity development report (stress case assessment) in order to reflect critical market developments. The stress case includes, for example, difficult funding conditions and additional cash flows under stress assumptions.

HSH Nordbank has been quantifying its liquidity maturity transformation risk since the beginning of 2008 by means of a value-at-risk approach. The liquidity value at risk (LVaR) is calculated using historical simulation (confidence level 99.9%) of the liquidity spread and its present value effect on transactions, which would be necessary theoretically in order to immediately close the current maturity transformation position. In doing so, it is assumed that these hypothetical close-out transactions could actually be effected in the market and that full funding is therefore possible.

Limiting and monitoring liquidity risk

Limits are set for the individual gaps as well as the cumulative gaps for the first 14 days as part of insolvency risk management. Furthermore, limits are set for cumulative gaps for numerous other time buckets up to 12 months.

Insolvency risk is in principle limited by the ability of HSH Nordbank to exhaust its total liquidity potential. This liquidity potential comprises different elements, the total of which represents the total limit. The liquidity potential (limit) represents the respective ceiling for cumulative gaps of individual maturities and is composed of a securities portfolio held as a crisis precaution measure (crisis liquidity), further liquid securities and promissory Notes, according to how liquid they are, unsecured funding options, secured funding potential from the issue of Pfandbriefe and commercial loans eligible for refinancing with central banks. In the year under review, the limit was expanded to include other components, e. g. the plans for the winding down of the portfolio within the realignment of the Bank are now reflected in the limit based on a conservative approach. Given the market situation, the unsecured short-term funding potential has been reflected more precisely since 2010 and, as a result, more restrictively in the liquidity potential through the separate assessment of the prolongation ratios of banks and nonbanks. The components of the liquidity potential are monitored continuously and validated in accordance with internal minimum requirements. Safety buffers and risk discounts were incorporated into the limits in order to keep the probability of full utilisation or overdrawing the limits as low as possible. These individual discounts are, for example, haircuts or other safety margins that reflect the uncertainty about the future development of the respective limit component.

Group Risk Management calculates and monitors limit utilisation daily and reports the results to the Management Board and Group Treasury. If limits are exceeded, Group Treasury determines and implements appropriate measures and their implementation is monitored by Group Risk Management.

The liquidity value-at-risk for the liquidity maturity transformation risk is determined each month by Group Risk Management and reported to the Management Board and management responsible for it. Limits are set at Group level and are an integral part of the risk-bearing capacity concept.

Group Risk Management informs the Management Board and the responsible management staff on a monthly basis in aggregate form with regard to the overall assessment of the liquidity situation of the Group. In addition to information on the market and funding situation, this report also contains in particular limit utilisations in the normal case and stress case, as well as in stress scenarios for insolvency risk.

An overview of the reports on liquidity risks is shown in Chapter 8.3 in Table 44.

Liquidity management

The Bank prepares a structural liquidity plan for the strategic management of the liquidity resource over the long-term. The internal liquidity committee is used, among other things, to manage liquidity over the short-term, whereby it makes decisions on a weekly basis with regard to relevant upcoming outflows and new transactions. The basis for decision-making is, among other things, the structural liquidity development report, which is updated regularly and is prepared in a manner consistent with the Bank's business planning.

The liquidity buffer on our securities and loans (collateral pool) was also managed and enhanced by Group Treasury in 2010 in order to utilise the potential for secured funding in the best possible manner.

Backtesting

In our backtesting we review the modelling of products with stochastic cash flows in the liquidity development report on the basis of statistical evaluations of historical cash flows. The selection of the relevant products is based on the product volume and its risk content in terms of uncertainty in previous modelling. In the year under review, we have carried out backtesting for numerous products, e. g. overdraft facilities, demand deposit / savings deposits, cash collateral for OTC derivatives, early redemption of own issues and promissory Notes, irrevocable loan commitments / liquidity facilities and rollover loans. Furthermore backtesting is performed on funding potential and the methodology applied in taking account of new lending business, prolongations and repayments.

In October 2010, we enhanced the parameters for measuring and setting limits for insolvency risk on the basis of the knowledge obtained from regular backtesting and the statistical analyses of the methods. Overall, the adjustments made resulted in a higher utilisation of the liquidity potential in the normal case and a lower utilisation in the stress case.

Stress tests

Our regular stress tests for insolvency risk include unusual scenarios and their impact on the liquidity situation of the Group in the risk assessment. When determining these scenarios, the risk and significant parameters were determined for all types of transactions included in the liquidity development report, which change the cash flow profile in the respective stress case. For example, inflows are lower or occur later or outflows are higher or occur earlier than expected.

The selection of our stress tests is the result of an analyis of historical events and hypothetical models. The knowledge obtained on the rating downgrade of HSH Nordbank in 2009 was also incorporated into the modelling or the parameter structure. Within the different stress modelling market specific scenarios (e. g. global recession) and institution specific scenarios (e. g. rating downgrade of HSH Nordbank AG) are assessed on the basis of assumed critical market developments. In each of these scenarios it is assumed that new lending business will continue to some extent and that loans and advances to customers now maturing must be extended and refinanced on an increasing basis while the rollover of liabilities is partially cut back or is quite impossible and as a result a funding gap is created. Furthermore increased drawdowns on loan commitments issued and the early redemption of own issues and securitised liabilities are incorporated in the modelling. The stress test results are reported to the Management Board and Group Treasury on at least a monthly basis.

