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**HSH
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MANAGEMENT REPORT OF HSH NORDBANK AG

BUSINESS ACTIVITIES

Headquarters, regional focus, clients and products

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

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

Segments, divisions and locations

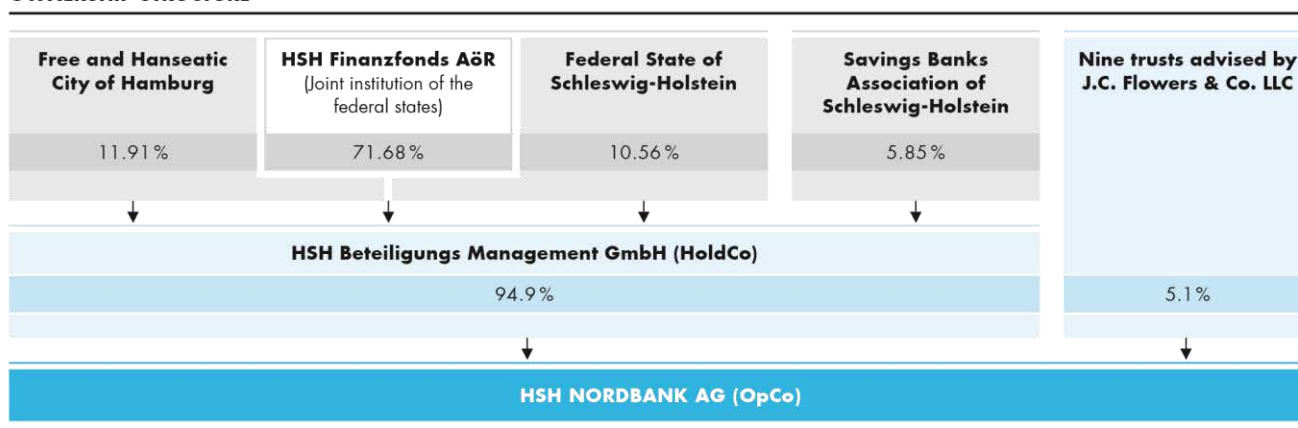
The business activities of HSH Nordbank are split between the Core Bank, which includes the strategic business divisions, and the Non-Core Bank, in which predominantly non-performing legacy portfolios from the years prior to 2009 are held. The administrative divisions and overall bank positions are disclosed as segments not subject to reporting requirements in the “Other and Consolidation“ division.

The Bank adjusted its internal reporting, and therefore segment reporting as well, in the second half of 2016 on the basis of the organisational changes implemented. The focus was on mapping the value creation structures of the individual segments in a more transparent manner based on causation. In conjunction with combining the market divisions under the responsibility of a single Management Board member the previous segments – Shipping, Project & Real Estate Financing and Corporates & Markets – were dissolved and transferred to the Real Estate, Shipping, Corporate Clients and Treasury & Markets segments. At the same time, the Bank made a portfolio reallocation between the Core Bank and Non-Core Bank (formerly: Restructuring Unit), which resulted in the optimisation of the Core Bank portfolio and consistent allocation of non-performing legacy portfolios earmarked for winding down to the Non-Core Bank. The complexity of the Group structure was thereby markedly reduced and the transparency of internal reporting and therefore segment reporting further increased.

The streamlining of the organisational structure was driven forward in addition to the changes made to the internal reporting, including segment reporting, as part of the cost reduction programme. In this regard, the Management Board was reduced from 5 to 4 members, the number of chief representatives from 2 to 1 and the divisions from 25 to 18. The lending processes of the Non-Core Bank were also integrated into the area of responsibility of the CRO as at 1 November 2016, whereby cross-divisional efficiency potential will be exploited to a greater degree in the future, expertise pooled in risk management and lending standards harmonised. Furthermore, methods for integrated bank steering were refined based on a close interaction between the CFO and CRO areas of responsibility in line with the statutory requirements (SREP, BCBS 239, among other things).

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

OWNERSHIP STRUCTURE

**Ownership structure, guarantee and EU proceedings**

The principal owner of HSH Nordbank AG as at the 2016 year end is HSH Beteiligungs Management GmbH with a shareholding of 94.9%. Private investors advised by J.C. Flowers & Co. LLC also have a shareholding of 5.1%. The Free and Hanseatic City of Hamburg and the federal state of Schleswig-Holstein indirectly hold a combined shareholding of 89.35% via HSH Beteiligungs Management GmbH and 5.55% is held by the Savings Bank Association (Sparkassen- und Giroverband) for Schleswig-Holstein.

The federal states of Hamburg and Schleswig-Holstein issued via HSH Finanzfonds AöR a guarantee in favour of HSH Nordbank that provided capital relief (second loss guarantee), but which did not affect liquidity at that time, under which payment defaults in a specified portfolio are hedged (mainly in the Non-Core Bank). First piece losses incurred in this portfolio are to be borne by HSH Nordbank itself up to an amount of €3.2 billion. Further details are set out in Note 2 of the Notes. Details regarding the impact of the guarantee on the net assets, financial position and earnings in 2016 are set out in the Economic report section.

In 2013, the guarantee facility provided by Hamburg and Schleswig-Holstein was replenished after a reduction in 2011 from €7 billion to the original facility of €10 billion in view of the changed underlying conditions. This measure was initially provisionally approved by the EU Commission in 2013. At the same time, the EU Commission instituted state aid proceedings to investigate whether the replenishment of the guarantee is consistent with state aid rules. In these EU state aid proceedings the owners, Hamburg and Schleswig-Holstein, the Federal Republic of Germany and the EU Commission, reached an informal agreement on 19 October 2015 to provide significant relief to the Bank from the adverse impact of legacy assets and guarantee fees.

It is also envisaged that HSH Nordbank be privatised by 28 February 2018. Based on the informal agreement the EU Commission reached a formal decision in the state aid proceedings on 2 May 2016 (hereinafter referred to as the EU decision) and thereby finally approved the replenishment of the second loss guarantee issued by the federal states. The decision of the EU Commission confirms the informal agreement, in principle, and defines it in concrete terms and is based on a list of conditions and commitments, which contains the foundations of the agreement, provided to the EU Commission by the Federal Republic of Germany as the representative of the federal state owners of HSH Nordbank.

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

However, from today's perspective, the originally intended improvements are due to the existing capital structures only partially suited to reduce the high proportion of NPE significantly. The second loss guarantee granted in 2009 had no direct liquidity effect at that time, on the basis of which the necessary, accelerated winding down of non-performing loans could have been carried out. Instead, complex settlement conditions under the guarantee agreement mean that economically sound wind-down measures can only be taken to a limited extent. Furthermore, total guarantee premiums of €3.2 billion paid to date have also put considerable strain on the capital base available for the absorption of potential losses.

From today's perspective, the recapitalisation of HSH Nordbank at the time of the financial crisis in the form of a second loss guarantee of € 10 billion has proved to be disadvantageous from an economic point of view when compared to a strengthening of capital at that time that would have had an effect on liquidity.

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

Further information on the EU decision can be found in the Business developments section under Major developments and events as well as in the Forecast, opportunities and risks report.

Membership in the German Savings Banks Finance Group

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

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

External influencing factors and processes

Besides the EU decision and the underlying list of conditions and commitments, other material external factors influencing HSH Nordbank's business include economic and financial market developments (movements in the EUR/USD exchange rate, interest rate level inter alia), developments in the relevant industry sectors such as the shipping industry (particularly charter rates and ship values), regulatory requirements and discretionary decisions of the supervisory authorities, external ratings, assessments of capital market participants and other stakeholders as well as the further course of the privatisation process.

HSH Nordbank has defined processes within its business organisation that form the basis for operating and managing the Bank as well as for

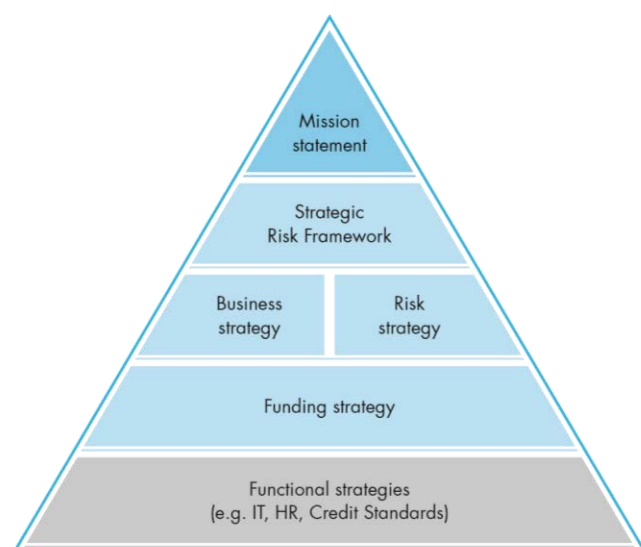
its internal control system. The main processes include strategy and planning, corporate management, customer management, financing, capital market as well as support processes.

OBJECTIVES AND STRATEGY

HSH Nordbank's vision is to be a Bank for Entrepreneurs from the metropolitan regional base of Hamburg. Central to this perceived role is a focussed and entrepreneurial approach that creates added value for clients, shareholders and the Bank. The overall objective of HSH Nordbank is to support the Northern German economy in particular and to provide larger medium-sized enterprises with an appropriate services and product portfolio with regard to all aspects of loan financing. The Bank is a competent partner for both business and private matters particularly for medium-sized enterprises in their home region of Northern Germany and also throughout Germany and abroad on an industry-specific basis. The Bank is developing strategies that are embedded in HSH Nordbank's strategy architecture to achieve its objectives.

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

STRATEGY ARCHITECTURE



The strategic risk framework, which, as a framework document, describes the direction of the Bank's risk management and establishes the foundation for the risk culture, provides consistent guidelines for effectively aligning the organisation and business operations to the basic risk-strategy principles. The strategic risk framework includes the risk coverage potential (risk capacity), which is determined on the basis of the capital and liquidity resources available, as well as key guidelines for risk-conscious actions on part of the Bank. Furthermore, tolerance ranges for the utilisation of risk capacity are determined for all material risks on the basis of various scenarios and the risk appetite. Details on the bank-specific risk types are explained in the Risk report section.

The business strategy, which is to be defined by management, describes the overriding strategic direction with regard to the business model and business area portfolio of the Bank. This transposes the overall strategic model into a specific strategic direction and plan. It describes the Bank's objectives for each key business activity and the measures to be taken to achieve these objectives. In this context, long-term objectives are to ensure sustained profitability and a manageable risk profile, to establish long-standing and solid customer relationships and follow a cross-selling approach. HSH Nordbank's operating business model comprises the Core Bank, in which the Bank's strategic divisions are consolidated, and the Non-Core Bank, which is responsible for ensuring that the portfolios bundled there are wound down in a swift and risk-commensurate manner. The business strategy also includes the definition of the strategic business areas and formulates a business area strategy for each business area. The business area strategies describe the strategic targets in the Bank's business divisions and define concrete implementation measures for each business area. An essential component for defining strategic goals and monitoring implementation are quantitative performance indicators, which are defined by a bank-wide target system as the basis for measuring performance and the effectiveness of the business strategy.

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

The funding strategy establishes the framework for the active and sustainable management of funding and liquidity. It is a core component of HSH Nordbank's overall bank management processes.

Functional strategies, which are not formally part of the strategy process, are defined on the basis of the Bank's core business strategies. The long-term IT objectives are set in the IT strategy. Developments in the key business activities planned for the business areas are also taken into account. The personnel management tools required for the monitoring and support of HSH Nordbank are anchored in the human resources strategy.

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

HSH Nordbank's stated objectives and strategies are basically aimed at ensuring the sustainable development of the institution. This is also the subject of the ECB's integrated analysis conducted as part of the supervisory review and evaluation process (SREP), based on which banks are monitored taking into account the business model, capital and liquidity position and governance structures.

Strengthening of the Bank for Entrepreneurs and systematic winding down of the legacy portfolios within the limits set by the guarantee agreement

In order to implement the business model with a sustainable focus HSH Nordbank is continuing to concentrate on strengthening the strategic business areas of the Core Bank and, at the same time, on winding down the risky legacy portfolios which are bundled in the Non-Core Bank.

The aim of HSH Nordbank in the planning period up to 2019 is to increase new business with risk-commensurate margins in accordance with the business and risk strategy. On the one hand, business is to be promoted further in the core region of Northern Germany, where the Bank already has long-standing client relationships and a high level of market penetration, and, on the other hand, business activities outside Northern Germany are to be expanded further in order to achieve the planned new business objectives and to ensure a balanced portfolio structure.

Furthermore, the product sales of the entire range of services over and above traditional lending transactions will continue to be driven forward to strengthen sustainable client relationships and exploit the business potential in the product divisions.

Strategic targets of the Core Bank's business areas

The strategic divisions are continually evolving and their business portfolios and positioning adjusted to the changing underlying conditions in the market and competitive environment.

The intention is to intensify new business in the Corporate Clients division. The approach of expanding business throughout Germany in the existing locations will be consistently continued in order to achieve this in a highly competitive market environment. At the same time, the potential in the core region of Northern Germany as well as in the project financing business in the Energy & Utilities and Logistics & Infrastructure business areas will be further exploited in the rest of Europe. In the past financial year, parts of the former Corporate Finance division were integrated into the Corporate Clients division. Specialists, who are an integral part of the division, will continue to support the client teams with special advisory and financing solutions and thereby contribute to the strengthening of client relationships.

The Real Estate Clients division will continue to make a risk-conscious contribution to the Bank's balanced portfolio mix taking account of the development in the German real estate markets. The profitability of transactions is the major driver for the sustained improvement in the Bank's risk/return profile.

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

The new Treasury & Markets division bundles together trading with capital market and investment products as well as the servicing of savings banks, banks and insurance companies. The responsibility for the central management of the liquidity and market price risks of the bank positions as well as the Bank's issuance activities are also anchored in this division.

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

Consistent winding down of non-performing loans

The Non-Core Bank is still aiming to achieve a significant reduction in the non-strategic loan and capital markets portfolios in the planning period up to 2019 while minimising losses by means of scheduled and early principal repayments, sales of loans as well as structured solutions, provided these are permitted under the guarantee agreement (see also statements made in the "Ownership structure, guarantee and EU proceedings" sub-section in the "Basis of the Group" section regarding this).

The winding down targets are derived from the risk strategy and reflected accordingly in the Bank's plan for the IFRS Group.

SUSTAINABLE COST REDUCTIONS AND EFFICIENCY INCREASES

The continuous improvement in the Bank's efficiency remains a high priority for HSH Nordbank. It has revised its cost and efficiency targets for the period to 2019 in view of the challenging environment of a sustained shipping crisis, intensive competition in the German corporates business and constantly increasing regulatory requirements. The objective is to achieve a sustainable, competitive cost-income ratio. HSH Nordbank is therefore continuing to aim to achieve a cost/income ratio of in principal less than 50% for the Group.

A comprehensive cost reduction programme was implemented to reduce administrative expenses. This is reviewed on an ongoing basis in light of the imposed privatisation and continuously adjusted to the extent necessary. The organisational structure and key bank processes were streamlined, and operating expenses as well as the number of employees, and therefore personnel expenses, were further reduced as part of the 2018PLUS programme. Overarching initiatives are a further focus of the programme and include the simplification and standardisation of key processes as well as adjustments to the Bank's IT systems. Details regarding the programme measures currently being implemented are set out in the Business developments section.

IT STRATEGY

Key elements of the IT strategy developed in 2014 were successfully implemented by the end of 2016 in line with the plan. These include, for example, the implementation of elements of the gradual upgrading of the IT system landscape, a significant reduction in IT costs and the expansion of IT control functions. In 2016 the Bank adjusted the strategic alignment of its IT, reorganised IT security and implemented an IT security strategy. This takes account of the requirements of the privatisation process and general technological changes. The most important objective of IT is to guarantee continuing stable production operations under more stringent regulatory requirements while further reducing IT costs. The conversion under way of the IT system landscape is to be continued with the objective of providing the Bank with an appropriate, cost-efficient IT system landscape that is capable of integration. The selective use of new technologies ("digitalisation") will also be driven forward.

FINAL EU DECISION

The basis for a viable business model of HSH Nordbank was improved by the EU decision reached on 2 May 2016 and the structural measures implemented to date in 2016. Together with further strategic and operating optimisation measures the starting basis for the successful privatisation of HSH Nordbank has thus been established.

Further details on the EU proceedings and the implementation of the agreed structural measures can be found in the Business performance – significant developments and events section.

MANAGEMENT SYSTEM

Key value drivers and key indicator and ratio system

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

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

In the 2016 reporting year, HSH Nordbank focussed on the internal management system and refined it in accordance with statutory requirements (SREP, BCBS 239). A focal point of this refinement process was the creation of an integrated view based on financial and risk key figures and ratios in a standardised and integrated management reporting system. This will be used by the Overall Bank Management committee to manage and allocate financial resources and to manage the business areas.

Revised management indicators of the IFRS Group

HSH Nordbank's most important management indicators were also revised based on the integrated and comprehensive management report. The Bank is thereby pursuing the aim of increasing reporting transparency and efficiency, also with regard to external communication, and therefore focussing on the key management indicators of each of the value drivers of the IFRS Group relevant for the Bank. The trend of these indicators will continue to be reviewed in relation to the previous year and the previous year's forecast ("Economic report" section) and their expected change in 2017 is also described ("Forecast, opportunities and risks report" section).

Compared to the previous year, the following indicators are no longer defined as important management indicators: total income and the liquidity ratio under LiqV. The change in total income is included in net income before taxes and is therefore no longer separately defined as a management indicator. Furthermore, new business concluded solely in the Core Bank in accordance with HSH Nordbank's lending standards will only be reported in the future at the Core Bank level and no longer at the Group level as well. Risk-weighted assets are already adequately covered by the CET1 ratio and, accordingly, are no longer explicitly defined as an important management indicator. In order to highlight the particular importance of the key management indicators – administrative expenses, loan loss provisions and the management indicators generated by the stressed view of the liquidity transformation balance sheet –, the cost/income ratio was defined on the cost side, the NPE ratio and coverage ratio were defined on the risk side and the minimum survival period in the combined stress scenario on the liquidity side. Furthermore, the regulatory ratios – liquidity coverage ratio and net stable funding ratio – are applied instead of the LiqV management indicator to manage liquidity risk, whereby the liquidity position is extensively incorporated within the management indicators.

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

DEFINITION OF THE IMPORTANT MANAGEMENT INDICATORS

Important management indicators	Definitions
Net income before taxes	Net income before taxes is equivalent to the IFRS result generated before deducting tax expense.
CIR = Cost/income ratio	The CIR is a cost efficiency ratio that measures administrative expenses as a percentage of total income plus other operating income.
RoE = Return on equity	RoE is calculated as the ratio of income before taxes to average equity capital disclosed on the balance sheet and shows the return on capital. The risk-adjusted allocation of the average equity capital disclosed on the balance sheet is determined on the basis of the regulatory capital committed.
NPE ratio = Non-performing exposure	The NPE ratio measures the sum of the risk positions (EaD, exposure at default) of borrowers in default as a percentage of the sum of the Bank's risk positions.
Coverage ratio	The coverage ratio is calculated as the quotient of the loan loss provisions (individual valuations allowances and general loan loss provisions) recognised on risk positions and the sum of the risk positions in default.
CET1 ratio (phase-in, same period) = Common Equity Tier 1	The CET1 ratio is defined as the quotient of the core Tier 1 capital excluding hybrid instruments and the sum of the risk-weighted assets, expressed as a percentage. The CET1 ratio is determined in the same period calculation (i.e. taking the Group financial statements into account) in accordance with the transitional rules (phase-in) of the Capital Requirements Regulation (CRR).
Minimum survival period in the combined stress scenario	The minimum survival period according to the liquidity development report describes the period, during which the net liquidity position (NLP) must be adhered to in the base and stress cases. A minimum survival period of 1 month is set for the combined stress scenario in accordance with MaRisk. Furthermore, additional internal risk limits and ambition levels are defined for the base and stress cases according to the Management Board's risk appetite. The internal ambition levels represent targets and are more conservative or longer than the MaRisk requirements. The liquidity development report maps expected cash flows over a specific time period in a structured manner.
LCR = Liquidity coverage ratio	The LCR represents the security provided to the Bank in the event of a short-term acute liquidity stress scenario of more than 30 days by maintaining a liquidity buffer (short-term stress test ratio). The LCR is calculated as the ratio of highly liquid assets to net cash outflows over the next 30 days.
NSFR = Net stable funding ratio	The NSFR shows that stable long-term funding is secured by the Bank under stress conditions. The amount of stable funding available over one year must be sufficient to cover the existing long-term funding required. The NSFR is calculated as the quotient of the amount of available and required stable funding (≥ 1 year).

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

MATRIX OF MANAGEMENT INDICATORS

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

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

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

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

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

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

Management Board remuneration

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

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

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

Further information on the Management Board's remuneration is set out in Note 76 (Remuneration paid to members of the Management Board and Supervisory Board).

Reconciliation

The IFRS ratios and figures for the Group as presented above are used to manage the HSH Nordbank Group and HSH Nordbank AG (single entity). Some important management indicators are reconciled to explain the earnings, financial position and cash flows as well as the forecast report of the single entity prepared under HGB.

The important management indicators – cost/income ratio, return on equity, NPE ratio, coverage ratio, minimum survival period in combined stress scenario, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), liquidity ratio as defined in the Liquidity Regulation (LiqV), liquidity development report (LDR) for the stress case, Core Bank's new business volume, total income and net income before taxes of the Core Bank as well as loan loss provisions, net income before taxes and total assets of the Non-Core Bank, as these are not determined for the single entity – are not reconciled accordingly. Actual figures for the CET1 ratio and RWA were determined for the past financial year at the HGB single entity level. However, these two key figures were not forecast separately for the single entity.

Major differences between the key ratios and figures of the single entity and the Group arise from the different accounting standards applied (HGB versus IFRS) and inclusion of subsidiaries in the Group financial statements.

Total income

IFRS total income comprises the net interest income, net commission income, net trading income, net income from financial investments, net income from financial investments accounted for under the equity method and result from hedging line items. HGB total income includes the net interest income, net commission income, net income/expenses from the trading portfolio as well as other operating income line items. The latter is disclosed separately in the IFRS state-

ment of income. In addition, operating income of subsidiaries is included in the IFRS Group, whilst current income of equity holdings included in the Group financial statements is omitted.

Premium expense for the second loss guarantee is included in net commission income under HGB, whereas this expense is disclosed as a separate line item in the IFRS statement of income outside total income. Measurement effects and realised gains or losses arising on securities and equity holdings are disclosed in IFRS total income under the net trading income and net income from financial investments line items, whereas they are included in the write-down/impairment line item under HGB.

Notwithstanding these disclosure differences these line items also include different figures. These result, for example, from the different measurement rules applied under HGB and IFRS.

Some securities held in the Credit Investment portfolio are classified as DFV (designated fair value) under IFRS and are therefore subject to fluctuations in measurement as a result of changes in market value. Under HGB these positions are classified as non-current assets and generally not written down. In principle, other measurement differences may also arise between HGB and IFRS with respect to other securities positions. These may be caused by the application of the historical cost principle in HGB. Furthermore, material securities positions are classified as LaR (loans and receivables) under IFRS and assigned to non-current assets under HGB. These positions are generally accounted for in an identical manner under HGB and IFRS with regard to impairment losses. Changes in the fair value of positions classified as AfS (available for sale) are recognised in the revaluation reserve under IFRS. Under HGB these are measured through profit and loss applying the strict lower of cost or market value principle.

Furthermore, measurement of hybrid capital in accordance with IAS 39.A8 is included in IFRS total income taking account of the expected cash flows (net interest income), whereas, depending on the result in the reporting period, income from the loss participation in the hybrid capital or expenses for the replenishment of the hybrid capital are disclosed under HGB as a separate line item outside total income. Other specific IFRS effects are the measurement of basis swaps and DFV liabilities as well as fair value adjustments. There are also differences in the accounting for hedging relationships and exchange rate effects arising on the translation of non-monetary items such as equity holdings denominated in foreign currency.

Administrative expenses

Differences in administrative expenses (important management indicator in the previous year) and the number of employees in the IFRS Group are mainly attributable to the inclusion of subsidiaries in administrative expenses reduced by consolidation effects. In the HGB-financial statements, administrative expenses also include expenses for the bank levy and deposit guarantee fund, which are separately disclosed in the IFRS Group financial statements.

Loan loss provisions

There are small differences in the amounts recognised for loan loss provisions (important management indicator in the previous year) due to the use of flat-rate loan loss provisions under HGB and general loss provisions under IFRS. The resulting differences have a slight impact on the amount of the guarantee effect. Additions and releases to/from the fund for general banking risks in accordance with Section 340g HGB are disclosed under the HGB loan loss provisions/valuation line item in addition to the measurement of securities and equity holdings commitments. There is no corresponding item under IFRS.

Hedging effect of credit derivative under the second loss guarantee

This line item only exists in the Group financial statements prepared in accordance with IFRS and comprises the valuation gain or loss arising on the credit derivative in connection with the hedging effect of the second loss guarantee (partial guarantee Two). Both partial guarantees of the second loss guarantee are accounted for as loan collateral received as defined IDW RS BFA 1. The hedging effect of the second loss guarantee is included under the loan loss provisions line item in the HGB financial statements.

Net income before taxes

Differences in net income before taxes between the IFRS Group and HGB single entity financial statements result from the differing effects as described above in the total income, administrative expenses and loan loss provisions line items. The result from restructuring and privatisation and expenses for government guarantees are also disclosed separately in the IFRS Group financial statements, whereas in the HGB single entity financial statements the result from restructuring is included in the extraordinary result and current guarantee expense from the base premium is disclosed under net commission income.

CET1 ratio and RWA

Differences in the CET1 capital ratio and RWA (important management indicator in the previous year) between the single entity and regulatory group mainly result from the different accounting standards applied (between HGB and IFRS) and the inclusion of companies consolidated for regulatory purposes in the regulatory capital and RWA of the Group.

ECONOMIC REPORT

UNDERLYING MACROECONOMIC AND INDUSTRY SECTOR CONDITIONS

2016 CHARACTERISED BY GEOPOLITICAL UNCERTAINTY AND VOLATILE FINANCIAL MARKETS

The global economy grew at a rate of 3.1% in 2016, which represents a slight slowdown compared to the previous year. Economic growth in the USA was particularly disappointing, whilst the rate of expansion declined less sharply in the eurozone. China's economy held up well despite a difficult start so that growth was only slightly lower than in 2015. The easing of the recession in Russia also had a stabilising effect, whereas the situation in Brazil remains difficult. The past year was characterised by a turbulent start in the form of sharp falls in prices on Chinese stock exchanges, the unexpected vote in Great Britain in the middle of the year to leave the EU (Brexit) and the outcome of the US presidential elections in November. Furthermore, concerns regarding inadequately capitalised banks, particularly in Italy, were one of the key issues that shifted markets. Interest rates also remained for the most part at an extremely low level in 2016. However, long-term yields increased significantly at the year end, as the US Federal Reserve raised its key interest rate, commodity prices rose and expectations of a future more expansive fiscal policy took hold. It was noticeable how quickly the financial markets processed unexpected events such as the so-called Brexit and the outcome of the US presidential elections without there being sustained turbulence.

MODERATE GLOBAL ECONOMIC GROWTH

Gross domestic product in the USA only increased slightly by 1.6% in 2016 (previous year: 2.6%). Private consumption was the most dynamic component, while investment activity except in the housing sector contracted. Exports again recorded only a below-average increase. According to the most recent economic indicators economic growth picked up somewhat at the end of the year. Employment increased steadily, the unemployment rate fell to below 5% and hourly wages recently rose sharply. In this environment, the inflation rate has moved closer to the inflation target of 2%. China's gross domestic product in 2016 was about 6.7% higher than in the previous year, driven not least by government investment programmes. India's economy grew at a similar rate, whereby growth in the final quarter may have suffered under the comprehensive currency reform. Brazil and Russia, whose national economies fell into a deep recession in 2015 as a result of political uncertainty and low commodity prices, showed signs of stabilisation, but to a lesser extent in the case of Brazil.

Gross domestic product in the euro area grew by 1.6% in 2016, thereby continuing the moderate recovery from 2014 and 2015. Growth was broad-based with both capital expenditure and exports increasing at an above-average rate. Government spending also made a significant contribution to the growth. All countries in the eurozone are likely to record positive growth for the first time since the financial market crisis of 2008/2009. Whereas Italy's and France's growth was 1%, the Spanish economy grew by around 3% at a dynamic rate similar to the previous year, Germany's growth of 1.8% (adjusted for calendar effects) was also above average. Unemployment rates in the currency union decreased slightly to 9.7%, while the inflation rate jumped to 1.1% at the end of the year, which was mainly attributable to higher energy prices. Although corporate lending increased in Germany and France, it decreased significantly in Italy and Spain. Even though the outcome of the EU referendum in Great Britain triggered much discussion, this has not visibly fed through to the eurozone economic indicators.

The comparatively high growth of the German national economy was mainly driven by private consumption, whereas investment activity hardly increased at all and exports grew at a considerably slower rate than in the previous year. Loans granted to non-financial enterprises increased in the final quarter by about 3% above the previous year.

SURPRISINGLY RESILIENT FINANCIAL MARKETS AND TO SOME EXTENT INCREASING INTEREST RATES

2016 started with increased nervousness due to the sharp fall in prices on Chinese equity markets. However, during the remainder of the year, the financial markets proved surprisingly resilient in the face of various unexpected events such as Brexit, news about the weak capitalisation of Italian credit institutions and the election of Donald Trump as US president. Their – temporary – impact was felt most strongly by German and US government bonds, whose yields declined sharply in the middle of the year. All German government bonds with a maturity of up to 15 years were trading at a negative yield at times at the end of June.

In this environment, the US Federal Reserve increased the key interest rate to a range of 0.25% to 0.5% in December 2016 and therefore only tightened its monetary policy once in the entire year, whereas the ECB had increased its monthly bond purchase programme from €60 billion to €80 billion in the first half of the year and included bonds of non-financial enterprises in its programme. Risk premiums for corporate and governments fell following the announcement of these measures. The ECB also introduced a new long-term refinancing programme, under which commercial banks can borrow liquidity from the ECB for a period of four years at an interest rate of up to – 0.4%.

In December the ECB announced the extension of the purchase programme to December 2017, whereby the purchase programme will again be adjusted back to the original monthly amount of € 60 billion from March 2017.

The DAX fluctuated within a range of 8,753 and 11,481 points in 2016. At the year end it was 6.9% higher compared to the 2015 year end, which was mainly attributable to the year-end rally in the wake of the outcome of the US presidential elections.

In the currency markets the euro depreciated against the US dollar by about 3.2% compared to the 2015 year end. The EUR/USD exchange rate was 1.054 at the end of December (2015 year end: EUR/USD 1.089). The currency pair reached an interim high of 1.153 EUR/USD in May after the Fed indicated a more cautious approach towards hikes in the key interest rate. The oil price (Brent) increased in 2016 by 51% to USD 56.8 per barrel. The agreement reached between the major oil exporting countries to cut production was mainly responsible for this.

UNEVEN TRENDS IN RELEVANT MARKETS

The shipping markets were still in a poor condition in 2016. The demand for container ships above all again disappointed the expectations of market participants. The market was somewhat friendlier for bulkers. The oil tanker market was unable to maintain its relatively high level and came under greater pressure in the third quarter 2016 than had been originally expected.

There was a further slump in the container ship market in 2016. Both charter rates and ship values declined significantly. The widening of the Panama Canal resulted in a concentration of overcapacity in the medium-sized segments and put particular pressure on their rates. Furthermore, the other, smaller sub-segments were adversely impacted by the capacity added by Neo-Post-Panamax ships. As the scrapping of ships increased sharply and deliveries fell significantly as a result of deferring delivery dates, fleet growth was pleasingly weak on the whole. Container demand improved slightly in 2016 compared to the previous year but could not yet achieve the desired momentum. The ongoing weak market situation is also reflected in the high number of laid-up ships. One positive aspect is that there were virtually no new orders for ships in 2016.