In addition to the previous calculations performed, we have developed in the year under review a US dollar stress test, which is applied to the normal case liquidity development report and simulates an appreciation in the US dollar affecting the US dollar cash flows and the cash collateral for US dollar derivatives. The stress factor for the appreciation is determined based on an analysis of the historical movement of the US dollar / euro exchange rate.

As part of the enhancements, we have also developed in the year under review a stress test for the liquidity maturity transformation risk. This stress test analyses how the LVaR moves on increasing liquidity spreads. The change in the liquidity spread is determined from an analysis of the historical movement for the purposes of deriving the scenario parameters. The stress LVaR serves as an indicator for the sensitivity of the LVaR to an increase in the spread / liquidity costs.

Risk concentrations

Risk concentrations occur in liquidity risk in several ways. Concentrations of both asset and liability products can increase liquidity risk. In addition to the existing management process for concentrations of asset products, HSH Nordbank has developed a monitoring system for concentrations of liability products. Special emphasis is placed on deposits that are analysed and reported on with regard to the depositor structure (investor, sectors), maturities (original and residual maturities) and currencies.

Various quantitative measures (e. g. concentration curve, Herfindahl index and relationship ratios) are calculated for the purposes of analysing risk concentrations. Furthermore, not only a simple structure analysis is performed but emphasis is placed rather on the risk content in order to derive efficient management incentives from the quantitative measures in combination with a qualitative discussion. For example, the residual maturities of deposits together with historically derived prolongation ratios, which also apply in the liquidity development report, are reflected in the analysis of the largest depositors.

In addition to the analysis of the depositor structure, liquidity concentrations are examined with regard to macroeconomic factors. This identified a strong dependency of the liquidity situation on the movement in the US dollar due to the large amount of US dollar assets that are refinanced through cross-currency swaps among other things. In the course of the euro crisis, the increase in the cash collateral to be provided for the currency derivatives represented a burden on liquidity halfway through the year 2010. For the purposes of analysing the dependency on the US dollar, sensitivity analyses are therefore carried out regularly for cash collateral. In addition a US dollar stress test of the liquidity development report is performed.

Liquidity position stabilised further

Further normalisation was initially observed in the money and capital markets at the start of 2010. However, uncertainty surrounding high budget deficits in particular in several Southern European countries and the associated weakness in the euro led to higher utilisation of the liquidity potential from April 2010 onwards. Furthermore, the above-plan prolongations in the lending business also had an initial adverse impact on the liquidity situation of HSH Nordbank. As the year progressed, the temporary high utilisation of the liquidity potential halfway through the year was significantly reduced by the reporting date through measures initiated by the Bank and the more stable euro against the US dollar.

In the course of the year we have used the tender transactions recently offered by the central banks just on a small scale. The volume amounted to € 150 million at the end of 2010. The liquidity received from the ECB in 2009 from the one year tender transactions in the total of approx. € 7.7 billion did not need to be replaced on maturity by follow-up tender transactions within the reported year.

The following measures were taken in the year under review in order to ensure a sufficient liquidity situation for the Group:

- Greater efforts to attract long-term funding through, among other things, increase in funds raising at savings banks and to retail customers
- Growth in sometimes large volume funding through private placements
- Increase in the cover pool and rating of the mortgage cover pool by Moody's with the top grade Aaa
- Floating of covered benchmark issues, e. g. issue of a three year public sector Pfandbrief
- Identification of further assets (e. g. commercial loans) eligible for refinancing with central banks for the collateral pool and depositing at the corresponding central banks.
- Measures to increase volume of customer deposits
- Close management of new business and prolongations
- Winding down of assets, e. g. from the credit investment portfolio.

Overall, the liquidity situation of HSH Nordbank has been stable in the reporting period through the above-mentioned measures and market developments. The long-term funding obtained is ahead of plan with a simultaneous stable movement in the deposit level. Access to capital markets remains limited so that future funding and the Bank's rating continue to be significant challenges.

Liquidity ratio of HSH Nordbank AG

The regulatory management parameter for liquidity risks is the liquidity ratio defined by the German Liquidity Regulation. With values between 1.44 and 2.01, our liquidity ratio remained above the regulatory minimum value of 1.0 at all times throughout the reporting year. The average value for 2010 was 1.72 (previous year: 1.66).

8.3 REPORTS ON LIQUIDITY RISK

In general, liquidity risk reporting of HSH Nordbank is embedded in the reports on overall risk (see Chapter 4.4). Furthermore regular special reports on liquidity risk are compiled; these have been summarised in Table 44.

Report	Recipient	Interval	Contents	Objective
Monthly group liquidity risk report	Management Board BUs Group Treasury, Group Risk Management, Internal Audit, Legal division, Finance	Monthly	Management summary incl. risk evaluation, central HSH liquidity ratios, insolvency risk normal- and stress case, stress testing, USD LAB normal and stress case, liquidity maturity transformation risk normal and risk case, risk concentration deposits, analyses	Regular information to the Management Board, risk calculation / limit utilisation and management information
Daily liquidity report	Management Board BUs Group Treasury, Group Risk Management	Daily	Insolvency risk normal case (daily) and stress case (weekly), new business funding, market and HSH intenral indicators, analyses	Regular information to the Management Board, risk calculation / limit utilisation and management information
Daily group liquidity risk report	BUs Group Treasury, Group Risk Management and Internal Audit	Daily	Insolvency risk normal case (daily) and stress case (weekly), liquidity gap anaylsis, limit calculation, analyses	Ongoing management information, risk calculation/limit utilisation and management information
Daily group report on liquidity risk in USD	BUs Group Treasury and Group Risk Management	Daily	Insolvency risk USD positions, liquidity gap analysis, analyses	Ongoing management information, risk calculation and management information

Table 44: Significant reports on liquidity risk

9 STRATEGIC RISK

Strategic risk is the risk of a 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 was successfully continued during the year under review. The strategic risk of the Bank was further reduced in the year under review through concentrating on the core business fields, the separation and active winding down of risk- bearing and non-strategic portfolios in the Restructuring Unit, the consolidation of the international network of locations together with the sale of numerous equity holdings.

Risk management in the Bank was also refined during the year under review and risk systems were continuously improved. For instance, an efficient lending decision process with strengthened competencies and responsibilities was introduced into the back office as a result of the implementation of a risk-oriented approach, the loan and collateral management function of the Bank was centralised and the entire CRO sector was reorganised.

10 NOTES

10.1 CONSOLIDATION MATRIX

Type of company / company		Treatment under supervisory law: Consolidation – Full	Consolidation – Proportional	Deduction method	Risk-weighted (equity holding/SPV	Consolidation under IFRS: Full	at-equity
CI	HSH Nordbank Private Banking S. A.	X				X	
CI	HSH Nordbank Securities S.A.	X				X	
FSI	DAL GmbH & Co. KG		X				
FSI	HSH N Financial Securities LLC	X					
FSI	Int. Fund Services and Asset Management S.A.	X				X	
FSI	Nobis Asset Management		X				
FE	AGV Irish Equipment Leasing No. 1 unlimited	X					
FE	AGV Irish Equipment Leasing No. 7 Ltd.		X				
FE	Alchemy Investment Plan (HLB) LP	X					
FE	Alchemy Plan (HSH) LP	X					
FE	Alida Grundstückverwaltungs- GmbH		X				
FE	Alliance HC I Limited Partnership	X					
FE	Alliance HC I Mezz Limited Partnership	X					
FE	Alliance HC III GP, L.L.C	X					
FE	Alliance HC III Saybrooke GP, L.L.C.	X					
FE	Alliance HC III Verandahs GP, L.L.C.	X					
FE	Amentum Capital Ltd.	X					
FE	Arbutus GmbH	X					
FE	Asian Capital Investment Opportunity Ltd.	X					
FE	AUGUR Financial Oppotunity SICAV		X				
FE	AVUS Fondsbesitz und Management GmbH	X					
FE	AVUS Grundstücksverwaltungs- GmbH	X					
FE	Azur Grundstücksverwaltungsgesellschaft mbH & Co LBSH KG			X			
FE	Belgravia Shipping Ltd.				X		X
FE	BIG Anteilsverwaltungs- GmbH		X				
FE	BIG BAU Investitionsgesellschaft mbH			X			
FE	Brinkhof Holding Deutschland GmbH	X					
FE	BTG Beteiligungsgesellschaft Hamburg GmbH			X			
FE	BTO Grundstücksvermietungs- GmbH & Co. Verwaltungs- KG	X					
FE	Burgville Investments Ltd.	X					
FE	BuWi Beteiligungsholding GmbH	X				X	
FE	Capcellence Dritte Fondsbeteiligung GmbH i.G.	X					
FE	Capcellence Erste Fondsbeteiligung GmbH i.G.	X					
FE	Capcellence Private Equity Beteiligungen GmbH & Co. KG	X				X	
FE	Capcellence Vintage Year 05/06 Beteiligungen GmbH & Co. KG	X				X	
FE	Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG	X				X	
FE	Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG	X				X	

Type of company / company		Treatment under supervisory law: Consolidation Full	Consolidation Propor-tional	Deduction method	Risk-weighted (equity holding/SPV	Consolidation under IFRS: Full	at-equity
FE	Capcellence Vintage Year 09 Beteiligungen GmbH & Co. KG	X				X	
FE	Capcellence Vintage Year 10 Beteiligungen GmbH & Co. KG	X				X	
FE	Capcellence Zweite Fondsbeteiligung GmbH i.G.	X					
FE	CHIOS GmbH	X				X	
FE	Credaris Portfolio Management GmbH	X					
FE	DAL Geschäftsführung GmbH		X				
FE	DMS Beteiligungs GmbH	X					
FE	Dolana Grundstücksverwaltungsges. mbH & Co			X			
FE	Dol-Zircon Grundstücks Verwaltungs- GmbH & Co. Obj. Hamburg KG		X				
FE	Dynamene GmbH	X					
FE	Ealing Investments Ltd.	X				X	
FE	Einkaufs-Center Plovdiv G.m.b.H. & Co. KG	X					
FE	Endor 6 Beteiligungs- GmbH & Co. KG	X					
FE	Endor 7 Beteiligungs- GmbH & Co. KG	X					
FE	Endor 8. Beteiligungs- GmbH & Co. KG	X				X	
FE	Equilon GmbH	X				X	
FE	European Capital Investment Opportunity Fund Ltd.	X					
FE	Fastlane 1. Real Estate GmbH	X					
FE	Fastlane 2. Real Estate GmbH	X					
FE	Fay GmbH	X					
FE	Feronia GmbH	X					
FE	gardeur Beteiligungs- GmbH	X					
FE	GBVI Gesellschaft zur Beteiligungs-Verwaltung von Immobilien mbH & Co. KG	X					
FE	GLB GmbH & Co. OHG		X				
FE	Godan GmbH	X					
FE	Gropius-Haus GmbH	X					
FE	Hamburgische Seefahrtsbeteiligung "Albert Ballin" GmbH & Co. KG		X				
FE	Harmonia HSH Beteiligungsgesellschaft mbH (vorher: BTA HSH Beteiligungsgesellschaft Alstercampus mbH)		X				
FE	H/H Capital Management GmbH		X				
FE	HGA Aviation Co-Invest I GmbH & Co. KG		X				
FE	HGA Bavaria Office GmbH	X					
FE	HGA/Colonia CareConcept 1 Fondsgesellschaft mbH & Co. KG	X					
FE	HGA Fondsbeteiligungs- GmbH	X					
FE	HGA/Hamburg Bavaria Office GmbH & Co. KG	X					
FE	HGA Mikado I AG & Co. KG	X					
FE	HGA Mitteleuropa III GmbH & Co. KG	X					
FE	HGA Mitteleuropa IV GmbH & Co. KG	X					
FE	HGA Mitteleuropa V GmbH & Co. KG	X					
FE	HGA NEW Office CAMPUS-KRONB. GMBH & CO.KG, Hamburg		X				