Rates and prices continued to stabilise for bulkers, with rates recording a seasonal upswing at the 2016 year end. Demand was surprisingly positive, but expectations were very low.

This was driven by positive impulses coming from China in particular, which again increased its imports of iron ore and coal. On the supply side, shipping lines were able to successfully lower fleet growth through scrapping and deferral or cancellation of orders for ships. Charter rates in all sub-segments were also recently slightly above the operating cost level, but were still below the level required to service debt. New orders for ships again decreased so that hardly any orders were observed in the recent past.

Trends in the oil tanker market were weak in the second half of 2016. On the demand side, the increase in the oil price slowed growth in transportation and storage needs. On the other hand, fleet growth accelerated significantly as a result of delivery lags on new orders. On the positive side, new orders for oil tankers have also been very low over a period of more than twelve months.

TREND OF TIME CHARTER RATES IN THE SHIPPING INDUSTRY

(Market average, USD/day)

Container ships



Bulk carriers



Oil tankers



Developments in the real estate markets in Germany were mostly very positive in 2016. Rents and property prices continued to increase sharply, especially in the housing markets of large cities. The increase in property prices exceeded that of rents by a very clear margin. The restrictions imposed on rent increases have hardly had any effect to date on new rentals.

In fact, the persistent very high demand for housing exceeded the increase in completions causing the vacancy rates to decrease further. Weaker regions also benefited from this trend, as the accommodation of refugees generated here as well a higher demand for residential properties. Rental growth in the office real estate markets remained high in 2016. The marked rise in the number of office staff generated a stable demand for office space compared to the previous year. At the same time, the available space only increased moderately, because the increased number of completions was partially offset by many changes in usage. Nevertheless, the vacancy rate continued to decrease. On the other hand, rental growth in retail real estate markets decreased noticeably. Only prime rents in central prime locations managed to increase moderately. Although retail stores benefited from very strong levels of private consumption, the sales growth generated was significantly less than the sustained above-average growth in e-commerce. On the investment markets, there was a noticeable shortage of supply on a high level of investor interest. Whilst market values of office properties increased very sharply, commercial properties recorded somewhat lower increases in value.

Trends in European office real estate markets in foreign markets were very mixed in 2016. Whilst some markets such as Stockholm and Madrid continued to recover, rent levels stagnated in many other regions due to the persistent high level of vacancies. Demand for space weakened markedly in the office real estate markets in London, especially after the Brexit vote. At the same time, completions increased sharply causing vacancy rates to rise appreciably. Whereas rents have so far hardly fallen, market values have already decreased noticeably. However, market values increased significantly in the rest of Europe due to the very high investor demand. The upwards trend continued in the USA in both the office and residential real estate markets on a slight fall in office vacancies and hardly any increase in housing vacancy rates as well as increased rents and market values.

Further progress has been made in the first ten months of 2016 in the expansion of renewable energy, but at an uneven pace. In Germany, new installations of onshore wind energy turbine generators were nearly a quarter above the previous year but did not quite achieve the level in the record year of 2014, whilst there was a return to normal levels in the offshore sector. The negative trend in the photovoltaic segment continued in Germany. Capacity added from January to October again declined significantly compared to the same period in the previous year. This is partly the result of the changeover to a competitive bidding process that has already been implemented in this sector.

According to preliminary figures, the project financing volume for transport infrastructure in Europe fell sharply in the first half of 2016. The proportion of public-private partnerships projects to the overall volume has fallen. The largest proportion of the financing was arranged for road projects. Transactions relating to airports and ports were also implemented. The regional focus of the activities was France, Spain, Great Britain and the Netherlands. The major institutional investors include pension funds and insurance companies, which regard infrastructure investments as an investment alternative in the low interest rate environment. Revenues in the logistics sector were weaker in the first nine months of 2016 than in the same period of the previous year.

Production growth in the manufacturing industry in the period from January to September 2016 was significantly higher than in the same period of the previous year. Trends were uneven in the individual sectors. Whilst production volume decreased in the chemical and engineering sectors, electrical engineering, the metal industry and companies in the pharmaceuticals and automobile industries reported growth. Production in the food industry also increased again following a decline in the previous year.

Wholesalers recorded lower sales in the first nine months of 2016 compared to the same period of the previous year, which is primarily attributable to the reduction in sales of production-related wholesalers. In contrast, wholesalers for consumer-related goods recorded slight growth. Compared to the wholesale sector the sales performance of the retail sector was positive. Both the food retail industry and other key segments of the retail sector were able to increase sales. However, the clothing retail sector recorded a significant drop in sales.

The health market is growing constantly, as is the hospital market as well, as a result of demographic trends and medical advances. The financial situation of many hospitals remains strained despite increasing revenues. It is expected that the profitability of hospitals will increase in the future with the entry into force of the Hospital Structure Act (Krankenhausstrukturgesetz) at the beginning of 2016.

UNSETTLED AND CHALLENGING ENVIRONMENT FOR BANKS

VOLATILE MARKET ENVIRONMENT CHARACTERISED BY UNCERTAINTY

Against the backdrop of uncertainty regarding the future policy of large central banks, growth prospects of important emerging markets, namely China, Brazil and Russia, and not least growing concerns about increasing protectionism following the US presidential elections, the market environment for banks in 2016 was also characterised by considerable volatility. Whereas global issues caused a sharp decline in share prices of banks especially at the beginning of the year, the vote of the British electorate regarding remaining in the EU (Brexit) was – following a temporary recovery – an additional factor that created turbulence. The fears of market participants regarding the impact of Brexit are not restricted to British banks but, due to the central role of the London financial centre for the European banking market, apply to other large European financial institutions. This resulted in the worsening of the negative market mood, particularly the already simmering concerns regarding the stability of the Italian banking system. There were renewed discussions at the year end regarding the need to recapitalise individual institutions and the application of BRRD. In Germany, the focus was on the high level of loan loss provisions recognised by ship financing banks.

An issue resolved during 2016 was the debt moratorium announced at the beginning of March 2015 for the Austrian Heta Asset Resolution AG (HETA). Following the rejection of an initial buyback offer from the province of Carinthia to the creditor banks, an agreement was signed in May, which became legally binding in October. Carinthia reached a compromise with the overwhelming majority of the creditors, which provides for the exchange of Heta bonds for zero coupon bonds issued by the Carinthia settlement fund (Ausgleichzahlungsfonds) with a net present value of 90% of the claims or, alternatively, a cash payment of 75% of the claims.

In view of the significant economic and political uncertainty the ECB maintained its expansionary monetary policy, which now also provides for the purchase of corporate bonds, thereby extending the outlook for market participants to a continuing low interest rate environment that adversely impacts bank earnings. An upward trend set in at the year end, triggered not least by the expectations of a rising budget deficit in the USA. The continuing flat yield curve resulted in sustained pressure on net interest income of banks due to lower earnings generated from the maturity transformation and lower interest earned on equity items.

Against this difficult backdrop, the banks feel challenged to constantly review their strategic direction, as the substantial pressure on earnings entails, in conjunction with the weak loan demand of German companies, the increasing risk that loan financing is not priced on a risk-commensurate basis. At the same time, higher expenses for the European bank levy and costs for the increasing regulatory requirements were clearly reflected on the cost side. Against this backdrop many banks in addition to focusing their business models initiated comprehensive cost and efficiency programmes in order to be able to generate adequate returns on a sustained basis.

BANKING SUPERVISION IN LIGHT OF SREP

Besides the difficult market environment, the banking market in 2016 was also characterised by regulatory changes as part of the further implementation of the European Banking Union and Basel III. The Bank Recovery and Resolution Directive (BRRD) entered into force as at 1 January 2016. The corresponding German Act on the Recovery and Resolution of Credit Institutions (SAG) had already come into force a year earlier than at the European level. In this connection, the ultimate responsibility for resolution plans was transferred from the national resolution authority (Federal Agency for Financial Market Stabilisation – FMSA) to the European Single Resolution Board (SRB) as at 1 January 2016.

Monitoring of banks by the banking supervisory authority has also been further intensified by the expansion of the Banking Union and protection schemes. Regulatory monitoring was substantially increased for banks directly supervised by the ECB through the supervisory review and evaluation process (SREP). The ECB has already set out its priorities at the beginning of 2016 for the topics to be examined in detail in the SREP process. The five priorities identified by the supervisory authorities are a review of the business models of banks, credit risk, appropriateness of capital and liquidity resources as well as governance and data quality. The main focus will be on risks associated with the business models and earnings weakness in the low interest rate environment. The review of credit risk focuses on the treatment of and reduction in non-performing loans.

The SREP process includes in particular large-scale data analyses, so-called “short-term exercises”. This also affected not least the German ship financing banks, which had to deliver extensive data to the banking supervisory authorities. The ECB as well as national supervisory authorities review the business models, funding plans and internal risk models of the banks more closely than under the previous supervisory practice and draw on EU-wide benchmark analyses for their assessment, for example, as part of the transparency exercise carried out again in autumn 2016. The objective of the more comprehensive regulatory monitoring approach is to identify failings at banks at an early stage and to take appropriate countermeasures. At the same time, market transparency is to be strengthened by the increase in disclosure obligations.

The European banks were also occupied in working on the stress test published on 29 July 2016. This was started in the first quarter of 2016 with the publication of the methodology and scenarios. Whilst in 2016 only a selection of European banks with total assets in excess of € 100 billion participated in the EBA stress test, other banks directly supervised by the ECB went through a so-called SREP stress test, the contents of which essentially corresponded to those defined in the EBA stress test, which will not be published for the institutions that did not take part in the EBA stress test. HSH Nordbank participated in the ECB stress test as part of the SREP process.

The key substantive areas of focus in the stress test were directly linked to the current challenges in the banking environment. The stress test provided in particular for the modelling of the effects of the low interest rate environment, currency fluctuations and exposure to legal risk. The stress test results were incorporated by the supervisors into the assessment of the banks' business models as part of the SREP process. In December 2016, the regulator notified the banks supervised by it in the SREP process of the individual capital requirements. These now include a regulatory early warning threshold (Pillar 2 Guidance "P2G") as well as a binding minimum requirement (Pillar 2 Requirement "P2R"). In total, the capital requirements for large European banks increased slightly.

The comprehensive and stricter regulatory requirements have made a significant contribution in their entirety to strengthening the stability of the European banking system. Against the backdrop of stricter capital requirements through the gradual implementation of Basel III and the planned introduction of additional regulatory capital buffers German banks on average are likely to have further strengthened their capital base in 2016. However, it is becoming increasingly clear at the same time that low market shares compared with international benchmarks and the weak earnings situation of German banks in particular is placing tight constraints on the ability to retain profits and the focus will therefore remain on strict cost management and the consistent winding down of risk positions.

HSH NORDBANK'S BUSINESS IMPACTED BY UNDERLYING CONDITIONS

The volatile and highly competitive environment was also reflected in the Bank's business performance. Trends in markets relevant for the Bank were uneven in 2016. Whilst the real estate environment in Germany was largely positive, the situation in the shipping markets remained very challenging. In the Corporate Clients division the solid liquidity base of clients and persistent low level of interest rates had a tangible impact in the increasingly competitive environment. In the context of these market developments, the Bank was able to maintain its good position in its target markets while taking account of the strict risk requirements. New business concluded was slightly above that of the previous year. Nevertheless, lending margins declined further given the highly competitive environment and is appreciably below the defined ambition level. The Real Estate division again maintained its good market position with a new business volume at the

previous year's level; the Corporate Clients division was able to clearly exceed the previous year's volume. Transactions were concluded on an extremely selective basis in the Shipping division against the backdrop of the difficult market situation.

The Bank's earnings and financial position and net trading income in particular were affected by the uncertainty prevailing in the financial markets, not least in the period around the Brexit decision. The slight appreciation in and marked volatility of the US dollar against the euro also had an impact on earnings, net assets and the financial position, even though the Bank's dependence on movements in the EUR/USD exchange rate has decreased significantly following the sale of non-performing loans of a nominal amount of € 5 billion, primarily denominated in US dollars, to hsh portfoliomanagement AöR. This also tangibly relieved the pressure on the Bank's refinancing requirements and liquidity position.

The uneven trends in the relevant markets were also reflected not least in loan loss provisions. The Bank again recognised high loan loss provisions in 2016 for the legacy portfolios concerned, which are predominantly covered by the federal state guarantee, due to the ongoing difficult sector trends in the shipping industry. On the other hand, the strong earnings, particularly of German corporate clients, enabled the Bank to reverse loan loss provisions in this division.

The Bank also responded to the continuing challenge regarding a cost base appropriate for the market environment. Controllable personnel and operating expenses were further reduced compared to the previous year as part of the implementation of cost savings measures. The Bank is also using these measures to counteract cost increases caused by the large number of new regulatory requirements and charges incurred in 2016 for the European bank levy and HSH Nordbank's contribution to the deposit guarantee fund.

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

BUSINESS PERFORMANCE – SIGNIFICANT DEVELOPMENTS AND EVENTS IN THE 2016 REPORTING YEAR

Developments in the 2016 financial year were mainly characterised by the preparations for and implementation of the decision reached by the EU Commission on 2 May 2016 in the EU state aid proceedings which concerned the replenishment of the second loss guarantee issued by the federal states from €7 billion to €10 billion and the focusing on the Bank's operating activities.

According to the list of conditions and commitments provided to the EU Commission by the Federal Republic of Germany, on which the decision in the EU state aid proceedings is based, HSH Nordbank AG is to be sold by its current strategic owners by 28 February 2018. Against the backdrop of this privatisation significant measures were initiated in the 2016 financial year to prepare for the upcoming change in ownership. These include, on the one hand, the implementation, largely in line with the plan, of the structural measures provided for in the EU decision and, on the other, organisational and personnel changes within the Bank. Concurrently with the preparations for the change in ownership the Bank vigorously drove forward its operating business in the past year. The focus was on generating new business with reasonable income and risk profiles in a partially very challenging market environment. Furthermore, restructuring activities in the Shipping division were rigorously stepped up to further reduce the volume of non-performing loans. The Bank also made progress in line with the plan in optimising the organisation and processes as part of the intensified cost reduction programme.

Overall, the Bank achieved its key stated objectives for 2016 and closed the financial year with a break-even result for the year under HGB and positive earnings before taxes in the IFRS Group financial statements, which were characterised by a good operating performance on the part of the Core Bank and structural charges in the Non-Core Bank.

FORMAL DECISION IN THE CURRENT EU STATE AID PROCEEDINGS

The EU decision reached on 2 May 2016 regarding the replenishment of the second loss guarantee issued by the federal states from €7.0 billion to €10.0 billion confirms the informal agreement made on 19 October 2015 and, in principle, defines it in concrete terms and is based on a list of conditions and commitments provided to the EU Commission by the Federal Republic of Germany (EU decision). The structural measures agreed should result in an improved financial and risk situation following implementation and create the basis for a sustainable structure and viable business model for HSH Nordbank.

The structural measures include the sale of non-performing loans of €5.0 billion to the federal state owners at market values determined by the EU Commission under state aid aspects and the sale of a legacy portfolio of up to €3.2 billion in the market, which was mainly covered by the guarantee. A further point in the EU decision is the change relating to the future fee structure for the second loss guarantee, which is linked to the formation of a holding company and a subsidiary, which comprises HSH Nordbank's operating business and is to be privatised. Furthermore, it is intended to sell the operating company by 28 February 2018. This divestment deadline is met upon the signing of a purchase agreement and may be extended by up to six months with the consent of the EU Commission where there are delays in the technical implementation of the model for reasons outside the control of the federal states.

Rigorous implementation of the EU structural measures

Following the EU decision the Bank immediately started making preparations and implementing the structural measures. Important structural measures were completed as far as possible in line with the plan.

In this connection, a portfolio of non-performing shipping loans of €5 billion had already been sold to the federal state-owned hsh portfoliomanagement AöR as at 30 June 2016 (reporting date: 31 December 2015), under which the Bank was relieved to an appreciable extent of the burden of legacy loans in the Shipping division, which were entered into as part of the significant business expansion in the years up to 2009. The purchase price (€2.4 billion) determined by the EU Commission for this portfolio was paid to the Bank in the third quarter of 2016, thereby further improving the Bank's liquidity position. Losses (€2.6 billion) incurred on the sale were invoiced under the guarantee as part of the settlement of losses, of which €1.3 billion was attributable to the first loss piece and €1.3 billion to the second loss piece of the guarantee. The second loss piece was drawn down by a total amount of €1.9 billion as at 31 December 2016. Nevertheless, the Bank has a very large portfolio of legacy assets from the years prior to 2009 due to the complex settlement conditions under the guarantee agreement and the provision of only a small amount of relief under the EU decision in relation to the total NPE volume, which makes the privatisation process more difficult and is continuing to be systematically wound down.

Furthermore, the holding structure was established in the second quarter of 2016 which provided the operating HSH Nordbank with considerable relief from guarantee fees. Under this the operating company pays from 1 January 2016 a base premium of 2.2% (previously 4%) for the provision of the second loss guarantee, which is calculated solely on the unutilised, i.e. undrawn, portion of the guarantee (previously calculated on the nominal amount of the guarantee facility).

The implementation of the holding structure also entailed a change in the ownership structure of HSH Nordbank. The principal owner of the operating HSH Nordbank is HSH Beteiligungs Management GmbH with a shareholding of 94.9%. Private investors advised by J.C. Flowers & Co. LLC. also have a shareholding of 5.1%.

The Bank also started making intensive preparations in the second half of 2016 for the planned portfolio sales in the market. The sale of non-performing loans of up to €3.2 billion was approved as part of the implementation of the EU decision. In this regard, the Bank selected important legacy portfolios with a clear focus on further reducing risk on the Bank's balance sheet (market portfolio) and conducted a sales process in various phases. As a result of this process a contractual agreement for the sale of a loan portfolio of around €1.6 billion was signed on 27 January 2017. This represents a slight delay in the planned implementation by the 2016 year end. The impact on earnings was nevertheless recognised in the financial statements as at 31 December 2016. This portfolio mainly consists of around €0.8 billion of aircraft financing transactions and around €0.5 billion of Continental European commercial real estate loans from the years prior to 2009. Additional relief of around €0.3 billion was also achieved by HSH Nordbank by individual sales to other investors and principal repayments within the portfolio originally held for sale. The parties have agreed not to disclose details of the purchase price. In addition to meeting further conditions, the purchase agreements still require approval from the cartel authorities, which is expected to be received in the second quarter of 2017.

Further details on the sale of the market portfolio are set out in the Forecast, opportunities and risks report.

Privatisation process has started

The privatisation process is proceeding at a rapid pace. The official part of the privatisation of HSH Nordbank started with the announcement of the sale by the federal state owners, which was published on 23 January 2017. The Bank has strongly supported its owners in making preparations for the sales process since the third quarter of 2016. Special sales documentation is being prepared, discussions are being held with potential interested parties and organisational changes initiated. In particular, the reporting structures of the Core Bank and Non-Core Bank (formerly the Restructuring Unit), and therefore the segment structure, were adjusted. A portfolio reallocation was made between the Core Bank and Non-Core Bank in order to present each value creation structure in a transparent manner. This

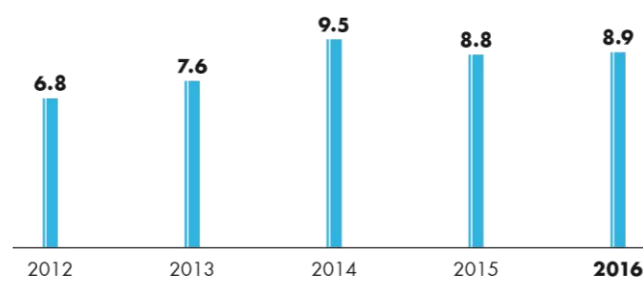
optimised the Core Bank portfolio and resulted in a more appropriate and uniform allocation of non-performing legacy loans in the Non-Core Bank, thereby further reducing the complexity of the Group structure.

POSITIVE NEW BUSINESS DEVELOPMENTS

New business of the Core Bank performed well, especially in the second half of 2016. In total, the Core Bank of HSH Nordbank generated new business of €8.9 billion in the past year. The Bank has therefore succeeded in slightly exceeding the previous year's volume of €8.8 billion as well as the forecast made at the end of the first half of 2016 despite the partially very difficult market environment. The Corporate Clients and Real Estate divisions made a significant contribution to these positive developments. The very good previous year's level was substantially exceeded in the Corporate Clients division in particular, whilst it was achieved in the Real Estate division and thus the new business plan was clearly exceeded in this segment. As expected, new business in the Shipping division was unsatisfactory due to the extremely challenging market conditions and the targeted management of the risk profile in this division. It is therefore both significantly below the plan amount and the previous year's level. This was the main reason for the original new business plan not being met.

NEW BUSINESS OF THE CORE BANK

(€ bn)



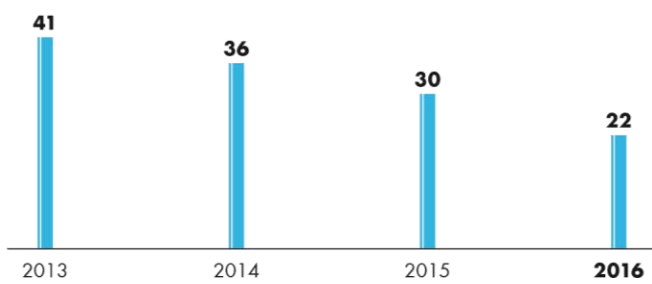
The ratio of new loans disbursed to new business concluded (disbursement ratio) increased during the 2016 financial year and was above the planned level as at 31 December 2016. Interest margins achieved in the highly competitive environment stabilised in the fourth quarter of 2016 but are still below the previous year and, overall, also failed to meet the targeted ambition level.

ACCELERATED WINDING DOWN OF LEGACY PORTFOLIOS

The winding down of the legacy portfolios held in the Non-Core Bank was also continued in 2016 according to plan taking account of the complex settlement conditions under the guarantee agreement. The portfolios have been reduced by € 8 billion in total (IFRS Group financial statements) since 31 December 2015. The change is composed of the reduction in connection with the federal state transaction of € 5 billion and, over and above this, the regular winding down of legacy assets of € 3 billion (including currency translation effects).

NON-CORE BANK: SEGMENT ASSETS

(€ bn)



Despite the continuing very difficult market conditions in the shipping industry, the winding down of non-performing ship financing transactions was continued in the first half of 2016 through restructuring shipping loans. Under the restructuring shipping loan tranches are transferred to investors thus reducing the Bank's risks in the portfolio. At the same time, the Bank secures as part of the transaction the option to benefit from a recovery in the shipping industry. Five new transactions of this type totalling around US dollar 0.5 billion were concluded in the first half of 2016. No further transactions of this type were entered into in the second half of 2016.

STRINGENT IMPLEMENTATION OF COST PROGRAMME

The reduction in costs achieved since 2014 is countering the increasing pressure on earnings in the highly competitive banking market and increasing costs incurred for regulatory requirements. The Management Board on 15 June 2016 agreed a further reduction in administrative expenses in the years 2016 to 2018 as part of the 2018PLUS cost reduction programme with the objective of achieving a sustainable, appropriate cost/income ratio of in principle under 50% for the Group. The planned measures provide for an additional reduction in headcount by 317 full-time employees (FTE) in the Group and further savings in operating expenses, especially for land and buildings as well as consultancy. Details regarding the implementation of the reduction in staff are governed by a reconciliation of interests, on which the Management Board and Group Works Council agreed in the third quarter of 2016. The social plan in place since 2011 was modified

slightly and contains the tools to be used for a socially acceptable reduction in staff. In the 2016 financial year further savings in the area of operating expenses were identified, agreed and have already been partially implemented.

The Bank made progress in 2016 in line with the plan in implementing measures for controllable operating expenses. The organisational structure in particular was streamlined as the basis for the planned reduction in staff. Furthermore, the Special Loans division, which is responsible in particular for loan restructuring in the legacy portfolios of the Non-Core Bank, was integrated under the responsibility of the CRO in the fourth quarter of 2016. In addition, the reduction in legal fees, building costs and other personnel-related operating expenses particularly contributed to the targeted management of operating expenses. In the case of personnel expenses around two thirds of the planned reduction had been contractually agreed with the employees by the year end.

Over and above the cost reduction programme the so-called lean management programme is contributing to the targeted improvements in processes and quality. The lean management philosophy and method has been gradually introduced since 2011 into the divisions with the help of the managers and with extensive employee participation. The bank-wide implementation had already been completed by the end of 2015. Further measures for improving efficiency were continually identified and implemented by the divisions as part of the so-called continuing improvement process. Since the beginning of the lean management programme a considerable amount of efficiency improvements has been identified and already implemented.

Already in 2015, the Bank launched a "Digital Business" initiative to benefit even more from the opportunities offered by digitisation. Key objectives are the development of tailored, innovative solutions to strengthen client relationships as well as the further improvement in internal processes. Focussed digitisation measures with a tangible value added for HSH Nordbank and its clients are being developed and already existing activities consolidated across the Bank. The first significant measures have already been implemented. For example, the introduction of the HSH banking app enables business clients to monitor and manage their accounts and payment transactions using mobile devices.

CHANGE IN COMPOSITION OF HSH NORDBANK'S MANAGEMENT BOARD IN 2016

In its meeting held on 9 May 2016, the Supervisory Board adopted changes to the Management Board: Stefan Ermisch, formerly Chief Financial Officer and Deputy Chairman of the Bank, moved to the head of HSH Nordbank AG on 10 June 2016 and, as Chairman of the Bank, will manage the Bank in the crucial phase of the planned change in ownership. Constantin von Oesterreich stepped down as Chairman following the annual results press conference on 9 June 2016, thereby initiating the change in leadership at the beginning of the privatisation process. Matthias Wittenburg, the Management Board member responsible for Market divisions, left the Bank with effect from 10 June 2016 by mutual agreement. On the same day Torsten Temp as sole Management Board member responsible for the Market divisions assumed this responsibility. Oliver Gatzke, who was previously head of the Finance division, was appointed Chief Financial Officer from 1 July 2016. Ulrik Lackschewitz was appointed Chief Risk Officer (CRO) of HSH Nordbank on 29 May 2015.

EARNINGS, NET ASSETS AND FINANCIAL POSITION

Balanced results of HSH Nordbank AG

HSH Nordbank AG disclosed a balanced result for the year 2016 of € 0 million (previous year: € -100 million). Net operating income after loan loss provisions/valuation amounted to € 207 million (previous year: € 75 million).

The Bank's strategic segments as well as non-recurring income of € 136 million from the sale of loans made a positive contribution to this result. In contrast to that, there are charges of € 111 million incurred in connection with restructuring activities and the privatisation process, which are disclosed under the extraordinary result. The result was also adversely impacted by a noticeable decrease compared to the previous year in the interest-bearing loan volume, which the Bank had accordingly included in its planning. The reduction in the interest-bearing loan volume is mainly attributable to restructuring measures and the recognition of loan loss provisions, which mainly relate to the shipping portfolio. Moreover, the low level of interest rates and intense competition continued to have a negative effect on the Bank's earnings situation.

To take account of the continuing very difficult market conditions in the shipping industry, which are reflected in charter rates not covering costs and very low ship values, again a high amount of valuation allowances had to be recognised in the reporting year for shipping loans. At the same time, the loan loss provision result was positively affected by the settlement of the losses incurred by the Bank on the sale of the loan portfolio of € 5 billion to hsh portfoliomanagement AöR. In connection with the settlement of losses arising from this federal state transaction and further settlement of losses under the guarantee with HSH Finanzfonds AöR primarily interest payments not received in the past of € 430 million could also be charged by the Bank in addition to loan losses incurred.

A further significant reduction in controllable operating and personnel expenses in total was achieved in line with the plan against the backdrop of the ongoing cost reduction programme.

Further details underlying the business performance are discussed below in the "Earnings, net assets and financial position" section.

EARNINGS, NET ASSETS AND FINANCIAL POSITION OF HSH NORDBANK AG

EARNINGS SITUATION

INCOME STATEMENT (SINGLE ENTITY)

(€ m)	2016	2015	% change
Net interest income	874	983	- 11
Net commission income	- 142	-362	61
of which: Fees for the second loss guarantee	- 227	-475	52
Net income from the trading portfolio	83	-37	> 100
Administrative expenses	- 573	-693	- 17
of which: Personnel expenses	- 207	-314	- 34
of which: Operating expenses	- 366	-379	- 3
Other operating income	- 8	-5	- 60
Operating result before loan loss provisions/valuation	234	- 114	> 100
Loan loss provisions/valuation	- 27	189	> 100
Operating result after loan loss provisions/valuation	207	75	> 100
Extraordinary result	- 106	-33	>- 100
Income tax expenses	- 101	-181	- 44
Income from the assumption of losses	-	39	-100
Result for the year	-	- 100	- 100

Increase in total income

Total income of the IFRS Group (important management indicator in the previous year) has decreased to € 921 million in the 2016 reporting year compared to € 1,296 million in the previous year. Total income exceeded plan, but, as expected, was below the previous year, which was positively affected by the implementation of the EU decision.

Total income of the Core Bank under IFRS (important management indicator in the previous year), which, as forecasted in the previous year, increased significantly (from € 850 million to € 1,003 million), reflects effects of the recognition of unrealised gains on the sales of promissory note loans and securities, which were recognised for the most part in the second quarter of 2016, and measurement effects in the net trading income in addition to the new business concluded.

Reconciliation between IFRS Group total income and HGB single entity total income is performed to explain the earnings of the single entity. Details regarding this are set out in the "Management system" chapter in the "Reconciliation" section.

Total income of the single entity under HGB is composed of net interest income, net commission income, net income/expenses from the trading portfolio and other operating income. It amounted to € 807 million at the 2016 year end and was therefore as expected significantly above the previous year's level (€ 578 million). The individual income line items contributed to total income under HGB as follows:

Net interest income of the single entity amounted to € 874 million compared to € 983 million in the previous year. In addition to interest income from operating activities the net interest income included non-recurring income arising on the sale of loans in the amount of € 136 million.

The average interest-bearing loan volume decreased overall. The positive income effects generated by the client business as well as non-recurring income were partially offset by the more rapid portfolio reduction, the recognition of loan loss provisions as part of the restructuring measures, primarily located in the shipping portfolio and the generally higher loan repayments. HSH Nordbank AG's net commission income amounted to € -142 million (previous year: € -362 million) was adversely impacted in particular by reduced fees for the second loss guarantee € -227 million under the EU decision (previous year: € -475 million). This adverse impact was offset in turn, inter alia, by commission income of € 117 million.

HSH Nordbank AG's net commission income of € 85 million adjusted for expenses for government guarantees decreased sharply compared to the previous year (€ 113 million). This decrease is primarily attributable to lower restructuring fees associated with the significant portfolio reduction.

Cross-selling of services in connection with new business in addition to loan financing had a positive impact.

Net income from the trading portfolio amounted to € 83 million (previous year: € -37 million). The significant increase is mainly attributable to net operating income from interest rate transactions. € 9 million was added during the reporting period to the fund for general banking risks in accordance with Section 340e from net income from the trading portfolio (previous year: € 0 million).

Other operating income amounted to € -8 million (previous year: € -5 million). This mainly includes cost allocations and expense reimbursements (€ 37 million), income from the settlement of legal disputes (€ 33 million), income from the reversals of other provisions (€ 22 million) option premium expense paid and adjustment payments for options held in the banking book (€ -65 million) as well as expense relating to the discounting of provisions (€ -33 million). The expense relating to the decrease in the discount rate used for pension provisions (€ -78 million) – based on the calculation of the discount rate using a seven year average – and income from the conversion of the calculation method to determine the discount rate from a seven year average to a ten year average (€ 86 million) is disclosed under this line item.