Type of company / company		Treatment under supervisory law: Consolidation – Full	Consolidation – Proportional	Deduction method	Risk-weighted (equity holding/SPV	Consolidation under IFRS: Full	at-equity
FE	HGA USA V GmbH & Co. KG	X					
FE	HGA USA VI GmbH & Co. KG	X					
FE	HSH Capitalpartners GmbH	X					
FE	HSH Corporate Finance GmbH	X				X	
FE	HSH Facility Management Holding AG	X					
FE	HSH Invest GmbH	X					
FE	HSH N Auffang- und Holding GmbH & Co. KG	X					
FE	HSH N Composits GmbH	X				X	
FE	HSH N Finance (Guernsey) Ltd.	X				X	
FE	HSH N Funding I Ltd.	X				X	
FE	HSH N Funding II Ltd.	X				X	
FE	HSH N Quartett I GmbH & Co. KG	X					
FE	HSH N Quartett II GmbH & Co. KG	X					
FE	HSH N Residual Value Ltd.			X			
FE	HSH Private Equity GmbH	X				X	
FE	HSH Quartett III GmbH & Co. KG	X					
FE	HSH Real Estate AG	X				X	
FE	HSH Real Estate Asia Pacific Pte. Ltd.	X					
FE	HSH Real Estate Care Invest GmbH	X					
FE	HSH Real Estate Lux S.à.r.l.	X					
FE	HSH Real Estate Treuhand GmbH	X					
FE	HSH Real Estate US Invest LLC.	X					
FE	HSH RE Beteiligungs- GmbH	X					
FE	HSH RE 2. Beteiligungs GmbH	X				X	
FE	HSH RE 3. Beteiligungs GmbH	X				X	
FE	HSH RE 4. Beteiligungs GmbH	X				X	
FE	HSH RE 5. Beteiligungs GmbH	X				X	
FE	HSH RE 6. Beteiligungs GmbH	X				X	
FE	HSH RE 7. Beteiligungs GmbH	X				X	
FE	HSH Swift Capital Partners Institutional 2007 S.A.	X					
FE	IHG Inamori Beteiligungs GmbH & Co. KG	X					
FE	Indian Infrastructure Development Seed Asset Limited	X					
FE	Jantar GmbH	X				X	
FE	Kaplon GmbH & Co. KG	X					
FE	Kipper Corporation	X					
FE	Kontora GmbH	X					
FE	Lamatos GmbH	X					
FE	LB Invest GmbH	X					
FE	Leashold Verwaltungs- GmbH & Co. KG	X				X	
FE	Marc Marco Polo Ventures GmbH & Co. KG	X					
FE	Mesitis GmbH	X				X	
FE	Milestone Apartments HC GP Inc.	X					
FE	Minimoa GmbH	X				X	
FE	Must 4 GmbH & Co. KG	X					