Cost savings take effect

IFRS Group administrative expenses (important management indicator in the previous year) amounted to € -634 million for the reporting period (€ -634 million). Savings realised in line with the plan under the ongoing cost reduction programme for controllable personnel and operating expenses were offset by unplanned special depreciation of € -66 million recognised in connection with the revaluation of property, plant and equipment of subsidiaries. Administrative expenses consequently exceeded the plan amount by a considerable extent. Excluding this one-off charge, administrative expenses would have decreased by 10% compared to the same period in the previous year despite increasing costs for regulatory requirements.

IFRS Group administrative expenses are reconciled to the HGB single entity administrative expenses to explain the earnings disclosed in the single entity financial statements prepared in accordance with HGB. Details regarding this are set out in the "Management system" chapter in the "Reconciliation" section.

The single entity administrative expenses (HGB) amounted to € -573 million in the past year after taking account of expenses of € -56 million for the bank levy and deposit guarantee fund (previous year: € -693 million). The moderate decrease in administrative expenses planned in the previous year was thereby exceeded.

Conversion effects also contributed to the reduction in administrative expenses in addition to the operating savings made. Administrative expenses for the previous year included an expense of € -64 million arising from the change in the discount rate used for pension provisions. The effects arising from the changes in the discount rate were disclosed under other operating income in the reporting year.

Continuing high level of loan loss provisions

Loan loss provisions continued to be dominated in the reporting year by a high level of additions in the shipping portfolio. Additional loan loss provision expenses were recognised for legacy portfolios in the shipping portfolio to take account of the very difficult market developments, which were reflected in a significant reduction in charter rates and ship values. This expense was mainly accounted for by loans for bulkers and container ships. The risk trend in the other segments (Real Estate, Corporate Clients) was unremarkable.

The IFRS loan loss provision expense (important management indicator in the previous year) amounted to € -1,577 million as at 31 December 2016 before taking account of the compensation effect under the guarantee (previous year: € -3,020 million). Although it was significantly below the previous year, it exceeded the planned amount. In the previous year, IFRS loan loss provisions were mainly shaped by the changed commitment strategies that took account of market values as at the planned disposal date for the portfolios to be sold in accordance with the findings of the EU state aid investigation. In this regard, additional IFRS loan loss provisions of € -1,584 million were recognised for the transaction portfolios. Compensation under the second loss guarantee for the guaranteed portfolio, which is disclosed within the IFRS loan loss provisions, amounted to € 2,208 million (previous year: € 2,666 million) after taking account of currency translation gains/losses. After taking account of the current loan loss provision expense IFRS loan loss provision income amounted to € 631 million (previous year: expense of € -354 million) after the compensation effect of the second loss guarantee. Taking account of the expense of € -475 million (previous year: income of € 658 million) arising from changes in the hedging effect of the credit derivative IFRS loan loss provision income after the guarantee effect would amount in total to € 156 million (previous year: € 304 million) and, as planned, has decreased significantly compared to the previous year, also as a result of the disclosure of the hedging effect of the credit derivative of € -475 million in the separate "Hedging effect of the credit derivative under the second loss guarantee" line item.

The IFRS Group loan loss provisions are reconciled to the HGB single entity loan loss provisions to explain the earnings disclosed in the single entity financial statements prepared in accordance with HGB. Details regarding this are set out in the "Management system" chapter in the "Reconciliation" section.

HSH Nordbank AG disclosed under consideration of the guarantee effect a negative amount of € -27 million (previous year: € 189 million) in the loan loss provision/valuation line item of the

HGB single entity comprising loan loss provision income after compensation (€ 92 million), valuation result in the securities business (€ 153 million), valuation result from equity holdings (€ -15 million) as well as additions to and releases from the Section 340g reserves (€ -257 million), which was in line with expectations.

Loan loss provisions recognised in the reporting year, particularly for legacy portfolios, continued to be compensated for by the guarantee if they related to portfolios covered by the guarantee.

Loan loss provision expense recognised in the reporting year before taking account of the compensation effect of the guarantee amounted to € 1,718 million as at 31 December 2016 (previous year: € 3,519 million). Compensation under the second loss guarantee for the guaranteed portfolio, which is disclosed within loan loss provisions, amounted to € 1,811 million (previous year: € 3,688 million) after taking account of currency effects. After taking account of the current loan loss provision expense loan loss provision income amounted to € 92 million (previous year: € 169 million).

The loan loss provision results were positively affected by the settlement of the losses incurred by the Bank on the sale of the loan portfolio of € 5 billion to hsh portfoliomanagement AöR via the compensation under the second loss guarantee. In connection with the settlement of losses arising on this federal state transaction and further losses under the guarantee with HSH Finanzfonds AöR interest payments not received in the past of € 430 million could also be charged by the Bank in addition to loan losses incurred.

The hedging effect of the guarantee also gave rise for the first time to a cash drawdown of the guarantee after also taking account of the transfer of non-performing loans to hsh portfoliomanagement AöR as at the 2016 year end. As of the reporting date, the Bank's first loss piece (€ 3.2 billion) was exceeded by € 2.3 billion by losses incurred in particular in connection with the settlement of losses relating to the federal state transaction. The balance sheet utilisation of the second loss guarantee amounted to € 9.9 billion including guarantee payments of € 1.9 billion already received as at 31 December 2016 (as at 31 December 2015: € 8.1 billion). Further information regarding the second loss guarantee is set out in Note 3.

Loan loss provisions/valuation result for the securities business increased significantly to € 153 million (previous year: € 47 million). This result reflected the positive effects of the sale and valuation of securities. Income of € 126 million was generated in the reporting year from the sale of securities held in the banking book. Moreover, gains were realised on the sale of positions in the credit investment portfolio carried out to further reduce the high risk portfolios over and above the reduction provided for under the guarantee agreement whilst maximising value and could not be invoiced under the guarantee also had to be taken into account.

In accordance with the announcement made under the Financial Market Stability Act HSH Nordbank exchanged its Heta Asset Resolution AG (HETA) holdings of securities and promissory note loans (€ 223 million) in the fourth quarter of 2016 for zero coupon bonds of the Carinthia Settlement Fund (Ausgleichzahlungs-Fonds). This resulted in the recognition of a gain of € 48 million as at the reporting date, which is included in the above-mentioned valuation result. This gain was offset by the recognition of an expense in the equivalent amount resulting from a corresponding reduction in the hedging effect of the second loss guarantee in loan loss provisions due to the hedging of transactions under the second loss guarantee.

Loan loss provisions/valuation result for equity holdings amounted to € -15 million (previous year: € -27 million). The negative result is mainly attributable to write-downs of equity holdings, which exceeded the gains arising from sales.

Operating result after loan loss provisions/valuation

The operating result after loan loss provisions/valuation amounted to € 207 million compared to € 75 million in the previous year. This primarily reflected the increase in total income, the positive compensation effect of the guarantee due to the settlement under the guarantee of interest losses incurred on loan loss provisions, realised gains on securities sold and the reduction in administrative expenses.

The extraordinary result increased to € -106 million compared to € -33 million in the previous year. This result was adversely impacted by restructuring expenses incurred in connection with the Bank's realignment and privatisation expenses. This was offset by the reversal of provisions recognised as part of previous restructuring programmes.

Net income before taxes positive as expected

In the IFRS Group (important management indicator) HSH Nordbank generated net income before taxes of € 121 million (previous year: € 450 million) in 2016, which was above expectations and takes account of the operating performance and the backdrop of the implementation of structural measures, in particular the sale of a loan portfolio of € 5 billion to hsh portfoliomangement AöR. The return on equity (important management indicator) calculated on the basis of net income before income taxes amounted to 2.5% (previous year: 9.4%) and exceeded plan. The cost income ratio amounted to 64.8% (previous year: 47.5%), which was significantly above the previous year and weaker than planned due to the special effects.

The IFRS Group net income before taxes is reconciled to the HGB single entity profit before taxes to explain the earnings disclosed in the single entity financial statements prepared in accordance with HGB. Details regarding this are set out in the "Management system" chapter in the "Reconciliation" section.

HGB net income before taxes for the single entity amounted to € 101 million (previous year: € 42 million). After taking account of income taxes of € -101 million (previous year: € -181 million) income from the absorption of losses of € 0 million (previous year: € 39 million) HSH Nordbank AG disclosed, as expected, a result for the year of € 0 million for the 2016 financial year (previous year: € -100 million).

HSH Nordbank AG's income tax expenses mainly comprise current tax expense for 2016. The income tax expenses line item also includes deferred income tax expenses of € 64 million. This is primarily attributable to the decrease in temporary differences due to the lower number of valuation differences between the commercial and tax balance sheets. Total tax expense after taking account of current and deferred taxes amounted to a tax result of € -101 million (previous year: € -181 million).

Distributions may not be made on silent participations in the event that a net loss for the year or an accumulated loss is determined. Furthermore, equity instruments must also share in the net loss for the year or an accumulated loss in the event of a net loss for the year or an accumulated loss. Silent participations shared in the Bank's losses in the amount of € 39 million in the previous year. No loss participation was required in the 2016 financial year due to the break-even results. Silent participations are placed in the international capital markets (€ 921 million) and with institutional investors (€ 321 million).

The existing loss carry forward from 2015 of € -100 million was offset by a transfer from the capital reserves in the 2016 financial year. The carrying amounts of hybrid instruments equate to 52.4% of the original nominal amount due to loss participations in previous years.

NET ASSETS AND FINANCIAL POSITION

BALANCE SHEET (HGB SINGLE ENTITY)

(€ m)	2016	2015	Change in %
Assets			
Cash reserve, debt instruments issued by public authorities, bills eligible for rediscounting at central banks	3,477	3,329	4
Loans and advances to banks	2,240	3,103	-28
Loans and advances to customers	52,937	61,014	-13
Securities	16,821	19,358	-13
Trading portfolio	3,228	5,001	-35
Equity holdings and interests in affiliated companies	784	775	1
Other assets	3,238	3,277	-1
Total assets	82,725	95,857	-14
Liabilities			
Liabilities to banks	10,275	14,855	-31
Liabilities to customers	41,495	46,348	-10
Securitised liabilities	17,554	20,811	-16
Trading portfolio	1,771	2,011	-12
Subordinated liabilities and profit participation capital	2,106	2,101	0
Fund for general banking risks	2,348	2,082	13
Equity capital	4,337	4,324	0
Other liabilities	2,839	3,325	-15
Total liabilities	82,725	95,857	-14
Contingent liabilities	2,399	3,289	-27
Other obligations	6,738	6,417	5
Derivatives held in the banking book (credit equivalents)	791	1,196	-34
Total off balance sheet business	9,928	10,902	-9
Business volume	92,653	106,759	-13

Decrease in total assets

Total assets in the HGB single entity financial statements decreased significantly during the 2016 reporting year to €82,725 million (31 December 2015: €95,857 million). This was mainly attributable to the sale of a portfolio of non-performing shipping loans of €5 billion to the federal state-owned hsh portfoliomanagement AöR. The reduction in total assets is also due to the accelerated reduction in risk positions.

The movement in material items on the asset side was as follows: Loans and advances to banks decreased significantly to €2,240 million (31 December 2015: €3,103 million). This was mainly caused by lower levels of call deposits held at other banks.

Loans and advances to customers amounted to €52,937 million (31 December 2015: €61,014 million). The reason for the reduction was the above-mentioned portfolio sale. Additionally, loan principal repayments in the client divisions played a significant role, which more than offset new business generated in the Core Bank. The securities portfolio decreased from €19,358 million to €16,821 million. Both securities as well as bonds and debentures declined. Trading portfolio assets recorded a significant decrease from €5,001 million as the 2015 year end to €3,228 million. Debentures and other fixed-interest securities in the trading portfolio contributed in particular to this reduction.

All material line items on the liability side of the balance sheet also decreased. Liabilities to banks declined to €10,275 million compared to €14,855 million as at 31 December 2015. This was mainly due to a decrease in liabilities to central banks and repurchase agreements.

Liabilities to customers decreased to €41,495 million (31 December 2015: €46,348 million). Demand deposits and repurchase agreements concluded with clients also decreased. Securitised liabilities of €17,554 million (31 December 2015: €20,811 million) were significantly lower than the previous year. The reduction was attributable to a higher volume of maturities than new issues.

Subordinated liabilities and profit participation capital remained constant compared to the previous year (31 December 2015: €2,106 million, previous year: €2,101 million). Equity capital of €4,337 million as at 31 December 2016 also remained on previous years' level (as at 31 December 2015: €4,324 million). The fund for general banking risks, to which net income from the trading portfolio of €9 million and other transfers of €258 million were added, recorded an increase.

Business volume also decreased

Business volume decreased in line with the reduction in total assets and amounted to €92,653 million (31 December 2015: €106,759 million). Contingent liabilities comprising primarily guarantees and warranties also decreased significantly to €2,399 million (31 December 2015: €3,289 million), whilst other obligations consisting mainly of irrevocable loan commitments increased slightly to €6,738 million (31 December 2015: €6,417 million).

Capital and funding

CET1 ratio of single entity increases to 16.5%

The core Tier 1 capital ratio (CET 1 ratio, under the Basel III transitional arrangements, phase-in) increased to 14.1% at the level of the IFRS Group financial statements of HSH Nordbank (key management indicator) as at 31 December 2016 and is therefore above plan and still at a good level from the Bank's perspective. It significantly exceeded the previous year's ratio also in the fourth quarter 2016. The development since 31 December 2015 (12.3%) includes the net income for the year, a significant reduction in RWA and the change made to the recognition of the senior tranche of the second loss guarantee for regulatory purposes. This was partially offset by significantly higher items deducted from equity capital.

RWA in the IFRS Group (important management indicator in the IFRS Group) have decreased compared to 31 December 2015 by around €9 billion to €28.6 billion and were therefore significantly below the plan level. The reduction in RWA is mainly attributable to the sale of shipping loans, mostly denominated in US dollar, to hsh portfoliomanagement AöR (federal states) as at 30 June 2016 and associated significant decrease in market risk RWA, securitisation of portfolio risks (synthetic securitisation transaction) and the continued active winding down of legacy portfolios. However, the trend in the Bank's key risk parameters was negative compared to the previous year, primarily because of developments in the shipping markets.

The calculated risk weight for the senior tranche of the second loss guarantee of the federal states amounted to around 24% and therefore slightly exceeded the regulatory minimum risk weight of 20%. There was no free guarantee buffer available at the 2016 year end (31 December 2015: around €1.7 billion of free capacity for expected and unexpected losses/guarantee buffer). Besides the deterioration in risk parameters in the shipping portfolio, this is mainly attributable to the settlement of losses (particularly those arising from the federal state transaction) under the second loss guarantee. In a change in the approach adopted as from the fourth quarter 2016 as compared to the approach used until the third quarter of 2016 full settlement of losses is assumed for loan loss provisions derecognised but not yet invoiced to the guarantor under the federal state guarantee.

Furthermore, full implementation of the findings of the supervisory review of the second loss guarantee and charges for regulatory purposes was taken into account by the creation of a virtual so-called "sub-senior tranche" as part of the regulatory recognition of the federal state guarantee as at the reporting date. The senior tranche of the Sunrise guarantee was split into two (virtual) tranches of whom a sub-tranche, receiving a risk weight of 1,250% is deducted from regulatory capital. The resulting deduction from capital amounted to €0.6 billion as at 31 December 2016. The economic utilisation of the second loss guarantee increased in the reporting year.

The capital ratios disclosed assume that the material transfer of risk is allowed for the second loss guarantee despite a marked increase in the economic utilisation of the guarantee as at 31 December 2016.

Even under the assumption of full implementation of the Basel III rules (fully loaded) HSH Nordbank's CET1 ratio increased significantly to 13.4% at the level of the IFRS Group financial statements compared to 31 December 2015 (11.6%).

As part of the supervisory process in the Banking Union, HSH Nordbank was assigned an individual minimum ratio by the ECB that is reviewed annually in the SREP process. This ratio was adhered to at all times during 2016. A CET1 capital ratio of 10.5% (phase-in), including a regulatory early warning threshold (Pillar 2 Guidance "P2G"), applies to HSH Nordbank at the level of the IFRS Group financial statements of HSH Nordbank from 1 January 2017. This is composed of the SREP minimum requirement of around 8.9% (Pillar 2 Requirement "P2R") plus an early warning buffer of 1.6%.

As part of the supervisory process in the Banking Union, the financial holding group was assigned an individual minimum ratio by the ECB, which is in line with the statutory regulations and reviewed annually in the SREP process. In this regard, a core Tier 1 capital ratio of 4.5% plus capital buffer requirements of around 5.8% in total then applies to the financial holding group from 1 January 2017. The CET 1 capital ratio was 7.9% as at 31 December 2016.

The Group's CET1 capital ratio is reconciled to the CET1 ratio of the single entity to explain differences disclosed in the single entity statements. Details regarding this are set out in the "Reconciliation" sub-section of the "Management system" section.

The same period CET1 ratio of HSH Nordbank AG (including Basel III transitional rules) amounted to 16.5% (previous year: 14.3%) in the HGB single entity. Allocations to the fund for general banking risks and the reduction in the aggregated RWA had a positive impact in this regard.

HSH Nordbank AG's classical Tier 1 capital ratio reached 20.8% (previous year: 17.7%), its overall capital ratio amounted 24.7% (previous year: 21.3%) (same period in each case).

Opportunities and risks regarding the capital and RWA forecast are set out in the Forecast, opportunities and risks report section.

Funding activities again expanded

HSH Nordbank has successfully continued to implement its funding strategy as planned in 2016 by using different sources of funding.

Retail funding performed well in the challenging low interest rate environment. The raising of funding was significantly above plan in the reporting period due to placements with institutional clients.

The Bank had already successfully used the capital markets in the first half of 2016 to issue two large volume Pfandbriefe. A public sector Pfandbrief of € 500 million was followed in April 2016 by a seven year mortgage Pfandbrief in the same amount of € 500 million, which was increased to € 850 million in July 2016 due to the strong demand.

Asset-based funding (ABF) also remains an important refinancing instrument for the Bank, which strengthens the primary US dollar refinancing base in particular. Two further long-term transactions were concluded in the past year via the ABF platform. USD 200 million was raised via a transaction secured by infrastructure loans and USD 250 million via a transaction secured by corporate loans.

Besides the issuing activities, the level of deposits contributed to the implementation of the funding strategy. The deposit and depositor structure was further improved by the liquidity inflow from the sale of the shipping loan portfolio to hsh portfoliomanagement AöR. Total deposits amounted to € 29.7 billion as at 31 December 2016 (31 December 2015: € 35 billion). Furthermore, at the 2016 year end, the Bank held liquidity reserves in the form of credit balances at central banks in the total amount of € 3.4 billion and collateral eligible for refinancing at central banks in the amount of € 12.0 billion, which the Bank can access at any time.

The sale of the shipping loan portfolio to hsh portfoliomanagement AöR resulted in a strengthening of the liquidity situation in the middle of 2016 following the receipt of the sales price of € 2.4 billion. The liquidity position was also improved by the receipt of payments of € 1.9 billion relating to the settlement of losses under the second loss guarantee. The regulatory requirements for the Bank's liquidity ratios were met during the reporting period. The liquidity ratio as defined in the German Liquidity Regulation (LiqV), important management indicator in the IFRS Group in the previous year) was 1.92 as at 31 December 2016 (31 December 2015: 1.89) and remained significantly above the regulatory minimum requirements. The liquidity coverage ratio (LCR, short-term minimum liquidity ratio) reached a very good level of 229% as at 31 December 2016 (31 December 2015: 112%, in accordance with the Basel QIS framework) and was therefore also significantly above the minimum requirements.

The liquidity development report showed a minimum survival period (important management indicator in the IFRS Group) of 10 months in the combined stress scenario as at 31 December 2016. This was 4 months as at the previous year's reporting date (31 December 2015) due to higher maturities of financial instruments covered by the guarantor liability. The regulatory requirement of 1 month was therefore clearly exceeded.

Opportunities and risks regarding funding, liquidity and ratings are set out in the Forecast, opportunities and risks report section.

FINAL ASSESSMENT OF HSH NORDBANK'S POSITION

The EU decision and structural measures implemented in the reporting period have made a significant contribution to the Bank's overall satisfactory performance in the past year. The CET1 ratio was substantially increased at the IFRS Group level (important management indicator) by the net income for the year and especially by the reduction in RWA due to the sale of non-performing loans to hsh portfoliomanagement AöR (federal state owners) as well the securitisation of portfolio risks (synthetic securitisation transaction). The NPE ratio also improved slightly despite the additional significant loan loss provision expense recognised on legacy loans in the Non-Core Bank. Funding requirements also decreased due to the ongoing reduction in total assets, particularly in the US dollar area. The Bank's overall liquidity situation has clearly improved as a result of this and the drawdown of the guarantee made as part of the settlement of losses. Furthermore, HSH Nordbank's operating performance was also satisfactory under the current conditions. New business concluded and product sales in the Core Bank made a significant contribution to this, although the Bank deliberately placed restrictions on new shipping business due to developments in the shipping markets. The Bank's positive performance was also supported by the cost measures implemented and progress made in optimising processes and organisational structures.

The Core Bank results show that the market successes and efficiency improvements achieved in the segments in the past year under demanding underlying conditions (including deterioration in market conditions in the shipping industry, low level of interest rates, intense competition, EU proceedings) are having a noticeable effect in the segments. With the implementation of the Core Bank's further expandable business model HSH Nordbank is well-positioned overall and is on the right track with regard to its operating business.

The Non-Core Bank mainly holds legacy loans that originate from the years prior to 2009 and are covered by the second loss guarantee. Shipping loans account for most of the portfolios. On the one hand, the continuing very difficult market conditions in the shipping industry and the resulting high additions to loan loss provisions for legacy assets in the reporting period had a clearly negative effect on the Bank's performance. On the other, the required acceleration in the winding down of non-performing loans is only possible to a limited

extent due to the complex settlement conditions under the guarantee agreement, thereby putting additional pressure on the Bank's performance.

In summary, HSH Nordbank assesses its performance as positive taking account of the EU decision and the operating progress achieved. Through the structural measures implemented by the Bank in 2016, in line with the plan to the greatest possible extent, key milestones were achieved on the road to meeting the divestment order. Overall, the improvements achieved in the Bank's financial and risk situation form a solid basis for the focussed driving forward of the sales process officially opened in January 2017.

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

EMPLOYEES OF HSH NORDBANK

Human resource strategy of HSH Nordbank

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

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

Effective resource management

The programmes initiated by the Management Board in 2015/2016 to permanently reduce administrative expenses were successfully implemented. It was possible to agree socially acceptable solutions for the reduction in staff with the Works Councils and achieve the targeted 2016 objectives in this regard.

The number of employees decreased to 1,902 based on full-time equivalents (FTE) by the 2016 year end in the course of the ongoing reduction in staff within HSH Nordbank (single entity) (31 December 2015: 2,117).

Focus on professional development

Staff development is the focal point of human resource functions for HSH Nordbank. To this end, the comprehensive range of programmes was tailored in 2016 to professional requirements in particular and focussed on the further development of sales expertise by offering a wide range of training sessions, coaching, seminars and linked in-house presentations by all client divisions. There are also programmes for the further development of managers with the focus on change and implementation skills. A wide range of continuing IT education as well as specialist and health-related seminars complete HSH Nordbank's multi-faceted personnel development programme.

Young professionals programme expanded further

In addition to developing all employees, the recruitment and promotion of young professionals was further boosted in 2016 by increasing the number of trainee places and the possibility of being hired and promoted after the training period. HSH Nordbank thus offers qualitatively high-quality education for the Bachelor of Arts/Science degree in business management/information systems and for the office management specialist occupations. A total of 33 students/trainees were employed in 2016. In the past year, seven dual students and one trainee completed their dual studies or training at HSH Nordbank with a very good or good overall score and received an open-ended job offer. These young professionals now have further promotion possibilities following the training.

A 24 month individual trainee programme covering a wide range of topics is offered to new entrants to the profession. High-quality training is hereby ensured by comprehensive and in-depth insights into each of the Bank's fields of activity. A total of 21 trainees were employed in 2016.

Due to the expanded young professionals programme HSH Nordbank was also again honoured in 2016 by Absolventa GmbH as a provider of a career-enhancing and trainee programmes as well as by Initiative Karriere.de as a Fair Company for its good treatment of trainees and university graduates.

The young professionals programme is a key element for counteracting the demographic trend of the workforce and increasing age of HSH Nordbank's employees. In 2016 HSH Nordbank developed a target for a balanced demographic employee structure for 2020 for this purpose. Vacant positions are used to achieve this target and – to the extent possible – are filled by young professionals. HSH Nordbank adopted new approaches in 2016 for this purpose and successfully used social media to recruit.

Further expansion of exemplary health care and social management services

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

HSH Nordbank was recognised in 2016 by the Hamburg Office for Occupational Safety for "exemplary occupational safety and health protection" due to its comprehensive health management tailored to employee needs. The award is also an incentive to ensure that there is no let-up in the activities to maintain and promote employee health.

Clear communication strategy prerequisite for a successful privatisation process

The wide range of health care and social management services offered as well as the interesting work opportunities make HSH Nordbank an attractive employer in a challenging, competitive environment with a clear objective for the future, but which is still subject to uncertainty. Managers at HSH Nordbank are committed to communicating openly with all employees regarding the privatisation objective as well as the associated uncertainty, as clear communication creates trust and is essential for the Bank's success.

Equal opportunities and women in management positions – Management Declaration pursuant to Section 289a of the German Commercial Code (Handelsgesetzbuch – HGB)

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

In August 2015, the Supervisory Board approved a target of 20% for the proportion of women on HSH Nordbank AG's Management Board, which is to be achieved preferably by 30 June 2017. There is currently no female member of HSH Nordbank AG's Management Board.

Furthermore, a target of at least 15% was agreed for the proportion of women at the department head level as at 30 June 2017. The lower limit for the proportion of women in management positions reporting directly to the Management Board is 16%. Whereas the department head ratio was clearly exceeded as at 31 December 2016 with females accounting for 21% of the department head positions, the target for direct reporting department heads, currently 15%, has not yet been fully achieved. However, the efforts made to promote young female professionals in particular allow the Human Resources division to fill vacant positions at the next higher level from the large group of female department heads. HSH Nordbank is confident that it will be able to achieve both quotas by the 30 June 2017 reporting date. To this end, the "Equal Opportunity Promotion Plan" has been expanded in 2016 to include further measures such as workshops on female promotion and the embedding of this topic in the overall bank objectives.

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

The Supervisory Board had already approved in 2011, based on the then new requirements of the German Corporate Governance Code (DCGC), the objective that the prevailing proportion of women should also not fall below 20% in the future. The Supervisory Board considers an initial target of 30% to be an appropriate proportion of women. With a current proportion of women of 37.5% the Supervisory Board has already met the target set by itself. The proportion of women employed by the shareholders is currently 25%, and 50% on the employer side.

Employee remuneration

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

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

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

The required adjustments identified on the basis of the amended InstitutsVergV that came into force on 1 January 2014 were implemented. Due to the fact that these regulations are dependent upon the relevant collective bargaining agreements, they have been adapted in 2015.

The Human Resources division is preparing for the changes in the InstitutsVergV and, together with the Mediation Committee, will probably make further adjustments to the remuneration systems in 2017. The objective is to ensure that remuneration is attractive and in line with the market.

In accordance with the ordinance further details are published in a separate remuneration report on HSH Nordbank's website.

REPORT ON EVENTS AFTER THE REPORTING DATE

Sale of the first tranche of the market portfolio

The sale of non-performing loans of up to €3.2 billion in the market was approved as part of the implementation of the decision reached by the EU Commission on 2 May 2016 in the EU state aid proceedings regarding the replenishment of the second loss guarantee. In this regard, the Bank has selected significant portfolios that are to be sold in the market by the middle of 2017 (market portfolio). By winding down the NPE portfolios the portfolio quality will be gradually improved and the Bank will be further relieved of high levels of legacy assets. The defined portfolio consists of four non-strategic portfolios – aviation, continental European real estate (Scandinavia, the Netherlands, Germany), energy and international real estate.

Sales agreements were signed on 27 January 2017 for the first tranche, which includes, inter alia, aircraft financing transactions (volume of around €0.8 billion EaD) and continental European real estate loans (volume of around €0.5 billion EaD). The purchaser of the aircraft portfolio is the Australian investment bank, Macquarie and the real estate loans were acquired by Bank of America Merrill Lynch. The parties have agreed not to disclose details of the sales price. The sales agreements still require approval from the cartel authorities in this context, which, if they have not already done so, is expected to be received in the second quarter of 2017.

There are further closing conditions with respect to the aircraft financing transactions, including technical inspections of the aircraft, which may give rise to other consequences (e.g. adjustments to the sales price or withdrawal from the contracts). Accordingly, the transfer in rem of the commitments, and therefore the de facto relief of the balance sheet, is expected to take place in the first half of 2017 (closing). The closing of the real estate loans transaction took place on 3 March 2017. The impact on the measurement of the receivables and aircraft concerned was recognised in the annual financial statements as at 31 December 2016.

Additional relief of around €0.3 billion was also achieved by HSH Nordbank AG as part of the market transaction with individual sales to other investors and principal repayments within the portfolio originally held for sale.

FORECAST, OPPORTUNITIES AND RISKS REPORT

FORECAST REPORT INCLUDING OPPORTUNITIES AND RISKS

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

One key assumption used in corporate planning in view of the ongoing sale process of HSH Nordbank AG is the overall sale of HSH Nordbank AG as a whole, i.e. the sale of all shares in the Bank held by the seller, including all assets and liabilities, as a preferred solution without any early disposals of assets or sub-areas at amounts below the carrying amount in the event of outstanding bids for an overall sale. The owners are responsible for the sale of the shares, HSH Nordbank's Management Board supports the sale accordingly. In its forecasts and assumptions, the Bank has assumed the sale of the overall bank, as scheduled, adhering to the time schedule agreed in the agreed list of conditions and commitments, such that HSH Nordbank's business model is not negatively affected. The plan is thus based on the assumption that a potential acquirer will in principle continue the Bank's business model. Within this context, it is assumed that the viability assessment to be performed by the European Commission following a successful change of ownership will have a positive outcome, meaning that the Bank will comply with all of the agreements reached in the EU proceedings. As it is not possible to objectively predict the course and outcome of the privatisation process, the process involved in the sale of HSH Nordbank AG creates considerable uncertainty regarding the implementation of the corporate planning, the determination of the loan loss provisions and accounting and measurement.

Estimates regarding the long-term trend in loan loss provisions as well as the planning for payment defaults and, consequently, the actual drawdown of the second loss guarantee are subject to significant uncertainty due to the very long planning horizon, which can influence the future development of the Bank to a greater degree than expected. The main uncertainty factors result, for example, from the movement in key market parameters such as freight and charter rates, ship values as well as the US dollar exchange rate.

A key driver of the amount of loan loss provisions is also the breakdown of impaired loan commitments into "capable of recovery" (and therefore recognition of a specific loan loss provision based on the assumption of the continuation of the borrower's business) or "not capable of recovery" (and therefore recognition of a specific loan loss provision based on the assumption of a workout). Estimates concerning long-term loan loss provisions assume a recovery in the shipping markets, in particular in the container shipping industry, as well as the continuation in general of the current commitment strategy and therefore assumes that HSH Nordbank is willing to continue to provide financing in order to achieve the planned significant reversals of impairment losses in the future.

Developments over the past years have shown that the ability to make forecasts in a volatile environment is limited. The difficult market conditions in the shipping industry are also lasting longer than expected.

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

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

ANTICIPATED UNDERLYING CONDITIONS

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

2017: Elections in the eurozone and uncertainty in US economic policy

Whilst the economic indicators are providing encouraging signs of a slight acceleration in global economic growth, there is considerable political uncertainty that may also influence the investment decisions of companies. For example, the economic direction of the new US government, especially with regard to the extent of the expected protectionism, is unclear. Many market participants could also become unsettled, if populist and euro critical parties were to make stronger gains in the numerous elections in the eurozone. HSH Nordbank expects increased nervousness in the financial markets in the first half of 2017, which could have an adverse impact on investment activity. The political situation is likely to calm down in the second half of 2017. The global economy should grow overall by 3.4%, a slightly faster pace than in the previous year (2016: 3.1%).

Europe's growth adversely impacted by political uncertainty

HSH Nordbank expects a sharp acceleration in growth in the USA following a weak 2016. The USA should be able to carry over the robust upwards momentum of the second half of 2016 into 2017. The announced tax reductions are also likely to stimulate economic growth. Inflation is expected to rise slightly, as it appears that the capacity of the labour market is being increasingly utilised.

China's economic growth will again be slightly lower than in the previous year but will still be over 6%. The risks of high levels of indebtedness and increased capital flight have increased. However, the Chinese government has already reacted to the higher stability risks by introducing, among other things, restrictions on the movement of capital. The Bank expects a revival in the economies of Brazil and Russia mainly as a result of higher oil and iron ore prices.

In the eurozone, HSH Nordbank anticipates a politically induced reluctance to invest in the first half of 2017. The elections in the Netherlands, France and probably Italy as well as the Brexit negotiations are likely to create uncertainty. The willingness to invest should increase again in the second half of 2017. This should not be affected by the German Bundestag elections in September. The Bank expects economic growth of around 1.3% for 2017 as a whole (2016: 1.6%).

In view of the uncertainty in Europe the Bank assumes that, in Germany, there may also be a temporary reluctance to invest. The risk posed by other referendums regarding EU membership is likely to affect the political and economic stability in Europe and may adversely impact the heavily export-oriented German economy.

Further hikes in the key interest rate in the USA, unchanged monetary policy in the eurozone

Trends in the financial markets will probably be determined in 2017 by both political developments and the monetary policy of the US Federal Reserve. The numerous elections in the eurozone could trigger fears of another euro crisis and cause increased nervousness in the financial markets. A slightly unpredictable economic policy of the US government may also have a negative effect on some markets. In this environment, HSH Nordbank expects the US Federal Reserve to make two further interest rate moves. As announced, the ECB is likely to maintain its bond purchase programme and not make any changes to key interest rates over the short term.

Long-term yields will probably increase further, but a sell-off of government bonds with a related sharp rise in yields is not anticipated by the Bank.

The euro remains susceptible to a depreciation against the US dollar in 2017, as new referendums in euro countries should also not least raise the question concerning the stability of the eurozone. The oil price will move in a sideways trend following the sharp increase of last year, because the new supply from the USA should depress the market.

Outlook for relevant markets

A continuing very tense situation is expected in the shipping markets over the short term.

Only a weak recovery trend for container ships is likely to emerge in the current year. The Bank expects that, although charter rates will slowly increase to levels moderately above operating costs, over the medium term they will not move to a level consistently above that necessary to meet debt servicing requirements. Although demand should rise slightly, fleet capacity will also increase more strongly, as new deliveries in 2017 will probably be higher again. The indications are that fleet utilisation will only be higher with an attendant market recovery from 2018 onwards. Any trade restrictions imposed by the new US government could become a dampening factor for container traffic.

It is also expected that there will only be a slight improvement in the demand trend for bulkers. However, in light of the new orders currently outstanding, growth in the supply of tonnage should fall even further in the second half of 2017. In conclusion, it can be expected that charter rates and ship values will stabilise initially. On average in 2017 they should be slightly above the previous year's level.

The oil tanker market will probably go through a trough in 2017. Although an increase in demand at the long-term historical average is expected, supply is likely to increase at an appreciably faster pace due to the upcoming deliveries. However, the absence of new orders indicates a withdrawal of investors from this market. Against this backdrop the Bank expects a scenario of a soft landing with lower, but still adequate, rates. A recovery is expected to start from 2018 onwards.

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

The German real estate markets should continue to benefit in 2017 from the favourable underlying conditions and develop positively overall. However, demand is falling slightly in the housing markets of most large cities despite the continuing increase in the level of immigration. More and more homes are coming onto the market while building activity is increasing at the same time with the effect that the reduction in the vacancy rate is likely to gradually decrease to a very low level. The retail sector currently benefits from the positive consumer sentiment and increasing household income. However, demand for space is growing at a noticeably slower pace. In the office real estate markets, declining vacancy rates can be expected due to only a slight increase in completions and a demand for space that is hardly flagging and is even buoyant. Office rents are likely to increase further, not least in central but also secondary locations. A considerably more moderate rate of growth is expected for retail real estate. Residential rents should also increase more slowly with an increase in completions. The statutory limits placed on rent increases on the re-letting of homes should only start to take effect in the medium term and after supplementary measures. After the very strong growth in the previous year and gradually increasing interest rates housing prices and market values of commercial properties are likely to only increase moderately in 2017.

Prospects for renewable energies also remain mixed in 2017: Whilst the capacity added is likely to stagnate at an overall good level in Europe, there are certainly growth opportunities globally. However, a distinction must be made between wind and solar energy: The substantial increase in capacity added over recent years should continue in the German wind energy segment. Demand should increase particularly as a result of the conversion to bidding procedures passed in the amendment to the Renewable Energies Act (EEG). New installations are also likely to increase again in the rest of Europe. The absolute increase in generation capacity in the solar energy sector in Germany – and also in Europe as a whole – should stabilise at a moderate level over the coming years. The more moderate outlook is due mainly to the implemented and intended restrictions on state subsidies.

The increase in transport demand as a result of stronger global economic growth on the one hand and high maintenance requirements on the other are providing positive stimuli for investments in transport infrastructure. Institutional investors are likely to continue to be important. Revenues of companies in the logistics sector should increase in the 2017 financial year at a slightly faster rate than in 2016. However, this cyclical sector is subject to the risks of a general macro-economic downturn and a weakening in global trade, also possibly as a result of increasing protectionist measures. It is not expected that any noticeable real economic effects on the logistics economy and trade flows with Great Britain will yet be felt at the beginning of 2017. The business climate indicator for the German logistics sector reached its highest level for more than half a decade at the end of 2016. However, this could change in subsequent years with the commencement of negotiations and depending on the specific Brexit structure.

It is not only the economic slowdown in China that discomforts heavily export-oriented sectors of the manufacturing industry such as automotive, engineering, electronics and chemicals. The consequences of the Brexit vote cannot yet be predicted, but should become increasingly clearer in 2017 as the exit negotiations are about to start. Furthermore it remains to be seen to what extent the new US government will actually implement the protectionist measures announced in the election campaign. This represents in total a significant downside risk for the global economy. The economic upswing in the USA as a result of the announced expansive fiscal measures (including infrastructure spending, tax reductions) and the weak euro can be regarded as positive over the short term. The positive growth rates will therefore be sustainable. The food industry will probably continue to grow due to the satisfactory consumer confidence of private households.

The outlook is less positive for the international business of companies in the wholesale and foreign trade sector due to the lack of any significant growth dynamics in German industry. As a result, the cyclical intermediate industries in particular will suffer.

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

Investment budgets of companies should initially remain at least stable sector-wide due to strong domestic demand in 2017, which could have a positive effect on loan demand at banks. As competition between banks remains intense in Germany, the strong pressure on credit margins will continue.

Ongoing challenging environment for banks

Against the backdrop of increasing geopolitical and economic uncertainty in conjunction with the economic policies of the new US government, the implementation of the vote of the British electorate to leave the EU (Brexit) and possibly continued high volatility on the financial markets as well as the significant slowdown in growth in important emerging markets, the macroeconomic environment is also likely to remain challenging for banks in 2017.

In view of the macroeconomic uncertainty, the ECB in particular is likely to maintain its expansive monetary policy with the effect that the pressure on net interest income resulting from the low interest rate environment will continue to increase gradually. Institutions will attempt to offset this negative effect on profitability by expanding income sources not dependent on interest rates (for example, commission income) and by further reducing costs.

Intense competition for medium-sized clients, particularly in Germany, is also putting additional strain on bank earnings. In addition, the comprehensive regulatory requirements, which demand increasingly more resources, are reflected in administrative expenses of the institutions. The European bank levy for the Single Resolution Fund, which was again significantly higher in 2016, is also making itself felt.

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

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

Even though an agreement on the application of the Basel IV rules had not been reached at the beginning of 2017, and there is still uncertainty regarding this, an increasing trend of higher capital requirements can be expected.

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

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

The introduction of IFRS 9 could also have an impact on the HGB single entity financial statements due to the identical approach so far applied in determining loan loss provisions for the IFRS Group financial statements and HGB single entity financial statements. In case of the further largely analogous application (if permissible) of the IFRS 9 requirements, this could also have a negative impact for the HGB single entity financial statements on loan loss provisions and also have effects on the capital ratios due to the relevance of the IFRS Group financial statements for the capital ratios under the SREP requirements. Further details are presented in the "Opportunities and risks in the loan loss provision forecast" section.

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

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

The introduction of a tax on trading in financial instruments (financial transaction tax), which is currently under discussion, would result in a significant reduction in income from the capital markets business. However, an agreement on the draft currently under discussion is not expected before the middle of 2017. In view of the varied regulatory requirements accompanied, on the one hand, by noticeably higher costs and, on the other, by exacting regulatory requirements regarding capital adequacy, banks will be required to continuously review their business models and constantly improve efficiency to be able to en-

sure sufficient profitability and maintain the ability to build up capital from their own resources.

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

In this context, the focus is placed on the detailed definition of the requirements for HSH Nordbank and on ensuring that the new standards are applied on a timely basis.

EXPECTED BUSINESS PERFORMANCE OF HSH NORDBANK

The following forecast is based on the plan for the Group. The planning of the key figures for the single entity according to HGB is derived from the Group's plan by means of a reconciliation account. Generally, similar developments are assumed for the single entity. Significant differences in the forecasts between the Group and single entity are indicated.

2017 – the year of privatisation

The final decision in the current EU proceedings and structural measures already implemented, particularly the sale of non-performing shipping loans of € 5 billion to hsh portfoliomanagement AöR, the market portfolio transaction signed in January 2017 and the formation of a holding structure and associated with that the relief from legacy assets and guarantee fees provided to the Bank are a good basis for vigorously driving forward the already begun privatisation process. Nevertheless, the total amount of NPE relief agreed as part of the EU decision is small which is why significant legacy portfolios continue to adversely impact the Bank's balance sheet and could make the privatisation process more difficult.

In principle, new business transacted (important management indicator for the Core Bank) in 2017 is expected to be only slightly below the previous year's level based on the Bank's improved financial and risk situation resulting from the implementation of the structural measures. At the same time, the winding down of high risk portfolios and reduction of the NPE ratio (important management indicator for the Group, Core Bank and Non-Core Bank) is to be continued at an accelerated pace. In addition, the ongoing cost reduction programme will be systematically continued to further build on the noticeable progress already made at the cost and process level and thereby enhance the Bank's performance over the long term.

Earnings forecast

HSH Nordbank is adapting itself to the current market environment for the 2017 financial year with regard to new business and the achievable margins. Against this backdrop the Bank expects a new business volume (important management indicator for the Core Bank) for 2017 that is slightly below that of the 2016 financial year. Furthermore, HSH Nordbank expects that the new business margins will continue to be risk-commensurate but at moderately lower levels than in the previous year due to the challenging competitive environment. At the same time, sales of the range of services offered over and above loan financing will continue to be driven forward to optimally exploit the business and earnings potential.

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

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

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

At the HGB single entity level – influenced by a decreasing net interest income – a moderate decrease of the total income compared to the previous year is to be expected.

Reconciliation between IFRS Group total income and HGB single entity total income is performed to explain the earnings, net assets and financial position and for the forecast report of the single entity under HGB. Details regarding this are set out in the “Management system” chapter in the “Reconciliation” section.

Opportunities and risks in the earnings forecast

Opportunities

The business opportunities in the corporate clients area as mentioned in the list of conditions and commitments, particularly the opportunity to finance German clients including their foreign investments as well as foreign clients, provided they are seeking transactions in Germany, could have a positive impact on the new business planned for the corporate clients sector.

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

Furthermore, a sharper, strategic focus of the Corporate Clients division on the renewable energy sector among others as well as other possible strategic alignments such as, for example, the planned expansion of asset management activities for institutional clients could have a positive impact on the Core Bank’s total income.

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

A sharper than planned increase in the US dollar viewed in isolation would have a positive impact on income generated by the US dollar business.

Risks

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

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

Despite the significant reduction in the amount of high risk securities held, higher measurement losses on debt instruments and derivatives arising as a consequence of market developments or tensions in the financial markets also cannot be ruled out in the IFRS Group. IFRS measurement effects resulting from movements in the US dollar or interest rates as well as basis swaps could have a more adverse impact than expected, although US dollar sensitivity has already decreased markedly after the planned portfolio transactions have been executed and will further decrease. Future planned results may be adversely impacted by a further appreciation in the US dollar. Total income may also be adversely impacted by uncertainties (for example, due to significant changes in exchange rates following an increase in interest rates) in the case of the planned recognition of unrealised gains on sales of securities.

US dollar and interest rate trends could also lead to stronger negative effects in the HGB single entity statements than expected. This could affect the participation of hybrid financial instruments in the profit or loss and the measurement of deferred taxes.

The implementation of the commitments made as part of the EU decision, particularly in relation to the business model and reduction in total assets, may have an adverse impact on the development of new business, cross-selling and refinancing of the Bank, and thereby also on the Bank’s earnings situation. Furthermore, the existing restrictions may have a negative effect on potential transactions. Delayed settlement under the guarantee of losses arising on the realised as well as possible further sales of loan portfolios may have a negative impact on HSH Nordbank’s earnings situation (for example, as a result of the reduction in the relief from premium payments for the guarantee).

A privatisation process that does not progress according to plan would also possibly have a negative effect on new business performance. An unsuccessful conclusion of the sales process would result in the cessation of new business under the list of conditions and commitments and thereby have a significantly negative effect on the earnings situation.

If uncertainties arise in connection with the risks described in the “RWA forecast” and “Formal decision in the EU state aid proceedings” sections, and also in the event that the viability review required in connection with the change in ownership is not positive and approval by the EU Commission is not obtained, this may then adversely impact the new business, cross-selling and funding performance as well as the future earnings situation. Delays in the planned and announced privatisation progress in the 2017 financial year may lead to uncertainties and therefore restrictions on new business as well as a resulting negative impact on earnings.

If sales of asset positions are more extensive than planned and new business expansion is consciously curtailed, this could result in a sharper reduction in total income at the Group level due to the elimination of interest income.

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

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

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

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

Forecast for administrative expenses

The aim of HSH Nordbank on the cost side is to continue to gradually reduce administrative expenses significantly, in order to achieve an appropriate cost income ratio for the Group on a sustained basis of in principle less than 50% by 2019.

Within the scope of the planning process, HSH Nordbank has planned a noticeable decrease in administrative expenses for the IFRS Group and in the cost income ratio (important management indicator for the Group and Core Bank) for the Group and Core Bank for the 2017 financial year compared to 2016.

Thereby, the guidelines of the Management Board were fully incorporated in the cost reduction programme (2018PLUS), which was intensified in May 2016. The plan includes, for example, an accelerated reduction in staff and further decreases in operating expenses. The reason for this is that the implementation of the personnel measures could be more rapidly implemented based on the reconciliation of interests and social plan agreed with the Works Council. Details regarding the additional operating expense measures have been specified during the course of business in 2016 and will be implemented in 2017. In general, according to the list of conditions and commitments, which forms the basis for the formal decision of the EU Commission, the Bank is obligated to gradually reduce administrative expenses during the divestiture period to € 540 million (excluding any potential IFRS 10 effects) in 2017. This requirement will be clearly exceeded in 2017 from today's perspective.

The cost reduction programme, which has existed since 2014 and was last adjusted on a needs basis in May 2016, is generally aimed at a further streamlining of the organisational structure, simplification of key processes, optimisation of the product portfolio and realignment of the Bank's IT and had a significant impact in the past financial year. Thus, the controllable administrative expenses for operating activities decreased noticeably compared to the previous year. Nevertheless, additional expenses arising from the consolidation of companies on applying IFRS 10 as well as part of the revaluation of property, plant and equipment (especially aircraft in IFRS 10 companies) had to be considered. Due to opposite income effects (Other operating income) from these companies, these additional expenses are partially offset in the Group. Concerning the planned interim servicing of hsh portfolio management AöR by HSH Nordbank, the Bank was able to reach an agreement that additional incurred expenses for IT, personnel etc. will be fully reimbursed taking applicable fiscal requirements into account.

Gradually, the number of employees will be significantly reduced by 2019 as part of the extended cost reduction measures. An additional moderate reduction is planned for the year 2017 as a whole. However, there remains the important task of retaining qualified staff at HSH Nordbank in order to secure key competences and limit operational risk.

Separate forecasts are not prepared for the cost income ratio at the HGB single entity level.

Reconciliation between IFRS Group administrative expenses and HGB single entity administrative expenses is performed to explain the earnings, net assets and financial position of the single entity and for the forecast report of the HGB single entity. Details regarding this are set out in the “Management system” chapter in the “Reconciliation” section.

Opportunities and risks in the forecast of administrative expenses

Opportunities

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

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

The Bank assumes that measures initiated to reduce costs will also continue to be implemented successfully with regard to the expected reduction in the number of employees. In this context, employee turnover higher than that assumed in the Bank's plan would have a positive effect on planned personnel expenses.

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

Risks

If the cost-saving measures are not implemented as planned, it cannot be ruled out that some costs cannot be reduced to the extent desired or not as quickly as planned. In addition, unexpected cost increases in individual divisions resulting from, inter alia, the constantly increasing regulatory requirements and support for the privatisation process, could exceed the cost reductions achieved in other areas. The extent is difficult to estimate, but unavoidable consequences for administrative expenses are possible.

It cannot be excluded that the reduction in headcount associated with the measures is not implemented as planned or results in an increase in operational risk due to higher turnover or implementation risk, for instance, in the area of internal bank projects. The risk of losing key expertise may also be increased as a result of the personnel measures taken.

It may not be possible to identify or implement other measures required in connection with the initiated and continuing cost reduction programme to achieve cost savings to the extent necessary or such measures may only be implemented by incurring higher restructuring expenses, resulting in the planned cost savings not being achieved.

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

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

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

Forecast for loan loss provisions

HSH Nordbank assumes that further significant loan loss provisions will have to be recognised for 2017 due to the continuing difficult shipping markets. The Bank estimates that net additions to be recognised in the IFRS Group and Non-Core Bank in 2017 will still be considerable, however, noticeably below the highly significant level of the 2016 financial year. The focal point of loan loss provisions will continue to be the non-performing shipping loans in the legacy portfolio, especially in the container ship segment. The Bank also expects a further noticeable reduction in the NPE ratio (important management indicator for the Group, Core Bank and Non-Core Bank) in the Group, especially in the Non-Core Bank, due to the ongoing winding down of non-performing loans. The NPE ratio for the Core Bank will remain at the low level reached. It is also expected that the coverage ratio (important management indicator for the Group, Core Bank and Non-Core Bank) in the Group and Non-Core Bank will gradually increase at a moderate pace in view of further net additions to loan loss provisions.

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

Moreover, it can be expected that loan loss provision measures will also be required especially in the shipping industry for transactions not covered by the guarantee in view of the still difficult sector environment.

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

At the single entity level under HGB, greater charges in the loan loss provisions/valuation line item compared to the previous year are to be expected. No separate forecasts are made for the NPE ratio and coverage ratio at the HGB single entity level.

Reconciliation between IFRS Group loan loss provisions and HGB single entity loan loss provisions is performed to explain the earnings, net assets and financial position and for the forecast report of the HGB single entity. Details regarding this are set out in the “Management system” chapter in the “Reconciliation” section.

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

The loan loss provision plan is based on valuation models that also take into account the regulatory environment, the expected development of risk parameters over time as well as the Bank’s empirical values in critical situations in addition to portfolio developments and key macroeconomic data (including the EUR/USD exchange rate, charter rates and ship values). A key driver of the amount of loan loss provisions is also the breakdown of impaired loan commitments into “capable of recovery” (and therefore recognition of a specific loan loss provision based on the assumption of the continuation of the borrower’s business) or “not capable of recovery” (and therefore recognition of a specific loan loss provision based on the assumption of a workout). The estimates concerning long-term loan loss provisions are based on the assumption of a recovery in the shipping markets and/or a recovery in the container shipping industry as well as the continuation in general of the current engagement strategies and therefore the assumption of HSH Nordbank’s willingness to continue to finance problem loans remaining after the planned transactions have been executed in order to achieve the planned significant reversals of impairment losses in the future.

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

Opportunities and risks in the forecast for loan loss provisions

Opportunities

Loan loss provisions would be lower than expected, if the relevant market parameters and macroeconomic environment developed more favourably than assumed. It is conceivable that the global economy might grow more strongly in the 2017 financial year than forecast, which in turn could support a gradual recovery of the shipping markets and therefore entail a lower need for loan loss provisions.

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

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

Risks

Estimates regarding the long-term trend in loan loss provisions as well as loss planning and, consequently, the final drawdown of the second loss guarantee are subject to considerable uncertainty due to the long planning horizon. This applies in particular to the movement in the US dollar exchange rate and key market parameters in the shipping industry such as cargo and charter rates as well as ship values, which are key input parameters for determining the loan loss provisions. In view of the existing overcapacity in the shipping markets, it cannot be ruled out that the extent and timing of the market recovery and recoverability of individual commitments may not be achieved in the planning period as assumed in the loan loss provision plan. Due to this and particularly in the case of falling charter rates, loan loss provisions required may continue to increase significantly. This could have a significant long-term impact on the total expected payment defaults and thereby on the drawdown of the guarantee. This would adversely impact HSH Nordbank mainly as a result of higher than planned loan loss provisions after also taking account of the expected full balance sheet utilisation of the guarantee. Reference is made to the explanations in the “Opportunities and risks in the capital and RWA forecast” section regarding the impact of the non-occurrence of the recovery in the shipping markets assumed as part of the planning.

Developments regarding the situation in other sectors may also be worse than expected and require higher loan loss provisions as a result.

Furthermore, it can also not be ruled out that the euro debt crisis in Europe will once again become the centre of attention or, following the Brexit vote in Great Britain, the cohesion of the EU will be further weakened, which could lead to a weakening in the relevant markets.

This in turn could result in additional impairment losses having to be recognised. Market turbulence in emerging countries and geopolitical risks could also have negative effects.

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

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

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

With respect to the sale of and reduction in loan portfolios, including sales of portfolios in the market, and related assumed improvement in the NPE ratio, implementation of the winding down strategy may not be feasible as to the amount, transaction prices and/or date assumed by the Bank. If the actual transaction prices achieved by the relevant winding down measures are below the carrying amounts after loan loss provisions, or also in the event of changes to the composition of the portfolios selected by the Bank for a and, if necessary, further portfolio sale(s), could result in a significant additional need for loan loss provisions and, on the other hand, the NPE ratio would not be reduced as assumed. Additional loan loss provisions may also be needed in the event of unplanned asset sales. The main reason for this is that, according to the requirements of the guarantee agreement, only the loan value based on the credit rating and not the current market price is applied in the settlement under the guarantee.

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

If it transpires in course of the Bank's privatisation process that the total sale of HSH Nordbank AG as an overall bank, i.e. the sale of all shares held in the Bank by the seller including all assets and liabilities as the preferred solution without any significant early disposals of assets or parts of divisions below their carrying amounts as the key assumption of the Bank's corporate planning, cannot be implemented, extensive sales of loan portfolios, particularly in the Non-Core Bank, could be required, which may result in a significant increase in loan loss provision expense. Additional measures to support HSH Nordbank AG could be required in this event in order to be able to still comply with the necessary capital requirements.

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

The introduction of IFRS 9 could also have a negative impact - in case of the further largely analogous application (if permissible) of the IFRS 9 requirements - on the loan loss provisions of the HGB single entity financial statements due to the identical approach so far applied in determining loan loss provisions for the IFRS Group financial statements and HGB single entity financial statements.

The IFRS 9 conversion effects in any case have an impact on the relevant capital ratios as the SREP capital ratios relevant for the Bank are determined at the level of the IFRS Group financial statements. For example, higher than planned required general loan loss provisions as a result of a deterioration in the risk parameters or a much more extensive application of fair value accounting under IFRS 9 than previously assumed, may adversely impact loan loss provisions in the lending business or capital on the adoption date. This applies in particular to a currently unanticipated situation, in which further portfolios are also assigned in connection with the possible outcome of HSH Nordbank's privatisation process to a business model as defined in IFRS 9 which is different to that in the current plan and requires the portfolio to be measured at fair value.

Capital and RWA forecast

For 2017, HSH Nordbank assumes that the capital ratios will continue to be significantly above the SREP requirements. HSH Nordbank expects to be able to continue to disclose a regulatory CET1 ratio of the IFRS Group (important management indicator) of around 13.0% despite more stringent requirements resulting from the gradual implementation of Basel III in accordance with the Basel III transitional rules (phase-in). HSH Nordbank has already included in this any additional charges arising during the remainder of 2017, such as exchange rate or counterparty risk relating to the shipping portfolio. Changes in RWA are primarily influenced by new business, the continuing reduction in the legacy portfolio under consideration of further portfolio sales as well as by risk and market parameters, particularly the trend in the

shipping markets and the EUR/USD exchange rate. Based on a stable EUR/USD exchange rate HSH Nordbank assumes a moderate increase in RWA for 2017 as a whole due to the expected new business taking account of the planned portfolio sales from the legacy portfolio and active RWA management. The relief provided by the market transactions signed at the beginning of the year should take effect in the first half of 2017.

Separate forecasts are not prepared for the CET1 ratio at the HGB single entity level.

The transfer of the majority of the shares in HSH Nordbank AG from the current shareholders to the holding company has resulted in the creation of a financial holding group subject to banking supervision, at the level of which banking supervision requirements, particularly minimum capital requirements (CET1 4.5%) as well as additional capital buffer requirements, are to be complied with. According to the plan the Pillar 1 minimum capital requirements pursuant to CRR (CET1 4.5%) and additional capital buffer requirements are complied with at this banking supervisory application level, which is temporarily relevant until the sale of HSH Nordbank AG is completed.

Opportunities and risks in the capital and RWA forecast

Opportunities

Opportunities for the capital ratios and RWA result from more favourable trends in the relevant market and risk parameters, particularly in the case of a stronger euro against the US dollar, and a more rapid reduction in risk in the guaranteed legacy portfolio.

Risks

Material risks for the capital ratios and RWA result from a potential deterioration in market and risk parameters in the Bank's core markets including a stronger US dollar, a lower than planned reduction in the portfolios and the regulatory environment, for instance from interpretation decisions or audits. There is the risk that defaults of individual and/or also major borrowers with significant loan volumes, for instance in the absence of a market recovery in the shipping industry, will result in a marked increase in losses and put considerable pressure on the capital ratios.

Developments that result in an increase in risk-weighted assets (RWA) in the hedged portfolio (these include, for example, declining charter rates or a lower EUR/USD exchange rate), have a direct, adverse impact on the Bank's CET1 ratio due to the guarantee buffer of the federal state guarantee having been exhausted from a regulatory perspective.

Non-occurrence of the recovery in the shipping markets assumed in the plan may result in a significant negative impact on the capital ratios. The impact of such developments in the guaranteed portfolio on the capital ratio was correspondingly offset in the past by the guarantee buffer.

It is also possible that additional individual and increased capital requirements or additional requirements will arise from the regular SREP process carried out in the Banking Union. Additional discretionary decisions made by the supervisory authorities and sector-wide capital requirements (capital buffer for systemic and cyclical risk) could increase capital requirements and significantly reduce the effectiveness of the guarantee.

Discretionary decisions made by the supervisory authorities regarding compliance with the material transfer of risk as defined in Article 244 of the Capital Requirements Regulation (CRR) for the regulatory recognition of the second loss guarantee may substantially reduce the regulatory relieving effect of the guarantee and put significant pressure on the capital ratios. It is possible that the material transfer of risk is rejected by the supervisory authorities in light of the significant increase in the economic utilisation of the guarantee as at 31 December 2016. In this case, the capital ratios would clearly decrease and measures to strengthen the capital ratios would become necessary.

If it transpires in course of the Bank's privatisation process that the total sale of HSH Nordbank AG as an overall bank, i.e. the sale of all shares held in the Bank by the seller including all assets and liabilities as the preferred solution without any significant early disposals of assets or parts of divisions below their carrying amounts as the key assumption of the Bank's corporate planning, cannot be realised, extensive additional loan loss provision expenses (cf. Opportunities and risks in the loan loss provision forecast section) and significant write-downs of deferred taxes could be required. In total, this could have a significant adverse impact on the capital ratios. In this case and particularly in this scenario in combination with other risks described for capital ratios, additional measures to strengthen HSH Nordbank AG's capital ratios may be required on the part of the owners and/or third parties in order to be able to comply with the necessary capital requirements.

If the recovery in the shipping industry assumed in the plan does not materialise, measures would be required to strengthen the capital ratios (for example, reduction in new business, sales of loan portfolios, sales of securities portfolios) in order to comply with the regulatory minimum requirements at the sub-group level. On the basis of the financial holding group, further additional measures over and above capital-strengthening measures that the Bank can implement from its own resources may be required on the part of shareholders and/or third parties to comply the Pillar 1 minimum capital requirements pursuant to CRR (4.5%, CET1).

With regard to the financial holding group subject to banking supervision, there is a risk that not all capital buffer requirements, which exceed the Pillar 1 minimum requirements pursuant to CRR (CET1 4.5%), can be fully complied with at the financial holding group level due to the high premiums payable for the federal state guarantee. Non-compliance with the capital buffer requirements, which exceed the Pillar 1 minimum requirements pursuant to CRR, would mean that a capital conservation plan would have to be prepared for the Group in accordance with Section 10i (3) KWG and, until its approval, additional restrictions under Section 10i (3) KWG, for example regarding the possibility of making distributions on equity instruments, would have to be observed.

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

Even in the case of a downside scenario the Pillar 1 minimum requirements pursuant to CRR (CET1 4.5%) could only be complied with after the implementation of capital strengthening measures by the Bank itself (for example, reduction in new business, sales of loan portfolios, sales of securities portfolios) and under the assumption of the deferral (supervisory phasing-in) of the capital impact arising from the first-time application of IFRS 9 over a period of three years.

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

The capital forecast for the financial holding group is based on the assumption of full settlement under the guarantee by 2022. If there are delays regarding the full settlement date and therefore the expiry of the guarantee, additional premium expenses would adversely affect the capital ratio at the holding company level.

The forecast of the medium-term CET1 ratio is based on the assumption that the operation of the guarantee structure remains unchanged under the regulations currently applicable to securitisations.

A tightening of the supervisory set or rules regarding securitisations due to the further development of the Basel III framework (Basel 3.5), which could come into force as from 2020 for HSH Nordbank through its implementation in the EU, could significantly reduce the RWA relieving effect and therefore the efficiency of the guarantee as of this date.

Delays in the planned implementation in the first half of 2017 of the portfolio sales signed at the beginning of 2017 and further portfolio sales in the market or the delayed settlement under the guarantee of the resulting losses incurred could have a negative effect on the planned capital ratios. An overall delay in the settlement for the entire second loss guarantee relative to the current settlement assumptions in the plan would result in significant pressure being put on the capital ratios at the holding company level (HSH Beteiligungs Management GmbH), as, in such a case, further guarantee premiums would be payable for the deferral period.