Type of company / company		Treatment under supervisory law				Consolidation under IFRS	
		Consolidation		Deduction method	Risk-weighted (equity holding/SPV		
		Full	Propor-tional			Full	at-equity
FE	NBV Beteiligungs GmbH, Hamburg			X			
FE	Neptune Finance Partner S.à.r.l.	X				X	
FE	Neptune Finance Partner II S.à.r.l.	X				X	
FE	Neptune Ship Finance (Lux.) S.à.r.l.	X					
FE	Neptune Ship Finance (Lux.) S.à.r.l. & Cie, SECS	X				X	
FE	Niederelbe Beteiligungs GmbH	X					
FE	Northern Diabolo (Holdings) S.à.r.l.		X				
FE	NSH Finance (Luxembourg) S.A.			X			
FE	Nubes GmbH	X					
FE	PL Projekt Anlagen Leasing Beteiligungsgesell-schaft- GmbH & Co.		X				
FE	PL Projekt - Anlagen Leasing Beteiligungsge-sellschaft- GmbH		X				
FE	Pluton Grundstücksverwaltungs- GmbH & Co. KG		X				
FE	Pregu GmbH	X				X	
FE	Prime 2006-1 Funding LP			X			
FE	PRIME 2 LP			X			
FE	Qundis Management GmbH	X					
FE	Railpool Holding GmbH & Co. KG		X				
FE	Real Estate Venture Capital Fonds 1 GmbH	X					
FE	RELAT Beteiligungs GmbH & Co Vermiertungs-KG	X					
FE	Resparcs Funding I Limited Partnership [1]	X				X	
FE	Resparcs Funding II Limited Partnership [1]	X				X	
FE	SB-HSH Seed Holding Limited	X					
FE	Semos 4. Verwaltungs GmbH IV	X					
FE	Solar Holdings S.à.r.l.	X				X	
FE	SLK GmbH für Immobilien Leasing & Co. KG Obj. Berlin-Pohlst.		X				
FE	Sotis S.à.r.l. , Luxemburg	X				X	
FE	Spheros Management Holding GmbH		X				
FE	Swift Capital 1 Europäische Fondsbeteiligungs-GmbH & Co. KG	X				X	
FE	Tapes GmbH & Co. KG			X			
FE	Terranum "die Zweite" AG & Co. KG	X					
FE	Terranum Gewerbebau Verwaltungs- GmbH	X					
FE	Teukros Canada Inc. Halifax	X					
FE	Teukros GmbH	X					
FE	Thestor GmbH	X				X	
FE	Turis 1. Beteiligungs GmbH & Co. KG	X					
FE	Turis 2. Beteiligungs GmbH & Co. KG	X					
FE	Turis 3. Beteiligungs GmbH & Co. KG	X					
FE	USTXVII Beteiligungs GmbH	X					
FE	Verwaltungsgesellschaft Gartenstadt Wismar	X					
ABSE	GmbH Altstadt Grundstücksgesellschaft			X			
ABSE	Unterstützungs- Ges. d. Hamburgischen Landesbank GmbH	X					
Oth	Adessa Grundstücksverwaltungsgesellschaft mbH & Co. Vermietungs- KG [1]				X	X	

	Treatment under supervisory law				Consolidation under IFRS	
	Consolidation					
Type of company / company	Full	Propor-tional	Deduction method	Risk-weighted (equity holding/SPV	Full	at-equity
Oth CPM Luxemburg S.A. [1]				X	X	
Oth CPM Securitisation Fonds S.A. [1]				X	X	
Oth DEERS Green Power Development, SL				X	X	
Oth HAMBORNER REIT AG [2]				X		X
Oth HGA Capital Grundbesitz und Anlage GmbH				X	X	
Oth LB Immo Invest GmbH	X				X	
Oth Northern Blue 2009 S.A. [1]				X	X	
Oth Plato No. 1 S.A.				X	X	

Table 45: Consolidation matrix

[1] Special Purpose Vehicle [2] On 24 February 2011 the HSH Nordbank Group sold its shares in Hamborner REIT AG

CI: Credit institution (Section 1(1) German Banking Act)

FSI: Financial services institution (Section 1(1a) German Banking Act)

FE: Financial enterprise (Section 1(3) German Banking Act)

ABSE: Ancillary banking services enterprises (Section 1(3c) German Banking Act)

Oth: Other

10.2 ALTERNATIVE CALCULATIONS WITHOUT TAKING THE GUARANTEE FACILITY INTO ACCOUNT

	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Exposure value (total)	105,859	121,463	3,754	6,236	2,339	4,181	19,078	20,959	7,998	8,796

Table 46: Exposure values by risk-bearing instrument in € m (alternative calculation without taking the guarantee facility into account)

	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
Main region	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Western Europe	84,999	97,722	3,157	5,205	1,690	3,049	17,526	18,455	6,236	6,933
North America	10,116	12,488	434	686	448	547	1,170	1,625	1,338	1,522
Asia Pacific Region	4,709	4,861	95	187	83	456	95	394	145	91
Latin America	608	927	12	66	12	16	36	179	5	7
Central and Eastern Europe	3,363	3,777	17	66	46	49	124	228	168	151
Middle East	1,372	1,157	10	20	60	60	0	0	105	93
African countries	235	221	29	2	0	4	3	0	-	0
Int. Organisations	125	0	0	0	-	0	123	73	-	0
Other	332	310	-	3	-	0	-	4	-	0
Total	105,859	121,463	3,754	6,236	2,339	4,181	19,078	20,959	7,998	8,796

Table 47: Exposure values by main region in € m (alternative calculation without taking the guarantee facility into account)

	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
Main sector	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Credit institutions	7,534	10,696	67	167	52	752	9,881	10,669	2,497	3,296
Other financial institutions	5,350	6,687	317	480	448	760	1,248	1,742	650	373
Public sector	10,871	14,908	170	281	108	165	6,136	5,800	357	343
Private households	3,126	3,182	55	67	21	23	-	0	50	52
Properties and flats	21,164	22,842	271	485	227	253	-	50	1,017	918
Shipping	28,725	27,439	647	1,177	177	409	531	568	1,424	1,407
Industry	11,978	14,926	1,097	2,102	894	1,190	52	131	498	539
Trade and transport	9,030	9,914	502	703	303	514	22	134	506	577
Other service activities	7,855	10,666	387	774	108	115	1,190	1,864	986	1,274
Other	225	203	241	0	1	0	17	0	11	18
Total	105,859	121,463	3,754	6,236	2,339	4,181	19,078	20,959	7,998	8,796

Table 48: Exposure values by main sector in € m (alternative calculation without taking the guarantee facility into account)

Contractual residual term	Loans		Loan commitments		Other non-derivative off-balance sheet assets		Securities		Derivative instruments	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
≤ 1day	4,178	5,482	130	208	9	36	76	112	0	0
> 1 day ≤ 3 months	5,836	7,835	229	384	209	341	1,675	1,513	91	100
> 3 months ≤ 6 months	1,707	2,732	121	202	16	119	522	761	55	52
> 6 months ≤ 1 year	5,950	6,325	513	758	311	422	1,201	823	301	215
> 1 year ≤ 5 years	35,305	38,317	1,929	3,149	731	1,423	9,123	10,185	1,748	1,902
> 5 years	52,884	60,772	831	1,534	1,063	1,840	6,480	7,564	5,802	6,527
Total	105,859	121,463	3,754	6,236	2,339	4,181	19,078	20,959	7,998	8,796

Table 49: Exposure values by contractual residual term in € m (alternative calculation without taking the guarantee facility into account)

Risk weighting in %	CRSA before credit risk reduction		CRSA after credit risk reduction		Advanced IRBA approach	
	2010	2009	2010	2009	2010	2009
0	308	198	372	269	-	-
10	196	-	196	-	-	-
20	213	292	242	461	-	-
35	-	-	705	1,025	-	-
50	19	17	56	209	-	-
70	-	-	7	-	-	-
75	1,222	1,468	499	638	-	-
90	-	-	-	-	-	-
100	7,647	11,214	6,707	9,759	-	-
115	-	-	-	-	-	-
150	849	1,577	725	1,487	-	-
190	-	-	-	-	185	112
200	-	-	-	-	-	-
250	-	-	-	-	-	-
290	-	-	-	-	25	30
350	-	-	-	-	-	-
370	-	-	-	-	49	61
1,250	2	-	2	-	-	-
Capital deduction [1]	15	15	15	15	0	0
Other risk weights	277	580	277	580	-	-
Total	10,748	15,361	9,802	14,443	259	203

[1] The figures as at 31 December 2009 have been corrected

Table 50: CRSA/IRBA exposure values by regulatory risk weight in € m (alternative calculation without taking the guarantee facility into account)

Securitisation portfolio	Exposure value 2010	Exposure value 2009
Traditional securitisations		
Real estate	93	94
Ships	-	-
Retail banking	150	324
ABS	1,687	1,221
Other	198	2,459
Sub-total	2,129	4,098
Synthetic securitisations		
Real estate	-	-
Ships	-	-
Retail banking	-	-
ABS	-	-
Other	-	-
Sub-total	-	-
Total	2,129	4,098

Table 51: Exposure values of securitised receivables in € m (alternative calculation without taking the guarantee facility into account)

Securitisation items	CRSA exposure value 2010	CRSA exposure value 2009	IRBA exposure value 2010	IRBA exposure value 2009
Balance-sheet items				
Credit enhancements[1]	-	164	-	117
Equity holdings in ABS transactions	2,697	3,415	3,775	6,520
Other balance-sheet items	142	3	1,679	2,307
Sub-total	2,839	3,582	5,455	8,944
Off-balance sheet items				
Liquidity facilities	3	9	8	63
Derivates	-	-	-	-
Other off-balance sheet items	-	-	-	-
Sub-total	3	9	8	63
Total	2,842	3,591	5,462	9,007

[1] Measures to improve credit quality

Table 52: Exposure values of retained or purchased securitisation exposures in € m (alternative calculation without taking the guarantee facility into account)

	Securitised items retained/purchased							
	CRSA exposure value		IRBA exposure value		CRSA capital requirement		IRBA capital requirement	
Risk weight range in %	2010	2009	2010	2009	2010	2009	2010	2009
0 ≤ 10	74	-	2,788	5,202	-	-	14	22
> 10 ≤ 20	1,852	2,860	1,059	2,023	30	43	14	30
> 20 ≤ 50	230	249	878	241	7	10	22	6
> 50 ≤ 100	159	132	108	124	12	10	4	9
> 100 ≤ 350	21	61	89	970	5	17	10	121
> 350 ≤ 650	-	-	82	75	-	-	24	28
> 650 to 1,250 excluded	-	-	-	-	-	-	-	-
1,250 or capital deduction	506	289	458	372	-	12	25	87
Total[1]	2,842	3,591	5,462	9,007	55	92	113	303

Table 53: Exposure values and capital requirements for retained or purchased securitisation items by risk weight ranges in € m (alternative calculation without taking the guarantee facility into account)

	Total non-performing or in-arrears[1]		Actual losses	
Securitisation portfolio	2010	2009	01.01.2010 to 31.12.2010	01.01.2009 to 31.12.2009
Real estate	-	-	-	-
Ships	-	-	-	-
Retail banking	-	-	-	-
ABS	-	-	-	-
Other	5	5	-	-
Total	5	5	-	-

[1] Total non-performing receivables (needing value adjustment) or in-arrears receivables (not needing value adjustment)

Table 54: Non-performing and in-arrears securitisations, actual losses on securitised receivables in (alternative calculation without taking the guarantee facility into account)