The capital ratios may be significantly impacted in future by the intended changes to the regulatory requirements (partly referred to as "CRR II/Basel IV"), presumably as from 2020. A large number of changes in the area of market, operational and counterparty risk are consolidated in this regard under CRR II. For HSH Nordbank, stricter rules concerning counterparty risk resulting from Basel IV will be of particular relevance. HSH Nordbank extensively uses models approved by the supervisory authorities to map counterparty risk (Internal Ratings Based Approach – IRBA). The supervisory authority are planning under Basel IV to significantly restrict the benefits resulting from the use of IRBA models by basing the capital backing more closely on the standard approach (CSA floor), by limiting the use of the IRBA model to certain exposure classes as well as limiting the use of internal risk parameters (Constrained IRB).

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

Movements in the EUR/USD exchange rate – particularly against the backdrop of the elimination of the guarantee buffer in the reporting year - have a significant influence on the RWA trend. An exchange rate below expectations would ceteris paribus lead to an increase in RWA and immediately reduce the Bank's CET1 ratio.

The transposition of the Bank Recovery and Resolution Directive – BRRD) into national law (Recovery and Resolution Act – Sanierungs- und Abwicklungsgesetz – SAG) will result in new capital requirements in 2018. The European Single Resolution Board will set an institution-specific ratio for the regulatory capital and eligible liabilities to be maintained at a minimum for institutions directly supervised by the ECB and therefore for HSH Nordbank (Minimum Requirements on Eligible Liabilities – MREL).

There are risks for German institutions regarding compliance with the MREL ratio in the discussions still in progress at the European Commission (trilogue) about the qualitative requirements for eligible liabilities for non-global systemically important institutions and the recognition of sub-senior liabilities existing since 1 January 2017 under Section 46f KWG (grandfathering) with regard to any requirement of the EBA to also set a minimum requirement for non-senior liabilities for non-global systemically important banks. Any potential tightening of requirements for non global systemically important institutions may be mitigated by a transitional period.

If any of the above-described risks for capital ratios materialise in combination with each other, additional measures to strengthen capital on the part of the owners and/or third parties may be required at all regulatory levels.

With the formation of HSH Beteiligungs Management GmbH HSH Nordbank as the “parent institution” is required under Article 11 (2) CRR to also comply with the large exposure regulations at the financial holding group level. HSH Nordbank AG’s large exposure limit (CRR Part 4) is therefore based on the regulatory capital at the group level of the financial holding group. However, as this is significantly lower than in the sub-group of the HSH Nordbank Group due to premium obligations assumed under the guarantee of the federal states of Hamburg and Schleswig-Holstein, this limit represents a powerful limiting factor in the Bank’s large exposure management. HSH Nordbank has also taken over the lower regulatory capital at the Group level of HSH Beteiligungs Management GmbH and has partially set limits for its trading and credit lines as a precautionary measure to reduce the risk of exceeding the large exposure limit.

The large exposure limit at the financial holding group level amounted to €930 million as at 31 December 2016, whereas that of the HSH Nordbank Group (sub-group) is €800 million higher at €1,730 million. A reduction in the large exposure limit may result in restrictions on the choice of restructuring instruments that can be used for loan recoveries.

If additional measures to strengthen capital are required in the event that one of the risks described in this section materialises, which cannot be implemented by the Bank itself or without state aid, this could result in the resolution of HSH Nordbank.

Reference is made to the “Opportunities and risks of the formal decision in the EU state aid proceedings” regarding the impact of this.

Funding forecast

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

The funding plan is based on access to the relevant markets including the German Savings Banks Association and other financial institutions. In addition, the retention of the investment grade rating is a key prerequisite for the implementation of the funding strategy. Another focus is on the issuing of covered bonds (Pfandbriefe) as private placements as well as on the public sector capital market, to the extent permitted by market conditions. Additional forms of potential funding are asset-based transactions, to which HSH Nordbank attaches great importance especially for the refinancing of the US dollar asset business.

For the remainder of 2017, the Bank expects the regulatory liquidity ratio as defined in the Liquidity Regulation (LiqV) to be at the high level prevailing at the 2016 year end. HSH Nordbank also expects that the trend of the liquidity coverage ratio (LCR, important management indicator in the IFRS Group) and net stable funding ratio (NSFR, important management indicator in the IFRS Group) will be stable compared to the 2016 year end and consequently that the corridor of 80% to 120% provided for in the list of conditions and commitments will be complied with. HSH Nordbank also expects that all other supervisory requirements such as the survival period in the liquidity development report for the combined stress scenario (important management indicator in the IFRS Group) will continue to be complied with and the key ratios will remain more or less at the currently high level.

Separate forecasts are not prepared for the LCR, NSFR and the survival period of the liquidity development report in the combined stress scenario at the HGB single entity level.

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

The sales of portfolios in the market contractually agreed at the beginning of 2017 and further sales in the market as well as any returns from winding down measures will also lead to a further improvement in the liquidity situation in the first half of 2017.

In this regard, the Bank assumed in its liquidity planning that the sales prices will be paid on the respective transaction dates and the liquidity effect of the associated settlement of losses for the market portfolio will occur six to nine months after the respective transaction date. The funding plan assumes that the first significant portion of the sold market portfolio will be completed as at 31 March 2017 with a further portion still to be sold by 30 June 2017. Market portfolio sales over and above these would have a positive effect on the current funding plan.

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

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

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

Opportunities and risks in the funding forecast

Opportunities

The fulfilment of the funding objectives is mainly influenced by external factors. A positive capital market environment should support the implementation of the issuing strategy in 2017. A sustained expansive monetary policy on the part of the ECB and the associated expansion of liquidity is likely to tend to have a positive impact on the refinancing options and costs.

The currently limited access to the capital markets would gradually improve by the continuing and successful implementation of the intended privatisation of HSH Nordbank in line with the plan, as this would reduce an important uncertainty factor. This is also of key importance for assessments made by the rating agencies. Like this, ratings that are continued to be confirmed as investment grade would significantly underpin the implementation of the funding targets.

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

Risks

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

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

If the implementation of the formal decision and list of conditions and commitments, particularly the privatisation to be completed by 28 February 2018 and the viability review of the new corporate structure required in this connection as well as the approval of the acquisition by the EU Commission, is not, not fully or not successful within the currently specified time frame or should the Bank be subject to an privately managed orderly wind-down ("geordnete privatwirtschaftliche Abwicklung"), this could have a significant adverse impact on funding and funding costs, trigger outflows of short-term funds or fundamentally restrict HSH Nordbank's funding options. In this case, additional measures would be required on the part of the owners and/or third parties to strengthen the liquidity situation.

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

Potential rating downgrades, which cannot be excluded despite the recently confirmed investment grade rating during the privatisation process, particularly in the case of unplanned developments, would fundamentally restrict the refinancing options via the capital markets, trigger outflows of short-term funds and increase funding costs. A rating downgrade by both Moody's as well as by Fitch would result in a rating outside investment grade. Adverse developments, particularly during the privatisation period (for example a decrease in capitalisation, non-compliance with the minimum capital requirements, liquidity problems, unplanned deterioration in earnings or setbacks in the privatisation process) may negatively affect the rating or directly put significant pressure on funding and funding costs, trigger significant outflows of short-term funds or fundamentally restrict HSH Nordbank's funding options. In the event of a rating downgrade, the Bank would have to take additional measures to secure an appropriate liquidity position due to the very short-term refinancing (see Group explanatory note 54: Residual maturity breakdown of financial instruments) and the existing depositor concentration on institutional investors.

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

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

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

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

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

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

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

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

Formal decision in the EU state aid proceedings

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

The EU decision is based on a list of conditions and commitments, under which the Federal Republic of Germany as representative of HSH Nordbank's federal state owners and the EU Commission agreed measures to provide legacy asset relief to the Bank. These measures are generally in line with the informal agreement already announced in the 2015 financial year. These include in particular the reduction in guarantee fees, formation of a holding structure and sale of non-performing loans in an initial amount of €5 billion to the federal state owners and in the amount of up to €3.2 billion in the market as well as a one-off payment of €210 million from HSH Nordbank to the holding company in connection with the premium obligations taken over by the holding and the provision of liquidity in the amount of €50 million to the holding company to ensure its operations.

The planned structural measures and resulting expected effect on the net assets, earnings and financial position are taken into account in the Bank's currently applicable planning for the coming years.

Key structural measures were implemented in line with the plan over the past months, such as the formation of the holding structure, in order to relieve the operating HSH Nordbank from guarantee obligations, sale of non-performing loans of € 5 billion as at 30 June 2016 to hsh portfoliomanagement AöR (federal state owners), sale of a portion of the market portfolio in January 2017 and possibly further sales in the market over the coming months.

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

HSH Nordbank's capital backing is to be strengthened by improved profit retention opportunities. Furthermore, the Bank's funding requirements, particularly for the US dollar business, will also decrease in the future due to the sale of loan transactions primarily denominated in US dollar. This also strengthens the Bank's liquidity situation affected by movements in the US dollar.

The replenishment of the second loss guarantee has been technically classified by the EU Commission as so-called resolution aid, and HSH Nordbank is regarded as not being viable in terms of state aid prior to the restructuring. The operating company is to be restructured in such a way that enables the successful sale of this company by 28 February 2018. This divestiture period is met with the signing of a sales agreement and may be extended by six months with the consent of the EU Commission, if the technical implementation of the model is delayed due to circumstances over which the federal states have no direct influence. The transfer in rem of the shares to a buyer (closing) may be made at a later date. The sale is intended to be made in an open, non-discriminatory, competitive and transparent process, in which other Landesbanks may also participate. Public savings banks may also take a minority interest in an acquisition by a private third party or by one or several Landesbanks, if the buyer is independent of HSH Nordbank AG and the public sector (Landesbanks are regarded as being independent of the public sector for these purposes).

The participating bidders must have the necessary financial resources and proven sector expertise to manage the operating company as a profitable and active competitor.

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

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

After the sale announcement published on 23 January 2017 it is conceivable in principle that, besides the preferred sale of the Bank as a whole in the form of the sale of all shares held by the seller in the Bank including all assets and liabilities to one or several investors (bidder consortium) that bidders, who have no interest in acquiring the overall bank, specify in their bid which divisions or assets they do not want to take over on the acquisition of the Bank.

In selecting bidders for the next stage of the process those, whose bid is based on the acquisition of the Bank at a positive sales price (with retention of the guarantee) are preferred.

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

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

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

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

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

Opportunities

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

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

The business opportunities in the corporate sector included in the list of conditions and commitments, particularly the opportunity to finance German clients including their foreign investments as well as foreign clients, provided they are seeking transactions in Germany, could have a positive impact on the new business planned for the corporate clients sector.

Acquisition of an ownership position by another strong partner as part of the planned privatisation of HSH Nordbank would increase business and refinancing opportunities of the Bank and thereby contribute to the further strengthening of the business model. Consolidation with Landesbanks could have a positive effect for the business model.

Risks

Should the implementation of the remaining structural measures provided for in the EU decision and the privatisation not be successful in full or in part or within the specified time frame, this would significantly jeopardise the further implementation of the business model and thereby the Bank's future prospects.

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

There is the risk that the privatisation is not successful or is not successful in due time. In this event, HSH Nordbank must cease new business and manage its assets to the extent legally permitted with the objective of a privately managed orderly wind-down. The long-term survival of HSH Nordbank in its present form would not be ensured in this case.

In view of the fact that cessation of new business would also include the deposit business, such a situation would have a significantly adverse impact on funding and funding costs, trigger significant outflows of short-term funds or fundamentally restrict HSH Nordbank's funding options. In this case, additional measures on the part of the owners and/or third parties and, where necessary, extensive sales of receivables with corresponding losses on disposal would be required to strengthen the liquidity situation.

In this regard, the Bank analyses different scenarios as a precaution in coordination with the supervisory authorities in order to ensure sufficient process certainty in a theoretically possible adverse privatisation process. Reference is made to the "Opportunities and risks in the funding forecast" and "Opportunities and risks in the capital and RWA forecast" sections regarding the direct impact of adverse developments.

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

If it transpires in course of the Bank's privatisation process that the total sale of HSH Nordbank AG as an overall bank, i.e. the sale of all shares held in the Bank by the seller including all assets and liabilities as the preferred solution without any significant early disposals of assets or parts of divisions below their carrying amounts as the key assumption of the Bank's corporate planning, cannot be implemented, extensive sales of loan portfolios, particularly in the Non-Core Bank, could be required, which may result in a significant increase in loan loss provision expenses and also put significant pressure on the capital ratios. Significant write-downs of deferred tax assets may also be required. Additional measures to strengthen HSH Nordbank AG's capital measures may be required in this case and particularly in this scenario in combination with other risks described for capital ratios in order to be able to comply with the necessary capital requirements.

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

The measurement of the portfolios possibly to be sold in the market could be lower at the actual dates of sale than previously assumed in the planning and calculation of loan loss provisions. In addition, execution of the portfolio sale could be delayed. Subsequent changes in the composition of the portfolios to be sold in the market, for example, in the course of the implementation of the transactions, may also have an additional adverse impact on loan loss provisions. The above-mentioned effects may have an adverse impact on the earnings, net assets and financial position as well as the CET1 ratio.

Furthermore, tax risks could arise in connection with the transfer of assets, particularly to foreign jurisdictions, as part of the implementation of the portfolio transaction. These may result, on the one hand, in higher loan loss provision expenses or other expenses and, on the other, in changes to the portfolio still to be selected for sale in the market in contrast to the assumed planning. Changes in the portfolio selected may also result in increasing loan loss provision expenses in connection with the planned portfolio transactions.

Under the list of conditions and commitments, the Bank is required to limit annual new shipping business to € 1.2 billion. Furthermore, total assets may not exceed € 98 billion at the end of 2017 (on an average EUR/USD exchange rate of 1.10). In addition, the list of conditions and commitments contains restrictions relating to the Corporate Clients division (restricted to German clients and their investments in Germany and abroad as well as foreign clients, provided that they are seeking transactions in Germany), a waiver on the part of the Bank not to resume the already discontinued asset-based aircraft financing business, a restriction on external growth by prohibiting the acquisition of control in other companies and an extension of the ban on proprietary trading. In the event that the trend in the shipping markets is significantly better than planned or good business opportunities arise in other business sectors, these restrictions could have a negative effect on potential transactions.

In light of the agreement in principle recently reached with the EU Commission HSH Nordbank AG remains a member of the Savings Banks Finance Group during the sales process. All issues of HSH Nordbank AG (excluding equity/instruments with equity characteristics, notably under paragraphs 41, 44 of the EU Commission Communication 2013/C 216/01 of 30 July 2013 ("Banking Communication")) therefore fall under the voluntary institutional protection of the guarantee fund of the Savings Banks Finance Group (Section 39 (1) of the Framework Statute). Under the voluntary institutional protection there is no legally binding entitlement to support funds vis-à-vis the protection scheme in the event of the occurrence of a guarantee case. Should HSH Nordbank AG's membership in the Savings Banks Finance Group end at a date not currently known, its membership in the guarantee fund of the Savings Banks Finance Group would continue to apply for a further two years in accordance with Section 94(4) of the Framework Statute.

In the event of a change in ownership as the result of a sale to private investors HSH Nordbank would cease to be a member of the DSGV, and therefore of the protection scheme of the Savings Banks Finance Group as well, after the expiry of a two year transition period. This could increase HSH Nordbank AG's refinancing costs, make access to funding channels more difficult and have a substantial negative impact on the external rating issued by the rating agencies.

The assumption of the Bank as a going concern for accounting and measurement purposes and the assumption of the continued going concern of HSH Nordbank AG and significant group companies is based in particular on the following assumptions:

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

(ii) the operating company, HSH Nordbank AG, is sold at a positive sales price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge during the privatisation period, it could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

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

(iv) the minimum capital requirements at all regulatory levels can be adhered to in accordance with the corresponding SREP resolutions passed by the European Central Bank and the statutory provisions during the forecast period. If there is a need for significant additional loan loss provision expenses and material depreciation of deferred taxes (e. g. in the scenario described above) or if the recovery of the shipping market that has been assumed in the Bank's corporate planning does not materialise as planned, or the significant risk transfer for the second loss guarantee is no longer ensured from the perspec-

tive of the banking supervisory authority, it could put considerable pressure on the capital ratios and additional measures may need to be taken by the owners and/or third parties to strengthen the capital ratios in order to be able to adhere to the minimum capital requirements, particularly at the level of the financial holding group. If such measures are not taken, it could result in the winding down of HSH Nordbank.

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

Overall appraisal and net income forecast

In view of the milestones achieved in preparing for and implementing the EU decision and overall satisfactory economic developments since the end of the past financial year, HSH Nordbank remains confident that a good foundation has been laid for a successful privatisation process. Following the promising start to the privatisation process the Bank together with its federal state owners is optimistic that it will be able to overcome the challenges of a naturally very complex sales process.

The Bank will continue to intensively support its owners in this and, at the same time, systematically drive forward the client business in 2017 on the basis of the operating progress achieved and implement in parallel the ongoing strategic and operating optimisation measures in a focussed manner to ensure sustainable competitiveness. The aim is also to quickly wind down the non-performing loans combined in the Non-Core Bank, which are still secured by the guarantee facility issued by the federal states, over and above the adjustments planned as part of the market transactions concluded at the beginning of 2017.

Overall, the basis for a sustainable alignment of the Bank is further strengthened and a business model created for HSH Nordbank which, at a minimum, should convince clients, employees and investors as well as potential bidders and facilitate a successful change in ownership.

Major risks for the future performance of HSH Nordbank arise primarily from a sales process not progressing in line with the plan. The continuing very difficult market conditions in the shipping industry represent a significant challenge with regard to the operating performance. In this regard, the future trend of charter rates and ship values as well as estimates of the long-term trend of loan loss provisions are subject to significant uncertainty. The Bank assumes that there will be a further significant need for loan loss provisions in 2017, primarily in the guaranteed legacy portfolio. Against this backdrop the Bank expects full balance sheet utilisation of the guarantee in the first half of 2017. There will be further challenges associated with the low level of interest rates and highly competitive environment, volatility in the financial and currency markets (the USD in particular), changing

assessments of the rating agencies and increasing requirements of the European banking regulation.

It is extremely important that, despite a multitude of influencing factors (recovery of the shipping markets, regulatory effectiveness of the second loss guarantee, discretionary decisions on the part of the banking supervisory authorities, uncertainty regarding the impact of the IFRS 9 conversion, potential losses on the sale of loan portfolios), the minimum capital ratios are complied with both at the level of the HSH Nordbank sub-group and the holding company level and the liquidity position is maintained at all times despite adverse developments in the privatisation process or, for instance, in the event of reactions of the rating agencies.

There are additional challenges, primarily for the ongoing privatisation process, arising from the very high amount of legacy loans, which were entered into as part of the significant business expansion up to 2009 and not decisively reduced in 2016 as a result of the EU decision. Despite the changes already made the Bank still has a high NPE ratio in a sector comparison, which is attributable not least to the guarantee construction, which makes the swift winding down of non-performing portfolios more difficult as well as to the overall only moderate relief provided to the Bank under the EU proceedings.

This results in related uncertainty as to whether the developments forecasted for 2017 and beyond will occur. HSH Nordbank is nevertheless confident that it will be able to further develop the Bank on a forward-looking basis in line with its restructuring plan. The implementation of the structural measures and operating progress made on the income and cost side will make a considerable contribution to strengthening of HSH Nordbank.

Over the coming years, the future results of HSH Nordbank are likely to benefit noticeably from the implementation of the structural measures and further implementation of the strategy. The Bank expects to generate net income before taxes at the Group level for 2017 that is at the previous year's level and a return on equity slightly above that of the previous year's level. A moderate increase in net income before taxes and a further noticeable improvement in the return on equity are expected for the Core Bank in 2017. Net income before taxes for the Non-Core Bank is to decrease even more markedly due to the ongoing winding down of the portfolio and the planned loan loss provisions on a full balance sheet utilisation of the guarantee.

Reconciliation between IFRS Group net income before taxes and HGB single entity net income before taxes is performed to explain the earnings, net assets and financial position and HGB single entity forecast report. Details regarding this are set out in the "Management system" chapter in the "Reconciliation" section.

Following the net income before taxes generated in 2016 a slightly negative net income before taxes is expected for HSH Nordbank AG in 2017 due to the restructuring and privatisation expenses. After

taking account of expected income in the "Income tax expense" line item a close to break even result after taxes is expected.

The Bank will make continuous efforts to ensure a competitive cost-income ratio. The cost income ratio benefits in the 2017 financial year from further reductions in administrative expenses. Structurally, the Bank's results will be improved by the implementation of the measures, especially by the gradual increase in the relief provided with regard to guarantee fees and the planned optimisation of the business model. Nevertheless, the Bank remains cautious in its earnings forecast for the whole of 2017 given the continuing challenging environment for banks in general and HSH Nordbank in particular.

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

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

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

RISK REPORT

RISK WITHIN THE HSH NORDBANK GROUP

As the presentation of risks relevant to HSH Nordbank cannot be meaningfully separated for individual legal entities, we consider below the risks of the Group, i.e. of HSH Nordbank AG as well as subsidiaries identified as relevant for purposes of risk management.

RISK MANAGEMENT SYSTEM

Principles of risk management

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

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

In order to identify material risks as defined by MaRisk, HSH Nordbank conducts an annual risk inventory. This includes a review of the existing quantitative and qualitative criteria for determining materiality taking due account of the Bank's risk tolerance and if necessary such criteria are redefined. Amongst the material risk types at HSH Nordbank that can be quantified are default risk, market risk, liquidity maturity transformation risk as a type of liquidity risk as well as operational risk, which also includes legal and compliance risks. These risk types are taken into account in the calculation of the risk-bearing capacity. In addition to the risk of insolvency as a second type of liquidity risk other material risk types of HSH Nordbank also include the business strategy risk and reputation risk. Due to the business model of HSH Nordbank, the default risk is the most significant type of risk.

The newly drafted 'Strategic Risk Framework (SRF)' document, which describes the focus of the Bank's risk management activities and lays the foundation for the risk culture, sets out, in addition to the results of the risk inventory, the basic risk strategy principles, quantitative and qualitative risk appetite statements, the overall risk and sub-risk strategies and the limit system. Risk management objectives and the measures used to achieve these objectives are defined in the SRF on the basis of the planned development of the main business activities. The focus is on securing and allocating scarce resources such as economic and regulatory capital and liquidity, taking into account risk tolerance, strategic business goals, the market environment and both the existing and planned portfolio. The risk strategies are supplemented by guidelines for granting loans (Credit Standards) and Investment Guidelines which contain detailed rules and regulations

concerning the individual business areas of HSH Nordbank. The SRF forms the risk framework for the business strategy and planning.

The major rules on the methods, processes and internal organisation used for risk management are documented in the Credit Manual of HSH Nordbank, in process descriptions as well as in illustrations of the internal organisation and are published throughout the Bank.

The risk management system is designed to identify, make transparent and manage risks arising from future developments. The Bank's management system is generally aimed at optimising the risk-reward profile of the Bank.

In view of the decision made by the European Commission on 2 May 2016 on the privatisation of HSH Nordbank by February 2018, the risk management system/risk strategy focus is also being optimized further to provide positive support to the privatisation process.

Organisation of risk management

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

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

The responsibility for risk management of HSH Nordbank lies with the Management Board. This also includes the methods and procedures to be applied for measuring, managing and monitoring risk. As a member of the Management Board, the Chief Risk Officer (CRO) is responsible for the risk controlling of HSH Nordbank AG, including risk monitoring, as well as for the back office functions of the Core Bank and Non-Core Bank. In detail this includes the divisions Group Risk Management, Credit Risk Management, Special Credit Management as well as Loan and Collateral Management.

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

Credit Risk Management is responsible, among other things, for the credit risk analysis, including the preparation and setting of the internal rating and drafting of the credit applications. Credit Risk Management is also responsible for designing the processes and rules that apply to the lending business within HSH Nordbank. Special Credit

Management, a new area that was set up in November 2016, is responsible for managing loan exposures in the Non-Core Bank portfolio, as well as workout and restructuring loan exposures. Loan and Collateral Management is responsible for the settlement and administration of the lending business as well as for obtaining and ongoing valuation of loan collateral.

Trading transactions are settled and controlled in the Transaction Banking and Group Risk Management divisions.

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

The internal Non-Core Bank of HSH Nordbank (formerly known as the Restructuring Unit), which was established in 2009 and includes positions of business areas that are no longer of strategic importance and non-strategic portfolios comprising legacy assets, has been largely incorporated into the existing organisation, meaning that it is still subject to the group risk management system of HSH Nordbank in full.

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

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

Business areas are managed in line with uniform Group standards on the basis of a global head principle. Based on this, the heads of the individual divisions as the respective Global Heads are responsible on a worldwide basis for the strategy of the business areas assigned to them and have the disciplinary responsibility for the employees active

in their business area. The Global Heads are supported by the head of the respective foreign branch (General Manager) in the implementation of the strategy on site in the foreign branches whilst maintaining the separation of duties in accordance with MaRisk. The General Manager is responsible for compliance with local legal and regulatory requirements. The global head principle also applies to risk controlling to ensure that a Group-wide coordinated risk controlling process is in place.

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

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

Risk management by a central committee structure

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

The Bank Steering Committee led by the Chief Financial Officer (CFO) and the Chief Risk Officer (CRO) is the body responsible for the management and allocation of financial resources within the framework of the risk limits and the targets. Its duties include responsibility for monitoring and managing the risks associated with the bottleneck resources (incl. risk concentration, credit, liquidity, FX and interest rate risks) taking all sorts of control mechanisms into account (return and costs, risks, liquidity and capital). This ensures an integrated view of key financial and risk indicators. The Bank Steering Committee also looks at market risk positions that serve the Bank's strategic goals. In order to ensure that all material risks affecting HSH Nordbank are monitored and managed and to ensure the Bank's risk-bearing capacity at all times based on its risk tolerance level, the Bank Steering Committee also looks at reports and analyses on the individual types of risk, the results of stress tests and the methodological

further developments of the risk management models. This means that the Bank Steering Committee prepares decisions on strategic guidelines, the type of management, targets, restrictions and other requirements for the corporate investment portfolio. The corresponding decisions are made by the Overall Management Board. The risk limits passed by the Management Board are monitored by the entities with operational responsibility. Scenarios in which risk limits are exceeded are escalated to the Management Board together with recommended courses of action, and the implementation of the measures/resolution of the risk limit breaches is monitored. In addition, the Bank Steering Committee is the body responsible for preparing the decision to transition to/remain in the phases defined in the recovery plan, as well as for convening and appointing the specific members of the teams that prepare for the implementation of the options identified and – insofar as the Management Board has passed a resolution on their implementation – implement them.

The scenario management circle provides key support to the Bank Steering Committee by monitoring the development of market indicators and making decisions on the simulation assumptions and scenarios (of both a macroeconomic and segment-specific nature). The simulation scenarios, their main assumptions and the analysis of the results are presented both to the Bank Steering Committee and to the Overall Management Board.

The Credit Committee (CC) is a body that makes independent decisions at the level of material individual loan transactions that is led by the Head of Credit Risk Management (CRM) and involves the CRO on a case-by-case basis. The CC is responsible, among other things, for the operational management of limited resources, i.e. liquidity, economic and regulatory capital, in particular where overall bank management requires the active control of capital and liquidity requirements relating to lending transactions. In this respect, the CC takes the requirements concerning resource management of the Group defined by the Bank Steering Committee as a basis. The committee also performs an active portfolio management function to achieve ongoing improvements in portfolio quality (profitability, diversification, granularity) and makes individual lending decisions from a credit risk perspective.

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

Risk reporting and measurement systems

HSH Nordbank maintains a central data storage system, which takes into account supervisory requirements, for the purposes of analysing, monitoring and reporting risks. Risk reporting is generally ensured by

means of the management and reporting systems of the Group Risk Management division. The risk management systems ensure effective risk management and are adequate with regard to HSH Nordbank's profile and strategy.

The following key reports are prepared for the overall risk:

- In 2016, the MaRisk Risk Report was the core element of risk reporting to the Management Board and the Risk Committee. It was prepared quarterly and shows HSH Nordbank's overall risk position together with detailed information on the material risk types.
- The HSH Management Report, a holistic finance and risk report on HSH Nordbank's overall situation with respect to the key value drivers, especially income, costs, liquidity, capital and risk, and on the development of the recovery plan indicators, is submitted to the Bank Steering Committee, the Management Board and, as of 2017, also to the Risk Committee (relevant excerpts only). Adherence to the risk limits and risk guidelines that are relevant for economic capital management is monitored with the help of this report. The HSH Management Report is prepared on a monthly basis as a general rule. It is also updated at weekly intervals in respect of selected key figures.

The Management Reporting Policy sets out the management requirements with respect to the structure, content, frequency, deadlines and form of the internal reporting bundled in the HSH Management Report for the purposes of ensuring both BCBS 239 compliance and the sustainability of internal reporting.

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

Internal control system

Bank-wide internal control system

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

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

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

The top priority of this ICS assessment is the structured and systematic examination of potential and/or known process risks together with the definition of and the decision on measures to be taken to mitigate them. Furthermore, the ICS makes a significant contribution to the effectiveness of the processes by specifying uniform rules that apply throughout the Bank. The ICS cycle also ensures that the ICS is continuously enhanced with respect to its correctness, appropriateness and effectiveness. Central responsibility for the management and monitoring of the ICS cycle as well as methodological requirements and their enhancement lies with the ICS Office within the “Methods & Tools” organisational unit.

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

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

The sub-processes of the Bank are defined annually for running the control cycle based on the risk level established and the last cycle run for each process. Approximately 45 % of the sub-processes were scheduled for a run of the control cycle in 2016. The need for improvement identified in respect of these sub-processes was imple-

mented in full. The ICS office also reports to the Management Board on an annual basis on the management of the ICS for the outsourcing of material functions.

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

Internal control system with regard to the accounting process

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

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

The organisational structure of the Finance division supports the internal control system. A comprehensive quality assurance by another organisational unit is performed for the functions responsible for the accounting of lending transactions and capital market transactions in Germany and the transactions in subsidiaries and foreign branches. Amongst other things, it is the responsibility of this organisational unit to combine the accounting information and to prepare the annual and consolidated financial statements. In addition this unit centrally monitors amendments to legislation concerning financial statements, in order to ensure uniform application of the law.

Regulatory requirements

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

risk under the standard approach. HSH Nordbank uses the standard method for CVA.

Regulatory figures are set out in the section Net assets and financial position. The requirements that resulted from the further implementation of the Basel III rules in 2016 were implemented within the framework of projects. For example, the implementation of new liquidity ratios (LCR based on Commission Delegated Regulation (EU) 2015/61 and the NSFR) was driven forward in the reporting year. In accordance with the requirements of Part 8 CRR in conjunction with Section 26a (1) Sentence 1 KWG HSH Nordbank publishes material qualitative and quantitative information on equity capital and risks incurred in a separate Disclosure Report.

As an institution that uses the IRB Advanced Approach for nearly the whole portfolio, particular requirements apply to HSH Nordbank in this context. The document provides more information than statements made in this Annual Report on the basis of the accounting principles applied, as it provides a comprehensive insight into the regulatory framework and the current risk situation of the Bank based on regulatory figures. The Disclosure Report as at 31 December 2016 is available on our website, www.hsh-nordbank.de, four weeks following publication of this Annual Report. With its publication HSH Nordbank complies with the third pillar of the Basel Accord (market discipline). The requirements regarding the disclosure of risk management objectives and policies in accordance with Article 435 (1) CRR and (2)(e) CRR are implemented in this Risk Report.

Risk-bearing capacity

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

As part of the monitoring of its risk-bearing capacity HSH Nordbank regularly compares the total economic capital required to cover all major quantifiable types of risk (overall risk) to the available amount of economic risk coverage potential and reports it to the supervisory

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

The primary management process for our calculation of risk-bearing capacity is a liquidation approach which focuses on protection of creditors (so-called gone concern approach). In addition to equity capital modified for economic purposes, the risk coverage potential takes into account, amongst other things, unrealised gains and losses arising on securities, equity holdings, the lending business and the corresponding hedging transactions (line items) as well as the liabilities. The risk coverage potential has been reduced by the second loss guarantee by the amount retained by HSH Nordbank of € 3.2 billion.

As at 31 December 2016, the risk coverage potential amounted to € 8.5 billion (31 December 2015: € 10.2 billion). The drop of € 1.7 billion is largely due to the maturities of subordinated capital. The overall risk takes into account default risk, market risk, operational risk as well as the liquidity maturity transformation risk as an element of liquidity risk. Economic capital required as an expression of unexpected losses is determined monthly for default, liquidity and market risks in a methodical consistent manner with a confidence level of 99.9 % and a risk horizon of one year. The economic capital requirements for the individual risk types are aggregated to an overall economic risk. In doing so, no risk-reducing correlations are utilised.

Overall economic risk increased by € 0.4 billion compared to the end of 2015 and amounted to € 2.9 billion as at the reporting date (31 December 2015: € 2.5 billion). This year-on-year increase is due, in particular, to the marked increase of € 0.6 billion in the default risk potential (details on the development of the default risk potential can be found under "Default risk management").

The utilisation of risk coverage potential amounted to 34 % as at the reporting date (31 December 2015: 25%). The risk-bearing capacity was secured at all times during the period under review.

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

RISK-BEARING CAPACITY OF THE GROUP

(€ bn)	31.12.2016	31.12.2015
Economic risk coverage potential¹⁾	8.5	10.2
Economic capital required	2.9	2.5
of which: for default risks ²⁾	1.9	1.3
for market risks	0.6	0.8
for liquidity risks	0.1	0.2
for operational risks	0.2	0.2
Risk coverage potential buffer	5.6	7.6
Utilisation of risk coverage potential (in %)	34	25

¹⁾ After deduction of the amount retained under second loss guarantee of the federal states of Hamburg and Schleswig-Holstein in the amount of € 3.2 billion.

²⁾ Taking the second loss guarantee into account.

As part of the regular review of the Strategic Risk Framework and the bank planning process, the risk appetite is derived on the basis of the risk coverage potential, keeping a capital buffer available. The latter is to be set in a way that ensures capital adequacy, also in stress scenarios.

Stress tests

In addition to stress tests specific to risk types, we regularly conduct stress tests across all risk types in order to be able to better estimate the effects of potential crises on key parameters such as utilisation of the risk-bearing capacity, regulatory capital ratios and liquidity and thus HSH Nordbank's overall risk position. Within the scenario management circle, resolutions are passed on simulation assumptions on a regular basis if corresponding market developments are observed. These result in simulation scenarios on which resolutions are passed by the Bank Steering Committee and the Overall Management Board. Both integrated macroeconomic scenarios, such as a severe economic downturn, a delayed recovery of the shipping markets as well as historical scenarios are calculated in this connection. Furthermore, the risk of excessive debt is analysed in the form of a stressed leverage ratio and reported. The results are incorporated in HSH Nordbank's internal reporting system every quarter and are analysed on a regular basis by the Management Board within the framework of an action-oriented management dialogue. Besides the review of the appropriateness of the buffer available for risk coverage potential, regulatory capital and liquidity maintained to offset stress effects, this analysis serves to discuss the need for options to strengthen the financial stability of HSH Nordbank.

HSH Nordbank's recovery plan under the Act on the Recovery and Resolution of Credit Institutions (*Sanierungs- und Abwicklungsgesetz, SAG*) has a comparable objective. It serves both the purpose of the early identification of any resource bottlenecks using appropriate indicators and their elimination in crisis situations by means of pre-defined options. The effectiveness of the options identified, the selected recovery plan indicators and related processes are reviewed in the recovery plan by means of specific stress scenarios. As at 31 December 2016, HSH Nordbank is in the early warning phase of the recovery plan.

The particular purpose of both processes is to ensure that the Bank is able to comply with the regulatory minimum requirements even under stress conditions. In addition, HSH Nordbank carries out inverse stress tests at least once a year to identify scenarios which could endanger HSH Nordbank's ability to survive. The potential impact of the persistent low interest rate environment is also analysed. This information is also used by HSH Nordbank's Management Board as additional guidance for explaining and deciding upon the action required for reviewing the sustainability of the business model in the event of developments that threaten the Bank's existence.

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

DEFAULT RISK

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

In addition to the traditional credit risk, credit risk also includes counterparty and issuer risk. The conventional credit risk is the risk of complete or partial loss in the lending business as a result of deterioration in the counterparty's credit standing. A counterparty default risk exists in the case of derivatives and refers to the risk that a counterparty defaults during the term of a transaction and HSH Nordbank must cover the shortfall for the residual term by means of a new contract on the market at the price prevailing at that time which might be less favourable. Issuer risk denotes the risk that a loss is incurred on a financial transaction as a result of the default or deterioration in the creditworthiness of the issuer.

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

HSH Nordbank understands country risk as the risk that agreed payments are not made or only made in part or delayed due to gov-

ernment-imposed restrictions on cross-border payments (transfer risk). The risk is not related to the debtor's credit rating.

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

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

Organisation of default risk management

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

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

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

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

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

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

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

The Bank has defined valuable collateral in order to differentiate between collateralised and non-collateralised loans. The focus is placed on meeting the requirements of the CRR (e.g. availability of a market value, ability to realise the collateral, no correlation to the collateralised loan, legal enforceability, and 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 & Taxes divisions.

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

Default risk management

In line with the HSH Nordbank's business strategy focus as a "Bank for Entrepreneurs" with lending as its anchor product, default risks account for the lion's share of the Bank's overall risk potential. In order to measure and manage these risks, Group Risk Management uses procedures and methods that are continually reviewed and enhanced to ensure they are appropriate.

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

As a result of the adverse developments on the shipping market, economic capital required for default risk increased significantly from € 1.3 billion to € 1.9 billion as at the reporting date after taking account of the second loss guarantee made available by the federal states of Hamburg and Schleswig-Holstein. The increase in the economic capital required for default risk results in the second loss guarantee facility being exceeded by € 0.9 billion in the reporting period. This part of the default risk that is no longer covered by the federal state guarantee results in an increase in the risk exposure.

Non-performing exposure (NPE), i.e. the total of all positions of borrowers in default, serves as an important management indicator that has also been defined as a risk guideline in the SRF. Information on the non-performing portfolio is shown in the table "Default risk structure by rating category". In addition, the coverage ratio (ratio of total loan loss provisions on the non-performing exposure to the total non-performing exposure) is monitored at overall bank level as a MaSan indicator. In accordance with the decision made by the EU Commission on 2 May 2016, HSH Nordbank is to be relieved of some of its troubled legacy portfolios. In line with the EU decision, for example, non-performing loans in an initial amount of € 5 billion were sold to the federal state owners based on market prices. The EU decision provides for the sale of additional portfolios on the market, with contractual agreements already being reached for a large part of these portfolios at the start of 2017. Progress has also been made with regard to the organic winding down of legacy portfolios. The loans in

default were reduced considerably from € 18.4 billion to € 14.6 billion despite a counter-trend resulting from defaults on further shipping financing arrangements, and will drop further as a result of the sale of the market portfolios, which in turn will lead to a continued general improvement of HSH Nordbank's non-performing exposure (NPE) ratio at Group level.

The syndication of lending transactions is also helping to actively shape the composition of the portfolio. In order to maintain the greatest possible degree of flexibility with regard to being able to sell financing arrangements again, either in full or in part, the Bank subjects all potential new business as of a certain volume limit to a market conformity assessment and a syndication assessment performed by the credit syndicate within the Credit Solutions department as part of the Credit Committee Pre-Check (CCPC). The CCPC/Credit Risk Management then makes a joint decision together with the credit syndicate and the deal team sales employees as to whether syndication should be arranged as part of the new business process. The existing portfolio is also reviewed for saleability on a quarterly basis as part of the MaSan procedure (and on an ad hoc basis where appropriate).

Rating procedures, LGD and CCF

HSH Nordbank collaborates intensively with other banks in the further development and ongoing validation of various internal rating modules. This is done in the association of Landesbanks via RSU Rating Service Unit GmbH & Co. KG (RSU) and in cooperation with Sparkassen Rating und Risikosysteme GmbH (SR), a subsidiary of the German Savings Bank Association (DSGV).

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

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

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

As part of the annual validation process the predictive accuracy of the rating modules was reviewed in the reporting year with regard to the

predicted probabilities of default using anonymous, aggregated data. In addition, the LGD and CCF processes were also validated and are being continually refined. All reviews have confirmed the full applicability of the models.

Risk concentrations

Within the framework of regular business segment analyses potential counterparty default risk concentrations, for example with regard to groups of connected clients (GcC), regions or industrial sectors in a broader sense, are identified and their trend is monitored. At the end of 2016, the material risk concentrations of HSH Nordbank in credit risk were in the real estate portfolio, which accounted for 20% of the overall portfolio (previous year: 19%) and in the shipping portfolio, which accounted for 20% of the overall portfolio (previous year: 24%). Other concentration risks relate to the US dollar business, which accounted for 25% of the overall portfolio (previous year: 30%). The shipping loan portfolios denominated in US dollars are included in both key figures. Despite a drop in the concentration in shipping financing and in financing denominated in USD, the key capital and liquidity figures remain sensitive, albeit less sensitive than before, to developments on the shipping market and in the EUR/USD exchange rate.

An internal process, which ensures adherence to the regulatory requirements, is in place to monitor large exposure limits in accordance with Article 395 CRR. As a supplementary measure, the material counterparty concentrations in the portfolio are identified on the basis of a risk-oriented parameter (risk of loss as the total of expected loss and unexpected loss) and reported quarterly to the Management Board and Risk Committee. Net rating-based upper limits are applied to new business to prevent future counterparty concentrations.

Country risk limitation is an additional management dimension within the management of risk concentrations. Country limits are set for country risk concentrations at the Group level. Utilisation of the limits is monitored continuously and centrally by the country risk management. In the event that a limit is fully utilised the decision regarding each new business transaction rests with the Overall Management Board.

Equity holding risk

The regulatory authorities state that equity holdings must be consolidated, deducted from equity or backed with equity capital in the receivable class equity holdings. In this context, regulatory law considers equity holding risk to be a sub-category of the default risk. HSH Nordbank has significantly reduced its equity holding portfolio and thereby equity holding risk over recent years, thus successfully bringing it in line with the Bank's strategic realignment. The acquisition of equity holdings only takes place, if it meets the strategic objectives of HSH Nordbank. The risks and rewards associated with a potential equity holding are analysed extensively prior to the conclusion of the transaction.

A regular company valuation represents an important instrument for monitoring and managing equity holding risk. At least once a year, impairment tests are performed on all equity holdings of HSH Nordbank. Important equity holdings are subject to a more detailed analysis in this context.

Furthermore, all equity holdings in the portfolio are analysed once a year, with a focus on the identification of risks in the individual companies, amongst other things. Measures are derived from the analysis in order to be able to actively counter the identified risks.

The articles of association and by-laws are formulated so as to ensure that the most intensive management possible can be exercised for the benefit of HSH Nordbank.

Management of default risk in pricing and actual costing

HSH Nordbank applies a uniform method across the Bank for the pricing of lending transactions through calculating the present value of the expected and unexpected losses arising on default risk positions. In addition to liquidity and standard processing costs, the rating, LGD and CCF risk parameters determined internally on an individual transaction basis are incorporated in the ex-ante calculation pricing by means of the standard risk costs. In the same way, an actual costing (profit centre accounting) is made for all transactions on a monthly basis, taking the cost elements stated above into account. Based on the current risk parameters of the individual transactions, standard risk costs and the resulting contribution margins are determined. Furthermore, utilisation of the regulatory default limits set as part of the Bank's annual plan were determined regularly at the division level for the purposes of managing default risk. When a limit is overdrawn, new transactions and prolongations are subject to stricter approval requirements. The objective of this dual limit system is to ensure that both the risk-bearing capacity and regulatory ratios are adhered to.

Default risk exposure

The figures in the following tables showing default risk exposure are based on the EaD. The EaD corresponds to the volume of loan receivables, securities, equity holdings, derivative financial instruments (positive market values after netting) and off-balance-sheet transactions (taking credit conversion factors into account). The EaD does not include any risk-reducing effects (e.g. allocation of collateral). The total EaD amount outstanding was € 83,626 million as at 31 December 2016.

The EaD broken down by internal rating categories is presented in the following table. The EaD with an investment grade rating (rating category 1 to 5) at Group level accounts for € 49,092 million or 59 %

of the total exposure (previous year: € 53,927 million or 55%). The loan amount outstanding for investment grade exposures amounts to € 35,521 million or 69% (previous year: € 35,043 million or 67% based on the new segment structure) for the Core Bank and € 3,375 million or 16% (previous year: € 5,320 million or 17% based on the new segment structure) for the Non-Core Bank. 34 % of the Overall Bank portfolio is covered by the second loss guarantee (previous year: 42%). For the Core Bank a share of 20 % is guaranteed (previous year: 25 % based on the new segment structure) and for the Non-Core Bank 85 % (previous year: 88% based on the new segment structure). At 87 % (previous year: 92 %) the share of the guaranteed portfolio is particularly high in the default categories 16 to 18.

DEFAULT RISK STRUCTURE BY RATING CATEGORY¹⁾

(€ m)	2016				of which guaranteed (in %)
	Core Bank	Non-Core Bank ³⁾	Other and Consolidation ³⁾	Total	
1 (AAAA) to 1 (AA+)	13,684	700	6,726	21,110	17
1 (AA) to 1 (A-)	6,889	755	2,006	9,650	18
2 to 5	14,948	1,920	1,464	18,332	19
6 to 9	11,270	1,373	66	12,709	27
10 to 12	1,609	569	–	2,178	52
13 to 15	2,296	2,394	69	4,759	60
16 to 18 (default category)	1,006	13,610	–	14,616	87
Other ²⁾	–	87	186	273	–
Total	51,703	21,406	10,517	83,626	34

¹⁾ Mean default probabilities (as %): 1 (AAAA) to 1 (AA+): 0.00–0.02; 1 (AA) to 1 (A-): 0.03–0.09; 2 to 5: 0.12–0.39; 6 to 9: 0.59–1.98; 10 to 12: 2.96–6.67; 13 to 15: 10.00–20.00; 16 to 18: 100.00.

²⁾ Transactions, for which there is no internal or external rating available, are reflected in the "Other" line item, such as receivables from third parties of our consolidated equity holdings, for example.

³⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

DEFAULT RISK STRUCTURE BY RATING CATEGORY¹⁾

(€ m)	2015				of which guaranteed (in %)
	Core Bank ³⁾	Non-Core Bank ³⁾	Other and Consolidation ³⁾	Total	
1 (AAAA) to 1 (AA+)	12,226	1,687	9,157	23,069	19
1 (AA) to 1 (A-)	6,113	1,229	2,793	10,135	29
2 to 5	16,704	2,404	1,614	20,722	23
6 to 9	13,692	3,403	29	17,124	38
10 to 12	1,736	1,675	–	3,412	66
13 to 15	847	3,905	87	4,839	75
16 to 18 (default category)	1,090	17,319	–	18,408	92
Other ²⁾	1	120	207	328	–
Total	52,409	31,742	13,886	98,037	42

¹⁾ Mean default probabilities (as %): 1 (AAAA) to 1 (AA+): 0.00–0.02; 1 (AA) to 1 (A-): 0.03–0.09; 2 to 5: 0.12–0.39; 6 to 9: 0.59–1.98; 10 to 12: 2.96–6.67; 13 to 15: 10.00–20.00; 16 to 18: 100.00.

²⁾ Transactions, for which there is no internal or external rating available, are reflected in the "Other" line item, such as receivables from third parties of our consolidated equity holdings, for example.

³⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

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

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	2016			Total
	Core Bank	Non-Core Bank ¹⁾	Other and Consolidation ¹⁾	
Industry	7,709	1,682	–	9,391
Shipping	6,542	9,555	42	16,139
Trade and transportation	3,428	851	–	4,279
Credit institutions	3,301	591	3,946	7,838
Other financial institutions	1,849	2,120	531	4,500
Land and buildings	10,343	3,832	29	14,204
Other services	5,377	1,121	942	7,440
Public sector	12,796	1,172	5,005	18,973
Private households	357	483	22	862
Other	–	–	–	–
Total	51,703	21,406	10,517	83,626

¹⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	2015			Total
	Core Bank ¹⁾	Non-Core Bank ¹⁾	Other and Consolidation ¹⁾	
Industry	7,561	2,325	–	9,886
Shipping	7,914	14,905	–	22,819
Trade and transportation	3,283	1,228	–	4,511
Credit institutions	4,055	724	4,333	9,112
Other financial institutions	1,897	3,461	1,032	6,390
Land and buildings	10,212	4,881	–	15,092
Other services	5,276	1,538	1,051	7,866
Public sector	11,734	2,101	7,457	21,292
Private households	477	579	13	1,069
Other	–	–	–	–
Total	52,409	31,742	13,886	98,037

¹⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

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

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	2016			Total
	Core Bank	Non-Core Bank ¹⁾	Other and Consolidation ¹⁾	
Up to 3 months	7,474	4,189	829	12,493
> 3 months to 6 months	2,227	836	311	3,374
> 6 months to 1 year	3,384	998	572	4,954
> 1 year to 5 years	22,660	8,545	6,436	37,641
> 5 years to 10 years	9,696	3,410	1,989	15,095
> 10 years	6,262	3,429	379	10,070
Other	-	-	-	-
Total	51,703	21,406	10,517	83,626

¹⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	2015			Total
	Core Bank ¹⁾	Non-Core Bank ¹⁾	Other and Consolidation ¹⁾	
Up to 3 months	7,220	5,058	458	12,735
> 3 months to 6 months	1,573	873	345	2,792
> 6 months to 1 year	2,548	1,626	568	4,743
> 1 year to 5 years	23,254	12,759	8,421	44,434
> 5 years to 10 years	11,238	7,536	3,632	22,406
> 10 years	6,576	3,890	462	10,927
Total	52,409	31,742	13,886	98,037

¹⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

The following table provides an overview of the foreign exposure by region, which reached € 33,617 million as at 31 December 2016 (previous year: € 39,650 million).

FOREIGN EXPOSURE BY REGION

(€ m)	2016			Total
	Core Bank	Non-Core Bank ¹⁾	Other and Consolidation ¹⁾	
Western Europe	10,808	8,907	3,146	22,861
thereof: eurozone countries	8,280	5,441	1,214	14,935
Central and Eastern Europe	550	582	–	1,132
thereof: eurozone countries	51	2	–	53
Africa	568	253	–	821
North America	1,302	1,770	52	3,124
Latin America	298	288	–	586
Middle East	44	650	–	694
Asia-Pacific region	1,307	2,399	1	3,707
International organisations	94	–	598	692
Total	14,971	14,849	3,797	33,617

¹⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

FOREIGN EXPOSURE BY REGION

(€ m)	2015			Total
	Core Bank	Non-Core Bank ¹⁾	Other and Consolidation ¹⁾	
Western Europe	10,219	10,783	3,906	24,907
thereof: eurozone countries	7,697	6,595	1,553	15,845
Central and Eastern Europe	444	928	–	1,371
thereof: eurozone countries	52	42	–	94
Africa	755	461	–	1,215
North America	1,828	2,725	41	4,595
Latin America	498	588	–	1,086
Middle East	46	809	–	856
Asia-Pacific region	1,740	3,037	–	4,777
International organisations	149	–	694	843
Total	15,679	19,331	4,641	39,650

¹⁾ Following the changes made to the segment structure as at 30 September 2016, the figures reported for the prior year have been adjusted accordingly.

The basis for the allocation of the transactions to the regions is the country of the customer relevant for transfer risk taking account of any collateral relevant for the transfer risk. At customer level, the country relevant for transfer risk is the country from where HSH Nordbank receives the cash flows. If this cannot be unambiguously assigned at customer level, the place of business where management is exercised is applied.

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

The following table shows the EaD of the exposures in the European countries stated. HSH Nordbank's total exposure to these countries has decreased by 4 % compared to the previous year and amounted to € 5,925 million in total as at 31 December 2016 (previous year: € 6,180 million).

EXPOSURE AT DEFAULT IN SELECTED EUROPEAN COUNTRIES

(€ m)	Country		Banks		Corporates/Other		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
Greece	-	-	-	-	1,478	1,163	1,478	1,163
Italy	425	445	-	-	602	639	1,027	1,084
Croatia	-	-	-	-	101	106	101	106
Portugal	219	223	-	4	26	29	245	256
Russia	-	-	3	4	74	135	77	139
Spain	151	156	46	58	1,215	1,328	1,412	1,542
Turkey	-	-	31	22	379	473	410	495
Cyprus	-	-	-	-	1,175	1,395	1,175	1,395
Total	795	824	80	88	5,050	5,268	5,925	6,180

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

Note 73 includes more information on the selected European countries.

Loan loss provisions

Within the framework of risk management, HSH Nordbank pays the most attention to default risk. Impairments of a loan exposure are shielded through the creation of individual valuation allowances for loans and advances and provisions for contingent liabilities in the amount of the potential loss in accordance with Group-wide standards. HSH Nordbank also creates general loan loss provisions, with regard to receivables not subject to loan loss provisions but which contain latent risks. In the case of loans to borrowers with a high country risk, a general country loan loss provision is created taking into account the respective internal country rating as well as collateral. All restructuring and workout loan exposures, as well as intensified loan management cases with a rating greater or equal to 13, are subject to a comprehensive two-step review process every quarter. In a first step, a review is carried out on the basis of objective criteria (so-called trigger events) to determine whether the receivable could be impaired (impairment identification). If this is the case, the loans identified are reviewed in a second step to determine whether a loan loss provision is actually required and the amount thereof (impairment measurement). The amount of the loan loss provision is calculated by deducting the present value of all expected future incoming payments from the carrying amount of the receivable. The expected incoming payments comprise in particular all expected interest and redemption payments, as well as payments from the liquidation of collateral.

In the case of problem loans the basis for the respective amount of the risk provision is the impairment in accordance with IFRS, as a matter of principle. Loan loss provisions were once again characterised by considerable additions of around € 1.8 billion in the shipping portfolio in the reporting year. The additional loan loss provision expense for legacy shipping portfolios was required in order to take account of the very difficult market developments, which were evident from the dramatic slump in charter rates and ship values, in particular. In the reporting period, they were attributable primarily to loans for bulkers and container vessels. In the Corporate Clients and Real Estate segments, on the other hand, risk developments remained unremarkable. The loan loss provisions set up again for legacy portfolios, in particular, in the reporting year were still compensated for by the guarantee to the extent that they related to portfolios hedged by the guarantee. An amount of € 1,811 million (previous year: € 3,688 million) has been taken into account, with a positive effect, under loan loss provisions in the statement of income. The loan loss provision result is influenced positively by the results of the loss settlements via the compensation provided by the second loss guarantee. In connection

with the settlement of losses under the guarantee with HSH Finanzfonds AöR, the Bank was able to compensate not only for credit losses incurred, but also for interest payments lost in the past. The hedging effect of the guarantee resulted in a cash draw down of the guarantee for the first time in the reporting year, also taking into account the transfer of non-performing shipping loans to the federal state owners. The Bank's first loss piece (€ 3.2 billion) had been exceeded on the balance sheet date by € 2.3 billion due to losses, particularly also in connection with the settlement of losses from the federal state transaction. The balance sheet drawdown under the second loss guarantee amounts to € 9.9 billion (including guarantee payments already received in the amount of € 1.9 billion) as at 31 December 2016 (31 December 2015: € 8.1 billion). The 2017 plan year is expected to bring the full balance sheet and regulatory utilisation of the guarantee facility, and the full drawdown of the guarantee by way of full settlement is expected by 2022.

The individual elements of loan loss provisions are shown in the table below:

TOTAL LOAN LOSS PROVISIONS

(€ m)	2016	2015
Loans and advances to customers	52,937	61,014
Loans and advances to banks	2,240	3,103
Volume of impaired loans	11,028	16,263
Total specific loan loss provisions for loans and advances to customers	-6,608	-7,827
Total general loan loss provisions for loans and advances to customers	-438	-671
Total specific loan loss provisions for loans and advances to banks	-	-14
Total general loan loss provisions for loans and advances to banks	-	-3
Total loan loss provisions for balance sheet items	-7,046	-8,515
Provisions for individual risks in the lending business	-67	-59
Provisions for contingent liabilities (general loan loss provisions) in the lending business:	-44	-52
Total loan loss provisions for off-balance sheet items	-111	-111
Total loan loss provisions (before compensation item)	-7,157	-8,626
Compensation item	8,060	7,841
Total loan loss provisions (including compensation item)	903	-785

The loss rate in the Group amounted to 3.37% in the reporting year (previous year: 1.35%). The loss rate is calculated based on the actually realised defaults (utilisation of SLLP plus direct write-downs less income from recoveries on loans and advances previously written-off) as a ratio of the credit risk exposure. The total amount of actually realised defaults in 2016 was € 3,046 million (previous year: € 1,392 million) and the credit risk exposure € 90,464 million (previous year:

€ 103,062 million). The credit risk exposure includes all balance sheet and off-balance sheet assets, taking account of the individual and portfolio valuation allowances for loans and advances to customers and banks that are subject to default risk.

Loan loss provisions for the Bank in the form of specific loan loss provisions and provisions for default risks amounted to € -6,675 million in total as at 31 December 2016 (previous year: € -7,900 million) corresponding to a ratio of 7.38% in relation to the credit volume (previous year: 7.67%). The loan loss provisions comprise the individual valuation allowances for loans and advances to customers of € -6,608 million (previous year: € -7,827 million) and provisions for individual risks in the lending business of € -67 million (previous year: € -59 million), as well as the individual valuation allowances for loans and advances to banks in the amount of €0 (previous year: € -14 million). General loan loss provisions (including country-specific general loan loss provisions and provisions) amounted to € -483 million (previous year: € -726 million). In addition, the total loan loss provisions for off-balance sheet items comes to € -111 million (previous year: € -111 million). Total loan loss provisions (including compensation item) amounted to € 903 million as at 31 December 2016 (previous year: € -785 million). The compensation item, which exceeds the loan loss provisions, can be attributed to the fact that the compensation item also includes the hedging effect for other transactions covered by the guarantee (e.g. securities). In such cases, corresponding impairments are not recognised with an offsetting effect in loan loss provisions.

Planning for loan loss provisions and losses

Loan loss provisions are planned as part of the annual Bank plan under the plan assumptions specified therein. The planning includes the annual changes in the amounts of the individual and portfolio valuation allowances, broken down by the amounts covered by and not covered by the second loss guarantee and including new business.

Other components of the plan are the change in the utilisation of the second loss guarantee as well as the actual losses invoiced and the total loss to be expected from the second loss guarantee.

In planning additions to as well as utilisations and reversals of loan loss provision HSH Nordbank mainly relies on models that simulate the expected loss at the individual transaction level over the planning period based on parameters specific to the transaction. Scenario analyses based on cash flows and historical data regarding changes in loan loss provisions based on the expected loss or migrations from portfolio valuation allowances to individual valuation allowances are also taken into account.

The effects arising from the sale, an agreement on which was signed in January 2017, of parts of the portfolios to be sold on the market in accordance with the EU decision (largely real estate, aviation and energy) have been taken into account for 2017, assuming the extensive settlement of the resulting losses against the guarantee. Further infor-

mation on the EU state aid proceedings is set out in the Forecast, opportunities and risks report section.

In addition to the amount of the specific loan loss provisions as described above that is recognised on the guaranteed portfolio less any individually retained amounts the plan for the guarantee utilisation (without effects from premiums) includes the actual losses invoiced under the second loss guarantee as well as amounts utilised in the past but not yet invoiced (less individually retained amounts), impairment losses on securities (less individually retained amounts) as well as any portfolio valuation allowances on the guaranteed portfolio.

The payment defaults expected in the portfolio covered by the second loss guarantee will increase further in 2017 and result in further actual payments under the second loss guarantee. Further details on the second loss guarantee can be found in Note 2.

A key driver of the amount of loan loss provisions is the breakdown of impaired loan exposures into “capable of recovery” (and therefore recognition of an individual valuation allowance based on the assumption of the continuation of the borrower’s business) or “not capable of recovery” (and therefore recognition of an individual valuation allowance based on the assumption of a workout). The estimates concerning long-term loan loss provisions are based on the assumption of a recovery of the shipping markets, in particular a recovery in container shipping, as well as basically a continuation of the current recovery strategy and therefore the assumption of HSH Nordbank’s willingness on a case by case basis to continue to finance problem loans remaining after the intended transactions, with the aim of achieving the planned write-up potential in the future. Further information on the loan loss provision forecast and uncertainties associated with the long-term loan loss provision plan is set out in the Forecast, opportunities and risks report section.

Reports on default risk

The Management Board and Risk Committee are regularly informed regarding the risk content and the trend in the individual asset classes and/or sub-portfolios, as well as the risk concentrations and recommended measures as part of the regular reporting process.

The new HSH Management Report that was introduced in 2016 contains information on the development of the relevant key default risk figures, as well as structural analyses on business areas, information on conspicuous individual loan exposures and reports on problem loans and new business. The HSH Management Report also includes the profit centre accounting, rating validation results and rating migration development, as well as information on the monitoring and management of the country risk.

MARKET RISK

Market risk represents the potential loss that can arise as a result of adverse changes in market values on positions held in our trading and banking book. Market movements relevant to the Bank are changes in interest rates and credit spreads (interest rate risk), exchange rates (foreign exchange risk), stock prices, indices and fund prices (equity risk) as well as, up until the end of 2016, commodity prices (commodity risk) including their volatilities.

Organisation of market risk management

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

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

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

Market risk management

Market risk measurement and limitation

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

The value-at-risk (VaR) is determined by HSH Nordbank using the historical simulation method. It is calculated for the entire Group based on a confidence level of 99.0 % and a holding period of one day for a historical observation period of 250 equally weighted trading days.

The 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 basis risk is also taken into account in determining the VaR. The basis risk constitutes the risk of a potential loss or profit resulting from

changes in the proportion of prices or interest rates on similar financial products within a portfolio. The individual market risk types are not restricted by separate limits. 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 units for the purposes of managing market risk, whereas losses incurred are restricted through stop loss limits. There are clearly defined processes for limit adjustments and breaches.

Where necessary, HSH Nordbank enters into hedging transactions to manage or reduce market risk in order to offset the impact of unfavourable market movements (e.g. with regard to interest rates, exchange rates) on its own positions. Derivative financial instruments in particular, such as interest rate and cross-currency interest rate swaps, for example, are used as hedging instruments. The impact of the hedging relationships entered into are included in the disclosed VaR. Further information on this and the type and categories of the hedging instruments and hedging relationships entered into by HSH Nordbank as well as the type of risks hedged is presented in the Notes. In particular, we refer to Note 13 Hedge accounting via valuation units and Note 71 Report on business in derivatives.