IRBA receivable class	Average PD in %		Average LGD in %		Average RW in %		Exposure value	
	2010	2009	2010	2009	2010	2009	2010	2009
Rating range 1: 1(AAAA) – 1(AA+)								
Central governments	0.0	0.0	23.7	24.4	0.7	0.3	12,792	26,870
Institutions	-	-	-	-	-	-	-	-
Companies	-	-	-	-	-	-	-	
Equity holding exposures[1]	-	-	-	-	-	-	-	
Subtotal	0.0	0.0	23.7	24.4	0.7	0.3	12,792	26,870
Rating range 2: 1(AA) – 1(A-)								
Central governments	0.1	0.0	20.0	24.2	14.9	17.1	1,615	1,633
Institutions	0.0	0.0	23.3	24.0	10.7	11.1	17,109	20,656
Companies	0.1	0.1	29.5	28.3	17.3	15.8	15,741	19,803
Equity holding exposures[1]	-	-	-	-	-	-	-	-
Subtotal	0.0	0.0	26.0	26.0	13.9	13.6	34,465	42,093
Rating range 3: 2 – 5								
Central governments	0.3	0.2	42.1	24.3	68.3	25.1	619	267
Institutions	0.2	0.2	30.1	30.4	33.3	32.6	2,378	3,657
Companies	0.3	0.2	32.3	30.9	38.5	36.2	21,166	26,593
Equity holding exposures[1]	0.4	0.4	90.0	90.0	166.7	176.1	85	5
Subtotal	0.2	0.2	32.5	30.8	39.2	35.7	24,248	30,521
Rating range 4: 6 - 9								
Central governments	0.6	0.7	20.6	22.6	50.0	47.4	58	29
Institutions	1.6	1.3	27.3	34.3	55.9	87.9	338	329
Companies	1.2	1.2	33.1	33.8	72.6	74.9	18,916	21,086
Equity holding exposures[1]	1.3	1.5	90.0	79.7	279.2	233.4	28	50
Subtotal	1.2	1.2	33.0	33.9	72.5	75.4	19,339	21,495
Rating range 5: 10 - 12								
Central governments	6.7	3.3	50.6	22.7	240.0	87.3	5	79
Institutions	4.6	4.3	25.4	25.5	82.8	77.7	58	184
Companies	4.9	4.7	33.9	40.2	120.8	139.1	11,034	11,484
Equity holding exposures[1]	4.6	4.2	90.0	81.9	372.2	324.7	29	41
Subtotal	4.9	4.7	34.0	40.0	121.3	138.5	11,126	11,788
Rating range 6: 13 - 15								
Central governments	17.3	17.9	46.2	45.8	280.0	268.3	15	27
Institutions	-	20.0	-	37.1	-	211.6	-	280
Companies	15.4	15.1	37.5	41.6	190.3	215.1	9,150	12,397
Equity holding exposures[1]	10.6	15.0	86.9	90.0	413.1	527.8	1	7
Subtotal	15.4	15.2	37.5	41.5	190.4	215.3	9,166	12,711
Rating range 7 (Default): 16 - 18								
Central governments	100.0	100.0	24.2	23.0	40.2	37.5	97	39
Institutions	100.0	100.0	78.9	49.3	128.2	80.5	209	556
Companies	100.0	100.0	41.6	51.2	67.8	83.4	17,573	10,425
Equity holding exposures[1]	100.0	100.0	66.6	65.0	108.7	106.0	94	40
Subtotal	100.0	100.0	42.1	51.0	68.6	83.2	17,973	11,060
Total (without default)[2]								
Central governments	0.0	0.0	24.1	24.4	5.5	2.0	15,104	28,905
Institutions	0.1	0.3	24.2	25.2	14.4	18.0	19,883	25,107
Companies	2.9	3.0	32.8	33.6	72.8	77.9	76,006	91,363
Equity holding exposures[1]	1.5	3.4	90.0	81.7	232.3	285.8	143	103
Total	2.0	1.9	30.1	30.4	53.4	52.6	111,136	145,477

[1] Only equity holdings under the PD-LGD approach; with regulatory LGD of 65% or 90%; CCF = 100% [2] Differences in amounts are due to rounding

Table 55: Average PD, average LGD, average RW and exposure values in € m according to rating ranges (alternative calculation without taking the guarantee facility into account)

IRBA receivable class	Central governments		Institutions		Companies		Equity holding exposures[1]		Total[2]	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
Rating range 1: 1(AAAA) – 1(AA+)										
Basis for evaluation of loan commitments	621	666	-	-	-	-	-	-	621	666
Basis for evaluation of non-derivative assets not reported	48	47	-	-	-	-	-	-	48	47
Avg. exposure value of loan commitments	29	33	-	-	-	-	-	-	29	33
Avg. exposure value of non-derivative assets not reported	21	22	-	-	-	-	-	-	21	22
Rating range 2: 1(AA) – 1(A-)										
Basis for evaluation of loan commitments	0	-	360	534	1,321	1,956	-	-	1,681	2,490
Basis for evaluation of non-derivative assets not reported	16	46	84	721	407	652	-	-	507	1,418
Avg. exposure value of loan commitments	-	-	1	2	7	10	-	-	5	8
Avg. exposure value of non-derivative assets not reported	14	8	6	56	90	55	-	-	73	54
Rating range 3: 2 - 5										
Basis for evaluation of loan commitments	0	0	0	80	3,639	5,814	-	-	3,639	5,894
Basis for evaluation of non-derivative assets not reported	0	0	10	154	1,134	1,331	-	-	1,144	1,486
Avg. exposure value of loan commitments	0	0	0	9	14	12	-	-	14	12
Avg. exposure value of non-derivative assets not reported	0	0	2	34	13	11	-	-	13	14
Rating range 4: 6 - 9										
Basis for evaluation of loan commitments	-	-	75	17	2,742	4,081	-	-	2,817	4,097
Basis for evaluation of non-derivative assets not reported	0	0	4	4	967	1,357	-	-	971	1,361
Avg. exposure value of loan commitments	-	-	46	5	6	11	-	-	7	11
Avg. exposure value of non-derivative assets not reported	0	0	1	1	4	9	-	-	4	9
Rating range 5: 10 – 12										
Basis for evaluation of loan commitments	-	-	-	75	696	1,370	-	-	696	1,445
Basis for evaluation of non-derivative assets not reported	-	-	-	3	312	503	-	-	312	506
Avg. exposure value of loan commitments	-	-	-	50	3	4	-	-	3	6
Avg. exposure value of non-derivative assets not reported	-	-	-	0	6	5	-	-	6	5
Rating range 6: 13 – 15										
Basis for evaluation of loan commitments	-	-	-	0	979	1,552	-	-	979	1,552
Basis for evaluation of non-derivative assets not reported	9	9	0	3	518	468	-	-	528	480
Avg. exposure value of loan commitments	-	-	-	0	5	5	-	-	5	5
Avg. exposure value of non-derivative assets not reported	5	6	0	0	3	4	-	-	3	4
Rating range 7 (Default): 16 - 18										
Basis for evaluation of loan commitments	-	17	6	0	733	1,477	-	-	739	1,495
Basis for evaluation of non-derivative assets not reported	-	-	-	-	390	484	-	-	390	484
Avg. exposure value of loan commitments	-	12	0	0	2	17	-	-	2	17
Avg. exposure value of non-derivative assets not reported	-	-	-	-	9	11	-	-	9	11
Total										
Basis for evaluation of loan commitments	621	684	441	705	10,109	16,249	-	-	11,172	17,639
Basis for evaluation of non-derivative assets not reported	73	102	99	885	3,728	4,794	-	-	3,900	5,781
Avg. exposure value of loan commitments	29	32	9	8	8	11	-	-	10	11
Avg. exposure value of non-derivative assets not reported	17	14	5	51	17	15	-	-	16	21

[1] Only equity holdings under the PD-LGD approach; with regulatory LGD of 65% or 90%; CCF = 100%

Table 56: Assessment basis in € m and average exposure value of undrawn loan commitments and of non-derivative off-balance sheet assets (alternative calculation without taking the guarantee facility into account)

Receivables class	2010 Expected loss (EL) as at 31.12.2010	2010 Actual loss 01.01.2010 to 31.12.2010	2009 Expected loss (EL) as at 31.12.2009	2009 Actual loss 01.01.2009 to 31.12.2009
Central governments	1	-	1	-
Institutions	3	72	6	-
Companies	736	234	986	281
Equity holding exposures[1]	2	-	2	4
Total[2]	742	306	995	285

[1] Only equity holdings under the PD-LGD approach; with regulatory LGD of 65% or 90%; CCF = 100% [2] Differences in amounts are due to rounding

Table 57: Expected losses and actual losses in the lending business in € m (alternative calculation without taking the guarantee facility into account)

Receivables class CRSA	Financial collateral 2010	Financial collateral 2009	Other and physical collateral 2010	Other and physical collateral 2009	Guarantees / derivatives 2010	Guarantees / derivatives 2009	Life insurance 2010	Life insurance 2009
Central governments	-	-	-	-	-	-	-	-
Regional governments	-	-	-	-	-	-	-	-
Other public sector entities	0	0	-	-	3	4	-	-
Multilateral development banks	-	-	-	-	-	-	-	-
International organisations	-	-	-	-	-	-	-	-
Banks	-	-	-	-	-	-	-	-
Collateralised Notes issued by banks	-	-	-	-	-	-	-	-
Companies	833	835	-	-	65	361	34	-
Retail banking	54	56	-	-	2	7	28	-
Items collateralised by real estate	-	-	703	1,079	-	-	-	-
Investment certificates	-	-	-	-	-	-	-	-
Equity holdings	-	-	-	-	-	-	-	-
Other items	-	-	-	-	-	-	-	-
Overdue items	59	28	79	65	0	5	3	-
Total	946	918	782	1,144	70	377	65	-

Table 58: Total amount of collateralised CRSA exposure values in € m (alternative calculation without taking the guarantee facility into account)

Receivables class IRBA	Financial collateral 2010	Financial collateral 2009	Other and physical collateral 2010	Other and physical collateral 2009	Guarantees / derivatives 2010	Guarantees / derivatives 2009	Life insurance 2010	Life insurance 2009
Central governments	0	-	32	-	101	99	-	-
Banks	-	118	290	279	1,777	2,418	-	-
Retail banking	-	-	-	-	-	-	-	-
Equity holdings	-	-	-	-	-	-	-	-
Companies	622	4,721	38,104	33,434	1,663	1,642	114	-
Other assets not related to loans	-	-	-	-	-	-	-	-
Total	622	4,839	38,426	33,712	3,541	4,159	114	-

Table 59: Total amount of collateralised IRBA exposure values (without securitisations) in € m (alternative calculation without taking the guarantee facility into account)

HSH Nordbank AG
Gerhart-Hauptmann-Platz 50
20095 Hamburg
Germany
Phone +49 40 3333-0
Fax +49 40 3333-34001

Martensdamm 6
24103 Kiel
Germany
Phone +49 431 900-01
Fax +49 431 900-34002

info@hsh-nordbank.com
www.hsh-nordbank.com