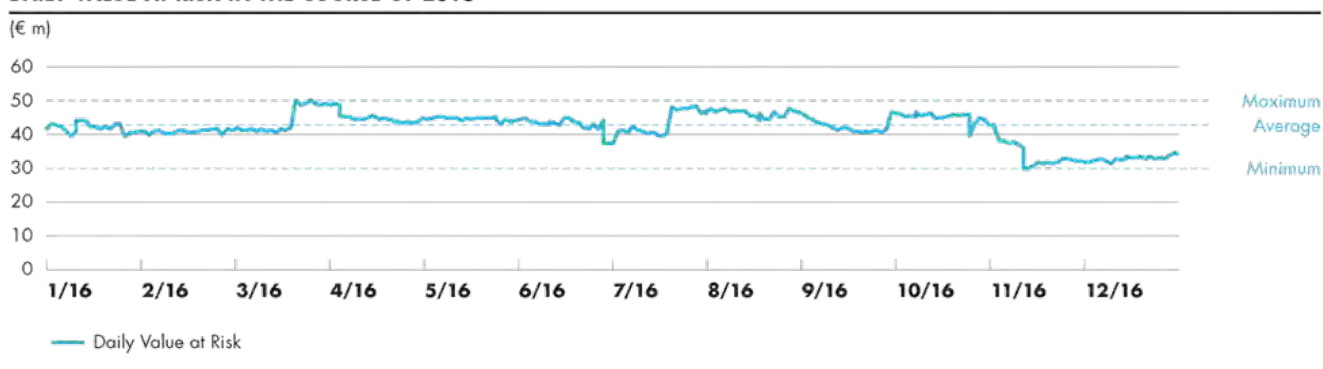
Market risks arising from the lending business and liabilities of the Bank are transferred to the trading divisions and taken into account in the corresponding risk positions. There they are managed as part of a proactive portfolio management process and hedged through external transactions.

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

Daily value-at-risk during the year under review

The following chart illustrates the movement in the daily VaR for the total trading and banking book positions of HSH Nordbank over the course of 2016.

DAILY VALUE-AT-RISK IN THE COURSE OF 2016



Market risk fluctuated between € 30 million and € 50 million. This figure fell from € 41 million on the last day of 2015 to € 34.5 million on the last day of 2016. The main drivers behind this drop in overall VaR included the portfolio reduction and lower market volatility compared with the previous year.

The VaR of the trading book positions amounted to € 0.5 million as at 31 December 2016, while that of the banking book transactions amounted to € 35 million. The overall VaR, which cannot be derived

from the total VaR of the trading and banking book positions due to risk-mitigating correlation effects, amounted to € 34.5 million as at the reporting date. This resulted in a limit utilisation of 49 % based on a VaR limit of € 70 million.

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

DAILY VALUE-AT-RISK OF THE GROUP

(€ m)	Interest rate risk ¹⁾		Credit spread risk ¹⁾		Foreign exchange risk		Equity risk		Commodity risk		Total ²⁾	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Average	9.7	18.3	25.1	23.0	18.1	19.5	2.0	2.9	-	-	41.8	41.6
Maximum	19.9	24.9	27.1	28.0	25.8	25.4	4.1	6.2	-	0.2	49.9	57.3
Minimum	4.6	11.4	21.6	17.7	9.1	10.3	0.9	1.1	-	-	30.2	24.7
Period end amount	12.3	19.4	22.9	24.0	18.3	21.3	1.4	4.1	-	-	34.5	40.9

¹⁾ Credit spread risk is a sub-type of interest rate risk. It is not disclosed as part of interest rate risk but as a separate item due to its significance for HSH Nordbank.

²⁾ Due to correlations the VaR does not result from adding up individual values.

With regard to the risk types there mainly was a drop in interest rate risk. This is due primarily to the incorporation of pension liabilities into the market risk measurement. The pension liabilities have a positive interest rate sensitivity and largely compensate for the negative interest rate sensitivity of the other portfolios of the Group. The commodity business was abandoned in 2016 and the last of the portfolio had been wound down by the end of the year. This means that there is no longer any commodity risk to be reported at the year end.

The market risk of the Core Bank is primarily characterised by interest rate and foreign exchange risk arising from the lending business, funding and the trading book, which predominantly contains positions resulting from trading in interest rate and currency derivatives with customers and bond trading. The market risk also includes the credit spread risk from the securities positions in the liquidity buffer and cover pool portfolios, which are characterised by good credit ratings. In 2016, the majority of the public cover pools of the Non-Core Bank were transferred to the Core Bank. There are only marginal equity risks.

The market risk of the Non-Core Bank arises predominantly from the credit investment business or the credit investment portfolio in the banking book. Accordingly, credit spread risk is the dominant factor.

Backtesting

HSH Nordbank performs regular backtests to verify the appropriateness of its VaR forecasts. On the assumption of unchanged positions, the daily profit and loss achieved in theory due to the market developments observed are compared with the VaR values of the previous day, which were forecast using historical simulation. Based on the assumption of the confidence level of 99.0% applied by HSH Nordbank, up to four outliers indicate that the forecasting quality for market risks is satisfactory. In 2016, there were no more than four outliers in any month at the level of the HSH Nordbank Group.

Stress tests

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

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

Instruments for managing market risk as part of hedge accounting

For purposes of managing market risk from loans and liabilities, as well as from securities, the Bank's financial market division also employs derivative financial instruments. In particular, interest rate swaps and other interest rate/currency derivatives are employed to hedge interest rate and foreign exchange risks from underlying transactions. This may include the hedge of market risks at the micro, portfolio, and macro level.

When hedging assets not held for trading, transactions which clearly are related to another in a documented hedge relationship may be accounted for as a valuation unit within the meaning of Section 254 German Commercial Code (HGB), provided the requirements for the application of Section 254 are met. In addition, a determination is made from a net present value perspective in accordance with IDW Statements RS BFA 3 in respect of all interest-related financial instruments held in the banking book as to whether a provision is to be

recognised for contingent losses arising on such financial instruments. Financial instruments not included in a valuation unit or in the netting area of the loss-free valuation of the banking book are measured individually.

Reports on market risk

The Management Board is informed on a daily basis with regard to the trend in market risk and results as well as limit utilisations. In addition, weekly or monthly reporting to the Overall Bank Management Committee takes place.

LIQUIDITY RISK

HSH Nordbank divides its liquidity risk into risk of insolvency and liquidity maturity transformation risk.

The risk of insolvency refers to the risk that present or future payment obligations cannot be met in part or in full. This is referred to as liquidity risk in the narrower sense. The key driver of this liquidity risk is the cash flow structure in the liquidity development report, which is determined by the assets (maturity/currency structure) and liabilities (funding structure by maturity/currency/investor). In this regard the market liquidity risk, i.e. the danger, that transactions cannot be sold or only at unfavourable conditions because of a lack of market depth, is reflected in the liquidity development report as a component of the insolvency risk. Another component of insolvency risk is the refinancing risk, i.e. the danger, of not being able to obtain liquidity or not at the expected conditions if required. The refinancing risk is determined by the refinancing structure. Information on the refinancing structure can be found in Note 42.

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

Organisation of liquidity risk management

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

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

The Bank Steering Committee is the central committee responsible for managing the resource liquidity and is assisted by the Credit

Committee in this task by means of an active portfolio management at the level of material individual transactions.

HSH Nordbank has a liquidity contingency plan which contains regulated procedures and responsibilities should a liquidity crisis occur. Institution-specific, risk-oriented and capital market-oriented early warning indicators are also taken into account as part of the contingency process in order to avert a liquidity emergency. The liquidity contingency plan is closely linked to the Recovery Plan as defined in the SAG.

Liquidity risk management

Measurement and limitation of liquidity risk

The transactions in the Group impacting liquidity are presented as cash flows and the resultant inflows and outflows allocated to time buckets (liquidity development report) for the purposes of measuring the risk of insolvency or funding requirements. The difference between inflows and outflows represents a liquidity surplus or deficit (gap) in the relevant time buckets. The gaps are presented accumulated from day one to twelve months in order to map future liquidity requirements. They are compared to the respective liquidity potential which is applied to close the cumulative gaps of the individual time buckets and consequently represents the respective limit for insolvency risk. The net liquidity position, which shows the extent of the insolvency risk, is determined as the net amount from the gaps and the respective liquidity potential. This means that the net liquidity position already includes the measures used to generate liquidity in normal market phases.

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

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

The components of the liquidity potential – such as the liquidity buffer required under MaRisk for example – are monitored continuously and validated in accordance with internal and external minimum requirements. Safety buffers and risk discounts are incorporated into the limits in order to keep the probability of full utilisation or

overdrawing the limits as low as possible. These discounts are, for example, haircuts or other safety margins that reflect the uncertainty about the future development of the respective component of liquidity potential. Permanent market access to the funding sources relevant for HSH Nordbank is also monitored on a regular basis. This is achieved firstly through the ongoing market observation of all funding sources by the Bank's divisions. Secondly, Group Risk Management daily reviews the funding potential based on the expected prolongation ratios for short-term deposits. The Bank Management business unit also prepares actual/plan analyses regarding long-term funding.

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

Liquidity management

The short-term liquidity base and the regulatory liquidity ratios are operationally managed by the Treasury & Markets division based on general parameters specified by the Bank Management business unit. In addition to the regulatory requirements the liquidity development reports are relevant amongst other things to determine these general parameters. Any setting of or change to the individual parameters or the framework requirements is decided by the Bank Steering Committee/the Management Board. This places HSH Nordbank in the position to react flexibly to market developments.

HSH Nordbank uses the so-called expected case liquidity development report as well as the stress case forecast, which contain expected/stressed cash flows and are prepared for a period extending beyond the current financial year, as the basis for managing the medium-term liquidity base. The Management Board defines the limits for the funding requirements of the individual divisions.

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

Stress tests

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

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

In addition, the Bank performs a monthly US dollar stress test which is based on the normal case liquidity development report and simulates an immediate as well as a gradual appreciation in the US dollar affecting the US dollar cash flows and the cash collateral for US dollar derivatives. The stress factor for the appreciation is determined based on an analysis of the historical movement of the EUR/USD exchange rate.

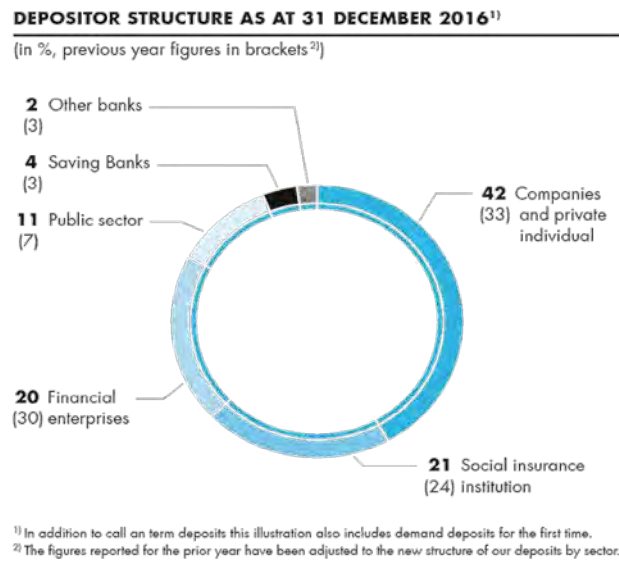
Within the framework of a stress test for the liquidity maturity transformation risk it is analysed how the LVaR moves on increasing liquidity spreads and stressed liquidity gaps. The stress LVaR serves as an indicator for the sensitivity of the LVaR to an increase in the spread/liquidity costs and constitutes an additional piece of management information.

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

Risk concentrations

HSH Nordbank has established a monitoring system for managing concentrations of both asset and liability instruments. Special emphasis is placed on deposits that are analysed and reported on with regard to the depositor structure (investor, sectors), maturities (original and residual maturities) and deposit drain risk. The deposit structure is characterised by a high level of concentration relating to a small number of large institutional investors that are dependent on interest rates and ratings. In addition, a large proportion (more than 20% of the total refinancing) are overnight deposits.

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



Quantitative measures are calculated for the purposes of analysing existing risk concentrations. Furthermore, an analysis is performed not only on the structure but especially on the risk content, in order to be able to derive according control impulses from the quantitative measures in combination with a qualitative discussion.

In addition to the analysis of the depositor structure with regard to existing depositor concentrations, risk concentrations are examined with regard to the US dollar asset/liability position. This shows a dependency of the liquidity situation on the movement in the US dollar, which is still to be regarded as relevant. This is due to the amount of US dollar assets that are refinanced through EUR/USD basis swaps amongst other things. A decrease in the EUR/USD exchange rate will increase the cash collateral to be provided on foreign currency derivatives, representing a burden on liquidity. For the purposes of analysing the dependency on the US dollar, a US dollar liquidity development report is prepared and sensitivity analyses are performed regularly. In addition a US dollar stress test of the liquidity development report is performed.

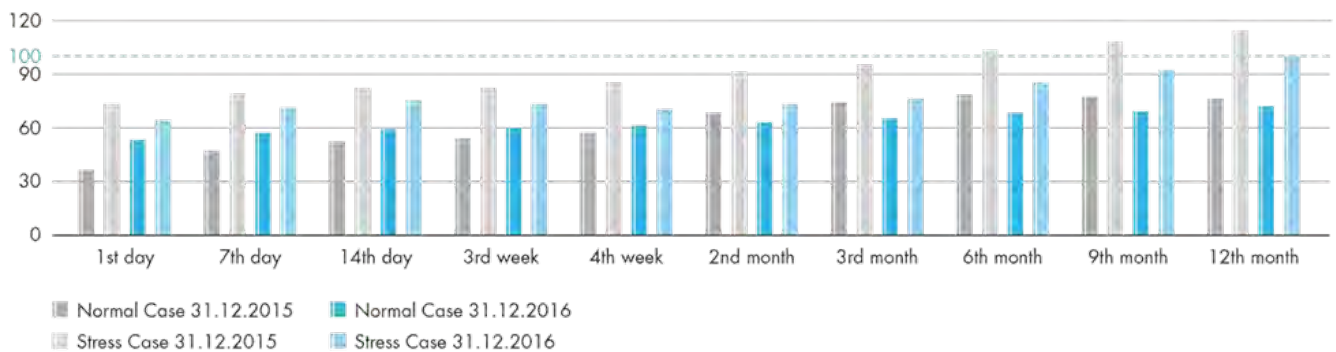
Quantification of liquidity risk

The following illustration shows the relative utilisation levels of the liquidity potential for individual cumulative liquidity gaps in the normal case and stress case as at 31 December 2016 as well as at the

end of 2015. Utilisation represents the share of the cumulative gap in total liquidity potential, which also includes the liquidity buffer required under supervisory law.

LIMIT ON CUMULATIVE LIQUIDITY GAPS

(Utilisation of liquidity potential in %)



Risk tolerance of HSH Nordbank with regard to liquidity risk is reflected, amongst other things, in the definition of a minimum survival period, which describes how long a utilisation of a liquidity potential lower than 100 % is to be maintained under the normal and stress cases for insolvency risk.

HSH Nordbank was covered for ten months up to twelve months despite the worst case assumptions for each scenario. A minimum survival period of one month is thereby maintained in all scenarios. The results show that HSH Nordbank is prepared accordingly for the crisis scenarios assessed.

In the normal case assessment that is based on the assumption of business development in an ordinary market environment with normal market fluctuations, the liquidity potential had a peak utilisation of 72 % in the twelfth month as at the reporting date. All limits within the minimum survival period of twelve months defined by the Bank were thereby adhered to. The stress case liquidity development report (combined scenario-economic downturn and rating downgrade – based on the assumption of a gradual increase in the US dollar, amongst other things) shows that the liquidity potential was also not exceeded within the minimum survival period of one month established taking Minimum Requirements for Risk Management (MaRisk) into account. In fact, the limits as at the end of 2016 are even adhered to for a period of ten months. Compared to the 2015 year end, utilisation levels have decreased in the normal case as of the second month and in the stress case in all maturity bands. The improvements are due, amongst other things, to the sale of loan portfolios with a volume of € 5 billion to hsh portfoliomangement AöR on 30 June 2016, and to the targeted further development of the long-term refinancing. Critical limit utilisation levels were recorded neither in the normal case nor in the stress case liquidity development report in the course of the period under review.

In the year under review, the LVaR as an expression of the liquidity maturity transformation risk decreased to € 83 million (31 December 2015: € 239 million). The decrease is attributable to the reduction of long-term financing requirements as well as the elimination of historical scenarios during the period of historical simulation.

Regulatory liquidity ratios

The regulatory management parameter for liquidity risks is the liquidity ratio defined by the German Liquidity Regulation (LiqV). With values between 1.51 and 2.06, HSH Nordbank’s liquidity ratio remained above the regulatory minimum value at all times throughout the reporting year. The average value for 2016 was 1.78 (previous year: 1.89), and 1.92 as the reporting date (31 December 2015: 1.89).

Under Basel III/CRR Delegated Regulation (EU) 2015/61, the Liquidity Coverage Ratio (LCR) was specified as an additional liquidity ratio to ensure liquidity in an acute stress phase of 30 days. When calculating the LCR the amount of highly liquid assets is compared to the net outflows over the next 30 days. The ratio is to be complied with since the Delegated Regulation (EU) 2015/61 entered into force in October 2015, whereby the compliance rate increases from an initial 60 % to 100 % in 2018. As at the reporting date, the LCR was 229 % within the framework of the data capture sheet of the Delegated Regulation (EU) 2015/61 (previous year: 115 % within the framework of Delegated

The results of the market-specific and Bank-specific stress scenarios determined in addition to the stress case liquidity development report show that as at December 2016 the liquidity requirement of

Regulation (EU) 2015/61) which means that it was above the future minimum threshold.

The Net Stable Funding Ratio (NSFR), which must be adhered to from 2018 at the earliest, is calculated as the ratio of available funding resources across all maturities to the funding required and also must be at least 100 % after full implementation. As at 31 December 2016, the NSFR under the QIS (Basel framework) amounted to 111 % (previous year: 95%).

Refinancing situation

The implementation of the funding strategy was successfully driven forward during the course of the financial year thereby improving the liquidity profile of the Bank. The measures stepped up in the year to date to reduce risk positions, thereby releasing liquidity, had a positive impact. Besides the issuing activities a stable level of deposits contributed to the refinancing of the business. However, there is no unrestricted access to the capital markets.

Future funding and HSH Nordbank's rating continue to be key challenges despite this positive development. In the reporting year HSH Nordbank accelerated the winding down of legacy portfolios, particularly in the US dollar area, to reduce the effect of changes in exchange rates on, inter alia, the Bank's liquidity. Restrictions were also placed on new US dollar business. In the event of a sustained appreciation in the US dollar HSH Nordbank has prepared measures that aim at further reducing the asset volume to be refinanced. Further information on HSH Nordbank's refinancing situation is set out in the Earnings, net assets and financial position and Forecast, opportunities and risks report sections.

Reports on liquidity risk

The CRO and divisions concerned are informed daily of the change in insolvency risk in the normal case and stress case. In addition, the Bank Steering Committee and the Overall Management Board receive a liquidity risk report at least every month. This includes in addition to the analysis of insolvency risk and maturity transformation risk in the normal case and stress case an analysis of other stress scenarios, of liquidity risk arising on US dollar positions and depositor concentration risk.

OPERATIONAL RISK

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

Operational risks are determined in accordance with the modified regulatory standardised approach for the purposes of managing the risk-bearing capacity. The corresponding economic capital required amounted to € 0.2 billion as at 31 December 2016 (31 December 2015: € 0.2 billion).

Organisation of operational risk management

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

The OpRisk Controlling department in the Group Risk Management division defines the basic principles of operational risk management applicable throughout the Bank and develops the central methods and instruments to be used in the identification, measurement, management and monitoring of operational risk.

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

Operational risk management

The identification, analysis, evaluation and monitoring of operational risk and the promotion of a corresponding risk culture in the Group represents an important success factor for HSH Nordbank. Different procedures and instruments are used in this process.

Loss event database

The loss events arising from operational risk are consolidated into a central loss event database for HSH Nordbank and relevant subsidiaries. The loss events are recorded locally by the divisions affected and forwarded to OpRisk Controlling. The results of the analyses of actual loss events provide a starting point to eliminate existing weaknesses. The OpRisk Steering Committee is informed on a quarterly basis regarding loss events and measures undertaken related thereto. The Management Board is immediately informed of material operational risk events.

The loss event database includes all loss events with a gross loss of at least € 2,500 and all material near-loss events.

In the reporting year 38 % (previous year: 49 %) of the operational loss events reported were incurred in the Employee risk category. This risk category includes, for example, processing errors or unauthorised actions. The proportion of operational loss events reported under the Internal processes risk category amounted to 26 % (previous year: 24%). These include, for example, deficient or missing processes. The proportion of operational loss events reported under the External influences category (e.g. criminal acts, regulatory and statutory requirements) amounted to 35 % (previous year: 23%). The proportion

of loss events reported under the Internal infrastructure category (e.g. system failures, functionality or security) amounted to 1% (previous year: 4%).

HSH Nordbank participates in the exchange of operational loss event data as part of the operational risk data pool (DakOR). Thus, HSH Nordbank obtains a more comprehensive database for the evaluation of risk scenarios and external comparisons.

Risk inventory

HSH Nordbank performs a risk inventory for operational risk each year for the whole Group. Information about the risk situation of the divisions gained from this inventory supplements the reporting and serves the purpose of preventive management and monitoring of operational risk. The Bank performs the risk inventory based on defined scenarios, which take into account both actual as well as potential loss events.

Control of measures

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

Risk indicators

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

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

Management of personnel risks

Personnel risk refers to the risk of losses that may occur as a result of the unplanned departure of key personnel of HSH Nordbank, shortage of skilled employees or poor motivation of employees. This risk could materialise particularly in light of the current reduction in staff. The Human Resources division is therefore focusing increasingly on measures to reduce personnel risk. A large number of personnel management tools for employee retention are used to prevent the unscheduled departure of key personnel. In addition, succession planning is performed, and regularly reviewed, for relevant positions.

IT risk management

The IT division is responsible for IT risk management. In the IT strategy the division has defined as the primary objective of IT risk management to identify IT risks at an early stage, in order to be able to avert or reduce serious damage on the basis of clear responsibilities in particular.

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

Business continuity management

HSH Nordbank is exposed to risks arising from unforeseeable events that may lead to an interruption of business operations and, as a result, losses and additional costs. Group Risk Management has established with the involvement of the relevant divisions processes to limit the risks arising from the fact that the information technology fails or service providers or employees are unavailable. The objective of the business continuity plans to be prepared and periodically reviewed by each division is to ensure the functional capability of critical business processes and activities, even in the event of an emergency.

Internal control system

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

Management of legal risk

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

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

HSH Nordbank recognised provisions of € 31 million (previous year: € 35 million) for litigation risks and costs as at the reporting date. In addition, contingent liabilities of € 28 million (previous year: € 34 million) arising from legal disputes are disclosed. A major portion of the provisions for litigation risks relates to the legal proceedings mentioned below. Since 2005 HSH Nordbank AG has been involved in legal proceedings with a Turkish shipping group and up to now had to pay a total amount of \$ 54 million in the year 2013 due to decisions of Turkish courts. The plaintiffs have filed new claims under which damages are asserted based on the same facts. Appropriate provisions have been recognised for this.

HSH Nordbank AG was also sued in January 2015 by a borrower for damages of approximately € 215 million. In March 2016, the claim was increased to approx. € 278 million. The underlying facts of the case had already been the subject of several court proceedings between the Bank and the borrower, in which the Bank has always succeeded before different courts apart from relatively small amounts. In the Bank's view, claims newly asserted by the borrower regarding the known facts of the case are unfounded. They do not contain any legally significant changes regarding the known facts and therefore do not provide any grounds for the previous legal assessment of this case to be revised. As the probability of success for the current legal action is assessed as small, no provision or contingent liability has been recognised.

HSH Nordbank AG recognised other provisions relating to legal risks in the amount of € 6.1 million on the basis of current German case law of the Federal Court of Justice (BGH) regarding liability for advice provided on swap transactions.

Tax risks are a component of legal risks and mainly result from the fact that the binding interpretation of rules that can be interpreted in specific cases may only be known after several years due to the long period between tax audits. The tax audits have not yet been finalised for the years starting from 2003.

HSH Nordbank recognised provisions/liabilities (including interest) totalling € 63 million (previous year: € 56 million) for tax risks as at the reporting date. A major portion of this relates to tax risks with respect to the tax audits (in connection with internal cost allocations to foreign entities, structured transactions, reimbursement of value-added tax on inputs, and risks resulting from the tax treatment of investment income).

There are contingent liabilities with regard to tax risks in connection with the tax audits that are ongoing at present. In particular, there is uncertainty surrounding how the tax authorities will interpret current trends in the court decisions made by the fiscal courts on various tax-related issues. The Bank, however, deems its legal positions to be correct, meaning that there is no need to set up corresponding provisions in this regard.

Management of compliance risk

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

The Compliance division is responsible for compliance risk management. Compliance with the different legal requirements is also ensured by the respective divisions concerned. Compliance monitors adherence to codes of conduct with respect to the topics of capital markets compliance, prevention of money laundering, terrorism financing and other criminal offences in accordance with Section 25h

KWG as well as compliance with financial sanctions and embargoes. In addition the division performs the compliance function as defined in AT 4.4.2 MaRisk and in this context strives to ensure that the essential legal regulations and standards are implemented at HSH Nordbank and complied with.

The Code of Conduct summarises the requirements of different legal sources and internal guidelines. It applies to all employees as well as the Management Board of HSH Nordbank AG and is a mandatory part of the overall Bank objectives. The behavioural requirements of the Compliance division are set out in detail in internal instructions.

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

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

Reports on operational risk

The OpRisk Steering Committee receives a quarterly report regarding the development of the risk position, material loss events and management measures addressed. The Overall Management Board is informed once a year regarding the capital required, the loss event trend and material loss events and loss potential, as well as any measures required.

OTHER MATERIAL RISKS

Amongst other material risk types of HSH Nordbank are business strategy risk and reputation risk.

Business strategy risk

The business strategy risk refers to the risk of financial damage being incurred due to long-term strategic decisions based on incorrect assumptions. Should HSH Nordbank not be successful in identifying changes in markets relevant for it on a timely basis, this could have a negative impact on its competitiveness. Changes to laws and regulations or new regulatory requirements for instance could also jeopardise the implementation of HSH Nordbank's business model.

This risk is managed via the regular review and updating of the business strategy by the Strategy business unit and the closely related overall Bank planning process established in the Bank. The responsibility for the strategy of HSH Nordbank rests with the Overall Management Board, while the Strategy and Board Advisory Service business unit is responsible for the process. An action-oriented management dialogue, including on the strategic business objectives, is conducted during the year as part of the monthly Business Area Management Dialogues.

Reputation risk

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

Damage to reputation can be directly caused by the behaviour of internal staff, external stakeholders or by the social environment as a whole or indirectly in connection with another risk type. HSH Nordbank can suffer adverse consequences in both cases, for instance due to a loss of clients.

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

SUMMARY OF RISK ASSESSMENT AND OUTLOOK

The 2016 financial year was characterised by the continuing winding down of high-risk, non-strategic lending and capital markets transactions held in the portfolios belonging to the "Non-Core Bank" segment as well as by the progress made in implementing the business model. In addition to the sale of the federal state portfolio, for example, progress was also made as a result of the organic reduction of the Non-Core Bank portfolio.

The risk-bearing capacity of HSH Nordbank was maintained at all times during the year under review with a maximum utilisation of the risk coverage potential of 35 %. The guarantee facility as well as the ongoing winding down of risk positions made a positive contribution in this regard.

There are still some challenges facing the Bank in particular with regard to risk concentrations in the shipping loan portfolios, in the US dollar business and with regard to the deposit structure of HSH Nordbank. Within this context, the ongoing difficult conditions on the shipping markets, in particular, are having a negative impact, even though a drop in the number of new orders, increased scrapping, increasing consolidation and rising freight rates in 2016 can be seen as the first signs of a moderate improvement on the shipping market.

The requirement relating to the privatisation of HSH Nordbank in 2018 linked to the European Commission's decision poses a further challenge for the risk organisation. In addition to the need for a highly effective and efficient CRO unit, one of the key duties of the risk organisation lies in stabilising the Bank during the privatisation process, in particular by ensuring risk-bearing capacity and appropriate capital and liquidity resources at all times. As far as the privatisation process is concerned, there will also still be a need to optimise the cost base, revenue planning and competitive position and to align the risk organisation with the future strategy and targets.

For information on further key challenges in connection with the privatisation process and the risks associated with maintaining appropriate capital and liquidity resources, we refer to the statements in the Forecast, opportunities and risks report.

The implementation of the new supervisory requirements will be another focus of our activities in 2017. The Basel Standard 239 (BCBS 239) gives rise, for example, to comprehensive future requirements regarding the capacity to aggregate risk data including the IT architecture and risk reporting by banks. In addition, the requirements of the EBA/ECB resulting from the supervisory review and evaluation process (SREP) and the expected update to the "Supervisory assessment of bank-internal capital adequacy concepts" guidelines have to be met. The requirements mentioned above will be implemented within projects.

The risk and bank management systems described in this report are aligned to take account of risk on a systematic basis. This also applies

to our expectations regarding future market and business developments. We believe that we have appropriately presented the overall risk profile of HSH Nordbank Group as well as the opportunities and risks inherent in the future development of our business activities in the Forecast, opportunities and risks report section and in this Risk report in an appropriate and comprehensive manner.

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

In accordance with Section 312 of the German Securities Act (AktG), the Management Board of HSH Nordbank AG is obliged to submit a Dependent Company Report for the financial year 2016.

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

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

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

Hamburg/Kiel, 14 March 2017



Stefan Ermisch



Oliver Gatzke



Ulrik Lackschewitz



Torsten Temp

ANNUAL ACCOUNTS OF HSH NORDBANK AG

BALANCE SHEET OF HSH NORDBANK AG AS AT 31 DECEMBER 2016

ASSETS

(€ k)	(Note)			31.12.2016	31.12.2015
1. Cash reserve					
a) Cash on hand			5,424		6,572
b) Balances with central banks			3,353,173		2,681,313
thereof:				3,358,597	2,687,885
with Deutsche Bundesbank	3,341,635				
	(previous year: 2,668,462)				
2. Debt instruments issued by public institutions and bills of exchange eligible for refinancing with central banks					
a) Treasury bills, discounted treasury notes and similar debt instruments issued by public institutions			118,499		641,052
thereof:					
eligible for refinancing at the Deutsche Bundesbank	–				
	(previous year: 356,570)			118,499	641,052
3. Loans and advances to banks	(6, 7, 24–28)				
a) Payable on demand			395,306		419,643
b) Other loans and advances			1,845,034		2,683,633
				2,240,340	3,103,276
4. Loans and advances to customers	(6, 7, 25–28)			52,937,483	61,013,978
thereof:					
secured by mortgages	8,592,678				
	(previous year: 11,323,802)				
public-sector loans	5,484,419				
	(previous year: 6,194,615)				
secured by ship mortgages	9,784,292				
	(previous year 9,645,045)				
5. Debentures and other fixed-interest securities	(9, 25–28, 30, 31, 38)				
a) Money market instruments					
aa) from other issuers		11,017			–
			11,017		
b) Bonds and debentures					
ba) from public-sector issuers		7,722,153			8,500,513
thereof:					
eligible as collateral at the Deutsche Bundesbank	7,474,045				
	(previous year: 7,829,195)				
bb) from other issuers		7,653,036			8,036,076
thereof:			15,375,189		
eligible as collateral at the Deutsche Bundesbank	5,765,118				
	(previous year: 5,941,165)				
c) Own debentures				1,263,955	2,523,674
Nominal value	1,249,037				
	(previous year: 2,511,571)			16,650,161	19,060,263
To be carried forward				75,305,080	86,506,454

ASSETS

(€ k)	(Note)			31.12.2016	31.12.2015
	Carried forward			75,305,080	86,506,454
6. Shares and other non-fixed-interest securities	(9, 30, 31, 38)			171,057	297,538
6a. Trading portfolio	(10, 29)			3,227,601	5,001,397
7. Equity holdings in non-affiliated companies	(16, 30, 38, 68)			89,448	87,756
thereof:					
in banks	42,107 (previous year: 41,103)				
8. Interests in affiliated companies	(16, 30, 38, 68)			694,925	686,782
thereof:					
in banks	49,700 (previous year: 57,000)				
in financial services institutions	– –				
9. Trust assets	(32)			5,147	6,848
thereof:					
trust loans	5,147 (previous year: 6,848)				
10. Intangible fixed assets	(17, 38)				
a) Industrial property rights acquired in-house and similar rights and assets			1,918		2,618
b) Licences, industrial property rights and assets as well as licenses to use such rights and assets purchased			8,204		7,719
				10,122	10,337
11. Tangible fixed assets	(18, 38)			88,377	91,361
12. Other assets	(33)			2,392,506	2,297,193
13. Prepaid expenses	(6, 20, 34)			131,888	191,743
14. Deferred tax assets	(19, 35)			609,119	679,443
Total assets				82,725,270	95,856,852

LIABILITIES

(€ k)	(Note)			31.12.2016	31.12.2015
1. Liabilities to banks	(20, 39–42)				
a) Payable on demand			1,450,524		585,112
b) With agreed maturities or notice periods			8,824,450		14,270,065
				10,274,974	14,855,177
2. Liabilities to customers	(20, 40–42)				
a) Savings deposits					
aa) with agreed notice period of three months		18,188			21,874
ab) with agreed notice period of more than three months		–			–
			18,188		21,874
b) Other liabilities					
ba) Payable on demand		12,256,733			17,062,710
bb) With agreed maturities or notice periods		29,220,531			29,262,798
			41,477,264		46,325,508
				41,495,452	46,347,382
3. Securitised liabilities	(20, 42, 72)				
a) Debentures issued			17,485,098		20,791,616
b) Other securitised liabilities			69,078		19,536
thereof:				17,554,176	20,811,152
money market instruments		69,078			
		(previous year: 19,536)			
3a. Trading portfolio	(10, 43)			1,770,739	2,011,469
4. Trust liabilities	(44)			5,147	6,848
thereof:					
trust loans		5,147			
		(previous year: 6,848)			
5. Other liabilities	(45)			1,221,822	1,631,896
6. Prepaid expenses	(6, 20, 46)			126,625	159,841
6a. Deferred tax liabilities	(19, 47)			174,356	180,152
7. Provisions	(21)				
a) Provisions for pensions and similar obligations			780,088		800,971
b) Tax provisions			77,464		45,094
c) Other provisions	(48)		452,982		500,117
				1,310,534	1,346,182
8. Subordinated debt	(49)			2,092,557	2,087,134
9. Profit participation capital	(50)			13,616	13,616
thereof:					
maturing in less than two years		13,616			
		(previous year: 13,616)			
10. Fund for general banking risks	(51)			2,348,495	2,081,858
of which special items under Section 340e (4) HGB		38,694			
		(previous year: 29,523)			
To be carried forward				78,388,493	91,532,707

LIABILITIES

(€ k)	(Note)			31.12.2016	31.12.2015
	Carried forward			78,388,493	91,532,707
11. Equity capital	(52)				
a) Subscribed capital					
aa) Share capital		3,018,225			3,018,225
ab) Silent participations		1,242,017			1,229,386
			4,260,242		4,247,611
b) Capital reserves			76,535		176,569
d) Accumulated loss			-		-100,035
				4,336,777	4,324,145
Total liabilities				82,725,270	95,856,852
1. Contingent liabilities	(64)				
a) Liabilities from guarantee and indemnity agreements				2,398,625	3,288,521
2. Other commitments	(64)				
a) Irrevocable loan commitments				6,737,564	6,416,835

INCOME STATEMENT OF HSH NORDBANK AG

FOR THE PERIOD 1 JANUARY TO 31 DECEMBER 2016

(€ k)	(Note)			2016	2015
1. Interest income	(53, 54)				
a) Lending and money market transactions		3,351,037			4,393,086
negative interest resulting from loan and money market transactions		- 114,964	3,236,073		- 40,673
b) Fixed-interest securities and book-entry securities		357,270			418,539
negative interest resulting from securities and book-entry securities		-	357,270		-
			3,593,343		4,770,952
2. Interest expenses	(54)				
from the banking business		2,846,251			3,872,101
positive interest resulting from the banking business		- 62,039			- 10,887
			2,784,212		3,861,214
				809,131	909,738
3. Current income from	(53)				
a) Shares and other non-fixed-interest securities			3,909		8,273
b) Equity holdings in non-affiliated companies			21,815		32,427
c) Interests in affiliated companies			33,012		33,043
				58,736	73,743
4. Income from profit pooling, profit and loss transfer or partial profit transfer agreements	(53)			6,452	-
5. Commission income	(53, 55)		116,621		150,804
6. Commission expenses	(55)		258,213		513,212
				- 141,592	- 362,408
7. Net income/Net expenses from the trading portfolio	(53)			82,537	- 37,402
8. Other operating income	(53, 56)			158,678	232,774
9. General administrative expenses					
a) Personnel expenses					
aa) Wages and salaries		194,320			210,691
ab) Compulsory social security contributions, expenses for retirement pensions and other employee benefits		12,435			103,215
			206,755		313,906
thereof: for retirement pensions		- 15,677 (previous year: 73,452)			
b) Other administrative expenses	(61)		358,143		364,805
				564,898	678,711
10. Depreciation, amortisation and impairments on intangible fixed assets and tangible fixed assets	(38)			8,357	14,146
11. Other operating expenses	(57)			164,234	234,371
12. Income from additions to loans and advances and certain securities as well as from the reversal of provisions in the lending business				64,702	153,234
To be carried forward				301,155	42,451

(€ k)	(Note)			2016	2015
	Carried forward			301,155	42,451
13. Additions to the fund for general banking risks				257,467	-
14. Income from additions to equity holdings in non-affiliated and interests in affiliated companies and securities treated as fixed assets				167,283	37,415
15. Expenses from the transfer of losses				1,817	1,622
16. Profit on ordinary activities				209,154	78,244
17. Extraordinary income	(58)		6,730		4,794
18. Extraordinary expenses	(58)		112,236		37,365
19. Extraordinary result	(58)			- 105,506	- 32,571
20. Income tax expenses	(59)		100,778		181,525
21. Other taxes not shown under item 11			2,870		3,657
				103,648	185,182
22. Income from the assumption of losses	(60)			-	39,474
23. Annual net loss				-	- 100,035
24. Loss carried over from the previous year				- 100,035	- 312,392
25. Withdrawals from the capital reserve				100,035	312,392
26. Accumulated loss				-	- 100,035

NOTES FOR THE 2016 FINANCIAL YEAR

GENERAL INFORMATION AND NOTES

1. HSH NORDBANK AG AND ITS SHAREHOLDERS

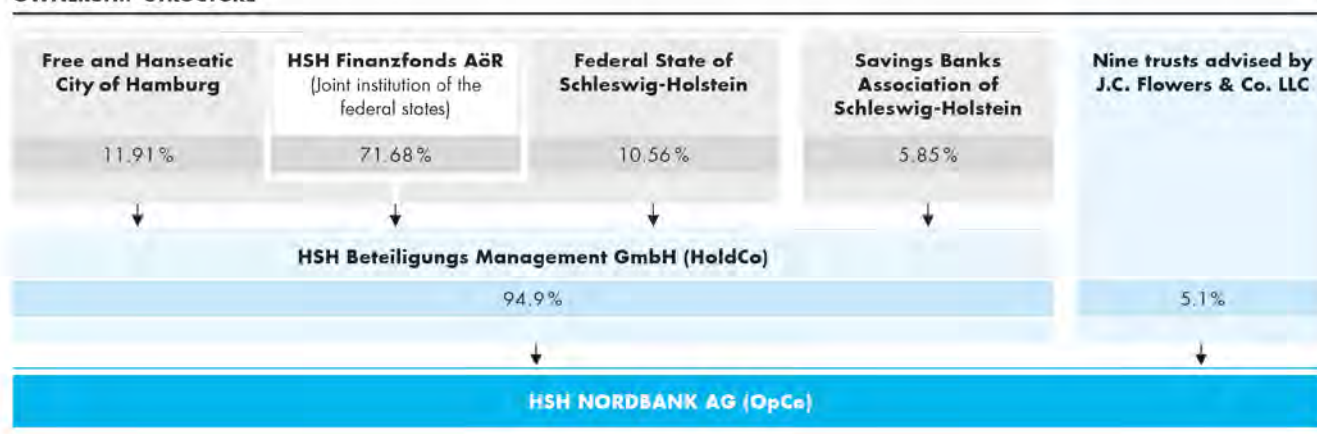
HSH Nordbank AG, with its registered offices in Hamburg and Kiel, was established by the merger of the Hamburgische Landesbank Girozentrale, Hamburg, and the Landesbank Schleswig-Holstein Girozentrale, Kiel, on 2 June 2003. For accounting and tax purposes, the merger took effect retroactively as of 1 January 2003.

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

HSH Beteiligungs Management GmbH, Hamburg, is the parent company and, at the same time, the top-level parent company of HSH Nordbank AG, which prepares Group financial statements.

The following overview shows HSH Nordbank AG and its shareholders with their respective direct and indirect holdings of voting capital.

OWNERSHIP STRUCTURE



2. EVENTS AFTER THE REPORTING DATE

Sale of the first tranche of the market portfolio

As part of the decision made by the European Commission in the EU state aid proceedings on the replenishment of the second loss guarantee on 2 May 2016, the sale of non-performing loans totalling € 3.2 billion on the market was approved. Within this context, the Bank selected key portfolios that were to be sold on the market by mid-year 2017 (market portfolio). The winding-down of the NPE portfolio will gradually improve the portfolio quality and continue to relieve the Bank of considerable legacy burdens. The defined market portfolio consists of the four non-strategic legacy portfolios Aviation, Continental European Commercial Real Estate (Scandinavia, Netherlands, Germany), Energy and International Real Estate.

As at 27 January 2017, purchase agreements were signed for the first tranche of the market portfolio, which includes, among other things, aircraft financing (volume of around € 0.8 billion EaD) and continental European commercial real estate (volume of around € 0.5 billion EaD). The aircraft portfolio was bought by the Australian investment bank Macquarie, while the real estate loans were purchased by Bank of America Merrill Lynch. The parties to the transaction agreed not to disclose any information on the purchase price. The purchase agreements are subject to the approval of the antitrust authorities, which, insofar as it has not yet been granted, is scheduled to be granted in the second quarter of 2017. There are further closing conditions for the aircraft financing, including technical aircraft assessments that could

have further implications (e.g. purchase price adjustments or withdrawal from the agreements). As a result, the transfer in rem of the commitments and, as a result, the de facto removal from the balance sheet is likely to take place in the first half of 2017 (closing). The deal relating to the real estate loans was closed on 3 March 2017. The impact on the valuation of the receivables concerned was taken into account in the annual financial statements as at 31 December 2016.

HSH Nordbank AG achieved further relief in connection with the market transaction of around € 0.3 billion with individual sales to further investors and as a result of repayments within the portfolio that was originally up for sale.

3. PROVISION OF A GUARANTEE FACILITY

I. Second loss guarantee of HSH Finanzfonds AöR

Basics of the effect of the second loss guarantee

On 2 June 2009, the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg granted HSH Nordbank AG a guarantee facility in the amount of € 10 billion via the HSH Finanzfonds AöR as the guarantor in order to secure the future of the Bank. This agreement on the provision of a guarantee facility as well as a related recapitalisation of the Bank is subject to approval by the European Commission in accordance with the law regarding state aid. The EU Commission concluded these state aid proceedings at the end of September 2011 and entered into an agreement on commitments with all the parties involved and imposed conditions. The conditions include a prohibition on the payment of dividends until and including the financial year 2014, among other things. The guarantee of the federal states is split into two partial guarantees for financial reporting purposes. Partial guarantee One relates to non-structured financial instruments and is accounted for in the same manner as loan collateral received in the annual accounts. Partial guarantee Two is also disclosed as a loan collateral received in accordance with IDW AcPS BFA 1 new version.

The guarantor guarantees actual rating-related defaults on financial instruments selected based on certain defined criteria that form part of the assets of HSH Nordbank AG.

The amount of default on a specific commitment is determined by the amount outstanding, taking into account the specific loan loss provision existing as at 31 March 2009. The amount outstanding is at 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 case for the full amount. Since 2014, HSH Nordbank AG may cancel the guarantee in full.

In 2011 the guarantee was reduced by a total of € 3 billion to € 7 billion. The guarantee facility was replenished as at 30 June 2013 by € 3 billion to the original amount of € 10 billion. The guarantee agreement was adjusted by way of an appropriate amendment agreement. Under this agreement the fee provisions for the replenished guarantee remain essentially unchanged. However, a one-off payment of € 275 million for the re-increased amount became payable on the coming into force of the amendment agreement. Through this, the guarantor is put in a position as if the guarantee had never been reduced. The one-off payment represents a fee for a time-related service and is amortised over the period of the expected benefit. In 2016, € 22 million (previous year: € 69 million) has been recognised through profit or loss in the commission expense line item.

The amendment agreement also included new stipulations concerning the capital protection clause which took effect on 1 January 2014. Insofar as the obligation to pay the additional premium would have the effect of decreasing the Tier 1 capital ratio (both from an ex post and ex ante perspective) excluding hybrid capital (common equity ratio) of HSH Nordbank to below 10% (minimum common equity ratio) or of increasing an already existing shortfall, the guarantor is obliged to waive the portion of the entitlement that would result in the ratio falling below the minimum common equity ratio against the issue of a debtor warrant (so-called capital protection clause).

Since January 2014, HSH Nordbank calculates the supervisory capital ratio on the basis of IFRS data (until 31 December 2013 HGB data were used). In the event that the common equity ratio falls below 10%, a waiver by the guarantor HSH Finanzfonds AöR was recognised to income from the additional premium, as in the past. However, under the new provisions of the capital protection clause, a debtor warrant was no longer issued immediately upon declaration of the debt waiver but was subject to certain conditions. The obligation under the debtor warrant only arose if these conditions were met.

In exchange for the guarantee HSH Nordbank AG paid a contractually agreed base premium of 4% p.a. on the guarantee volume outstanding at the time up until 31 December 2015. Drawdowns did not reduce the calculation basis. The recurring base premium payable was

recognised through profit or loss on an accrual basis in commission expense.

As long as and insofar as the cash drawdown of the guarantee is not yet made through the invoicing of losses that in total exceed the first loss piece of € 3.2 billion to be borne by the Bank, a claim for compensation against HSH Finanzfonds AöR cannot be recognised. Against this background the hedging effect of partial guarantee One recognised in the balance sheet is accounted for on a net basis. The Bank initially determines specific and general loan loss provisions without taking the hedging effect of the second loss guarantee into account and then records the hedging effect on the face of the balance sheet through the use of a compensation item and deducts it from loan loss provisions disclosed separately under loans and advances to customers on the assets side. The specific and general loan loss provisions recognised are not changed by the accounting applied to the hedging effect.

The compensation item was reduced by the additional premium imposed by the EU Commission in the amount of 3.85% p.a. This additional premium was only to be paid to HSH Finanzfonds AöR in the case of an actual drawdown of the guarantee. The additional premium was payable at the latest until 31 December 2019 and was to cease to apply retroactively in the event that the guarantee was not drawn down. The current hedging effect of the second loss guarantee is used as the measurement basis for calculating the additional premium (ex post). The anticipated total loss payable by the guarantor was the measurement basis for the calculation of the additional premium (ex ante).

If it was more likely than not that the guarantee would be drawn down, the premiums to be paid in the future also needed to be recognised (on a present value basis) as loan collateral expense, as, according to the guarantee agreement, drawdowns did not reduce the basis for calculating the guarantee premiums. The future premiums resulted in a reduction of the compensation item as did the additional premium. The present value calculation gave rise to an interest effect, which was disclosed under Net interest income.

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 Two under the framework agreement, subject to approval from the trustee appointed by the guarantor. The maximum guarantee amount is not altered by the revival of partial guarantee Two and the respective partial amounts offset each other.

Decision made by the European Commission in the EU state aid proceedings

On 2 May 2016 the EU Commission issued a decision in the current EU state aid proceedings and thereby approved the replenishment of

the second loss guarantee provided by the federal states from € 7.0 billion to € 10.0 billion. The decision is based on a catalogue of conditions and commitments provided by the Federal Republic of Germany to the EU Commission. Based on this catalogue, HSH Nordbank has to provide the holding with liquidity in the amount of € 50 million to ensure its operations and make a one-off payment of € 210 million to the holding company.

The holding company was set up as HSH Beteiligungs Management GmbH on 20 May 2016 and was entered in commercial register B of the Local Court (*Amtsgericht*) of Hamburg on 13 June 2016. The abovementioned payments were made on 30 June 2016. They had already been included in the compensation item "Remaining payment obligations in 2016 for guarantee premiums" as at 31 December 2015, meaning that they were utilised in the financial year.

In exchange for the guarantee HSH Nordbank AG since 1 January 2016 has been paying a contractually agreed base premium of 2.2% p.a. on the guarantee volume that has not yet been drawn down. The recurring base premium payable is recognised through profit or loss on an accrual basis in Commission expense. The other fee components of the guarantee (base premium on the utilised portion of the guarantee, base premium of 1.8% p.a. on the nominal amount of the guarantee, additional premium) were assumed by the newly established holding company.

Due to a binding statement of the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein vis-à-vis HSH Nordbank AG already existing as at the reporting date 31 December 2015 with regard to the assumption of guarantee obligations (additional premium and parts of the base premium), it had become unlikely that future premium payments excluding those payments still to be expected after the decision of the EU Commission (one-off payment of € 210 million and provision of liquidity of € 50 million to the holding company) would be made by HSH Nordbank. As a result, the obligations recognised in the compensation item in the past, as well as the debt waiver, had already been derecognised through profit or loss as at 31 December 2015.

Accounting impact of the second loss guarantee in the 2016 financial year

The guarantee facility granted by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein via HSH Finanzfonds AöR which had a hedging effect for the first time as at 31 December 2010, amounted to € 8,060 million as at 31 December 2016 (previous year: € 8,101 million).

As at 31 December 2016 the hedging effect of the second loss guarantee resulted in a compensation item on the balance sheet in the amount of € 8,060 million (previous year: € 7,841 million) which is offset in the item loan loss provisions. An amount of € 1,811 million (previous year: € 3,688 million) has been recognised, with a positive effect, in loan loss provisions in the income statement.

The compensation item on the balance sheet includes compensation claims of HSH Nordbank AG vis-à-vis the guarantor in the total amount of € 409 million, as the settled payment defaults under the guarantee exceeded the first loss piece to be borne by the Bank of € 3.2 billion as at 31 December 2016. This means that HSH Nordbank

now has a contractual entitlement to loss compensation with regard to the main claims in default and the interest accrued.

The payments already made under corresponding compensation entitlements amount to € 1.9 billion as at 31 December 2016.

HEDGING EFFECT OF THE SECOND LOSS GUARANTEE ON LOAN LOSS PROVISIONS

(€ m)	2016		2015		Net interest income
	Balance sheet	Balance sheet	Income statement	Income statement	
	Loan loss provisions	Loan loss provisions	Loan loss provisions	Loan loss provisions	
Hedging effect before guarantee costs	8,060	8,101	-41	3,073	-
Additional premium ex-post	-	-	-	1,130	-
Debt waiver	-	-	-	-673	-
Base and additional premium ex-ante	-	-	-	418	-
Claim for compensation of interest	-	-	-	-	8
Remaining payment obligations for guarantee premiums	-	-260	-	-260	-
Payments of HSH Finanzfonds AöR	-	-	1,852	-	-
Compensation under the second loss guarantee	8,060	7,841	1,811	3,688	8

Taking into account the payments of HSH Finanzfonds AöR already received for credit losses in the hedged portfolio of € 1,852 million (previous year: € 0 million), the utilisation of the guarantee as at 31 December 2016 comes to € 9,912 million (previous year: € 8,101 million). Since the 2009 reporting year the Bank has recorded premium expense totalling € 3,706 million for the provision of the second loss guarantee. € 3,659 million has been paid to date, of which € 2,624 million is attributable to the current base premium and € 1,035 million to one-off payments (thereof € 260 million to HSH Beteiligungs Management GmbH).

II. Synthetic securitisation transaction

In the fourth quarter of 2016, largely for capital management reasons, HSH Nordbank AG securitised loan receivables from the Corporate Clients and Real Estate Clients areas accounting for a volume of € 3 billion in total. By way of a financial guarantee, this involves the transfer of the default risk associated with a mezzanine tranche (with an initial amount of € 235 million) to an unconsolidated structured entity in Luxembourg (Horizon 2016 S.A.), which has, in turn, passed the default risk on to an investor. The financial resources that the investor received from the structured entity were deposited as cash collateral for the guarantee at HSH Nordbank AG. HSH Nordbank AG in turn provides the structured entity with securities as collateral for this cash deposit.

A vertical tranche approach is used in accordance with Art. 405 (1a) CRR. This means that loan receivables are included in the reference portfolio at a maximum of 95% of their nominal value. The resulting first loss piece of at least 5% is not treated as an additional retained tranche, but rather as unsecuritised outside of the Horizon transaction and as ranking *pari passu* with the securitised share regarding the allocation of losses.

The use of the financial guarantee allows the risk weighting of the secured loan portfolio to be reduced. This allows the two following objectives to be achieved:

- Risk management (reduction of credit risks in the portfolio)
- Relief on equity capital (reduction in regulatory equity capital requirements)

HSH Nordbank AG pays an annual premium on the respective outstanding mezzanine tranche. The premium to be paid in each case is determined primarily by the extent to which the guarantee has actually been utilised. The premium is recognised through profit or loss in commission expense. In 2017, the Bank expects to incur premium expense totalling a maximum of around € 26 million. The contractual term of the guarantee is 9 years.

As long as and insofar as the cash drawdown of the guarantee is not yet made through the invoicing of losses that in total exceed the first loss piece to be borne by HSH Nordbank AG (on the securitised portfolio) in an initial amount of € 30 million (the aforementioned first loss piece comprises a first loss tranche of € 22.5 million and an initial excess spread, i.e. a loss buffer to be determined on an annual basis, of € 7.5 million), then there is no claim for compensation against the guarantor that is eligible for capitalisation. Against this background the hedging effect of the financial guarantee recognised in the balance sheet is accounted for on a net basis. The Bank initially determines specific and general loan loss provisions without taking the hedging effect of the financial guarantee into account and then records the hedging effect (if the first loss piece is exceeded by the individual valuation allowances and general loan loss provisions) on the face of the balance sheet through the use of a compensation item, which reduces the amount recognised under loan loss provisions in the lending business in the balance sheet accordingly. The individual valuation allowances and general loan loss provisions recognised are not changed by the accounting applied to the hedging effect. At the end of the year, no compensation item was recognised because the individual valuation allowances and general loan loss provisions did not exceed the initial first loss piece of € 30 million. The maximum possible hedging/compensation effect of the guarantee is limited to the volume of the mezzanine tranche in the amount of € 235 million.

4. DEPOSIT GUARANTEE FUND, GUARANTEE OBLIGATION (GEWÄHRTRÄGERHAFTUNG) AND MAINTENANCE OBLIGATION (ANSTALTSLAST)

HSH Nordbank AG as a member of the Savings Banks Finance Group is integrated into the support system of the Landesbanken via the support fund.

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

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

The institutional guarantee scheme of the German Savings Banks Finance Group also meets the statutory deposit guarantee requirements under the EinSiG by its official recognition as a deposit guarantee scheme. Under the statutory deposit guarantee the customer has a

claim against the guarantee scheme for the repayment of its deposits up to € 100,000.

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

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

5. ACCOUNTING STANDARDS APPLIED

We prepared the annual financial statements and the management report of HSH Nordbank AG as at 31 December 2016 in accordance with the provisions of the German Commercial Code (HGB), the German Stock Corporation Act (AktG), the German Bank Account-

ing Regulation (RechKredV) and the German Mortgage Bond Act (PfandBG). In addition, we complied with the applicable pronouncements of the Institute of Public Auditors in Germany, Incorporated Association - IDW.

ACCOUNTING AND VALUATION PRINCIPLES

Accounting and measurement are based on the assumption that the Bank is a going concern. The Bank's corporate planning forms the basis for the going concern assumption. Assessments, which form the basis for the corporate planning and in particular the planning for the movement in loan loss provisions over the long-term, the payment default plan and the resultant actual drawdown of the second loss guarantee, take information available to us at this point in time into account. These assessments are dependent on factors that are mostly outside the control of the Bank and are therefore subject to a significant degree of uncertainty. This applies, for example, to expectations regarding macroeconomic trends, exchange rates, freight and charter rates or changes in the regulatory framework. Furthermore, the very long planning horizon for the long-term loan loss provision planning

is causing significant uncertainty. One key assumption used in corporate planning in view of the ongoing sale process of HSH Nordbank AG is the overall sale of HSH Nordbank AG as a whole, i.e. the sale of all shares in the Bank held by the seller, including all assets and liabilities, as a preferred solution without any material early disposals of assets or sub-areas at amounts below the carrying amount in the event of outstanding bids for an overall sale. In its forecasts and assumptions, the Bank has assumed the sale of the overall bank, as scheduled, adhering to the time schedule agreed in the agreed list of conditions and commitments, so that no adverse effects on the business model of HSH Nordbank AG arise. Insofar the planning is based on the assumption that a potential buyer would in principle continue with the Bank's business model. Within this con-

text, it is assumed that the viability assessment to be performed by the European Commission following a successful change of ownership will have a positive outcome, meaning that the Bank will comply with all of the agreements reached in the EU proceedings. As it is not possible to objectively predict the course and outcome of the privatisation process, the process involved in the sale of HSH Nordbank AG creates considerable uncertainty regarding the implementation of the corporate planning, the determination of the loan loss provisions and accounting and measurement. Additional assumptions, uncertainties, opportunities and risks of corporate planning as well as the structural measures are discussed in the Management Report in the section "Forecast, opportunities and risks report".

The assumption of the Bank as a going concern for accounting and measurement purposes and the assumption of the continued going concern of HSH Nordbank AG are based in particular on the fact that

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

(ii) the operating company, HSH Nordbank AG, is sold at a positive sales price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge during the privatisation period, it could trigger outflows of short-term

funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

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

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

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

6. LOANS AND ADVANCES

We recognised loans and advances to banks and to customers (asset items 3 and 4) at their nominal value or at their cost of acquisition. Premiums or discounts are recorded under prepaid expenses or deferred income and amortised on a straight-line basis over the term of the loan or the fixed-interest period, whichever is shorter. Pro-rata

interest is recognised on an accrual basis and disclosed in the corresponding loans and advances line items. We observe the strict lower-of-cost-or-market principle by rigorously applying our risk provisioning principles which are described below.

If, in the case of non-genuine securitisation transactions, loans and advances are not derecognised and the risk on such loans and advances remains fully with HSH Nordbank AG, any necessary loan loss

provisions are recognised solely on our original loans and advance amounts.

7. VALUATION ALLOWANCES AND PROVISIONS IN THE LENDING BUSINESS (LOAN LOSS PROVISIONS)

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

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

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

Finally, we create general loan loss provisions in accordance with the German commercial law for the remaining loan exposures not

accounted for in the first two steps, but still involving latent risks. The general loan loss provisions are determined as of the reporting date on the basis of risk parameters derived from the determination of internal economic counterparty default risk. For the calculation the parameters probability of default (PD), loss given default (LGD) and for off-balance sheet items the credit conversion factor (CCF) are used. The loss identification period factor (LIP) used in the calculation represents the interval between the occurrence of a loss event and its becoming known and serves to derive the losses that actually occurred from the expected loss. We recognise general loan loss provisions for loans and advances, contingent liabilities and irrevocable loan commitments to customers. These general loan loss provisions are determined for tax purposes in accordance with the bulletin of the Federal Ministry of Finance dated 10 January 1994.

There are also general loan loss provisions for risks resulting from the challenging environment in particular in the shipping market.

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

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

Please refer to Note 3 for details on the hedging effect of the second loss guarantee of HSH Finanzfonds AöR and the synthetic securitisation transaction.

8. DETERMINING FAIR VALUE

Fair value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. The fair value of financial instruments is determined on the basis of the listed price on an active market (mark-to-market), or, if this is not possible, on the basis of recognised valuation techniques and models (mark-to-matrix or mark-to-model respectively).

Fair value can be determined using the mark-to-market method if a market price is available at which a transaction could be entered into or has been entered into. This is generally the case with regard to securities and derivatives traded on liquid markets.

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

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

Where valuation techniques and models are concerned, a distinction can be drawn between procedures based exclusively on observable market data or parameters that are non-observable only to an insignificant extent (mark-to-matrix) on the one hand and those based to a significant extent on non-observable parameters (mark-to-model) on the other hand. Observable market data is usually available for liquid securities and simple OTC derivatives traded on liquid markets (for example interest rate swaps, forward foreign exchange transactions and foreign exchange options in certain currencies as well as derivatives of certain listed equities or indices). Valuation techniques and models based on non-observable market data or valuation parameters, and which therefore require assumptions to be made with regard to these parameters, are usually necessary for structured securities – or more generally for securities whose markets are illiquid – and for complex OTC derivatives. Examples of non-observable parameters are special correlations and volatilities. In these cases a significant number of judgements have to be made with regard to the selection of both the model and the parameter estimates.

If the valuation technique or model used to determine the value of a derivative does not appropriately reflect modelling risks, parameter uncertainties, funding costs and benefits as well as credit or counterparty risk, the value is correspondingly adjusted by the Bank. The

methods applied for this draw to some extent on non-observable market parameters in the form of estimates.

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

The financial crisis has resulted in derivatives being increasingly concluded on a secured basis in the interbank market (under a collateral agreement, e.g. CSA). At the same time the collateral is also explicitly taken into account in the valuation of OTC derivatives. The impact of the collateral provided is taken into account as part of measurement.

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

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

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

9. SECURITIES

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

Given that securities held in the investment portfolio are intended for long-term investment, we value these at the moderate lower-of-cost-or-market value. When impairments are considered to be temporary we recognise the corresponding securities at acquisition cost. Impair-

ments are considered to be temporary if they are not considered indications of future disruptions in the servicing of interest and capital payments. This is the case, for example, where impairments are caused by changes in interest rates. We thus avoid reporting performance volatility, which would not be economically justified based on the short-term nature of the value fluctuations. As part of the risk provisioning process for securities, we have defined comprehensive criteria (trigger events) for identifying possible permanent impairments. These are identified on a quarterly basis. All securities under review

including any cover assets/underlyings are subjected to an analysis and a two-stage risk assessment process. Depending on the security's asset class, this analysis includes additional indicators (e.g. external ratings, calculation of over-collateralisation for mezzanine tranches, cash flow analyses). As long as this analysis of an individual case does not confirm a trigger event in economic terms or no trigger event is identified, there is no permanent impairment. In the case of impairments expected to be permanent – usually caused by changes in the credit rating – we write down the security to the lower of the exchange price, market price or fair value.

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

For the balance sheet treatment and the presentation of hedging relationships, please refer to our remarks under Note 14.

Interest resulting from the Bank's own securities holdings is reported as interest income. In this connection, pro rata interest is recognised on an accrual basis. Valuation gains or losses and realised profits on securities held in the investment portfolio are allocated to Net income from financial investments (item 14 in the income statement); in the case of securities held in the liquidity reserve, they are allocated to Credit risk income/expense (item 12 in the income statement).

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

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

10. FINANCIAL INSTRUMENTS HELD IN THE TRADING PORTFOLIO

We include in the assets and liabilities held for trading (asset item 6a and liability item 3a) all financial instruments which we acquired or sold for purposes of realising a short-term proprietary trading profit. In addition to securities, these include in particular derivative financial instruments, but also certain receivables (such as promissory notes). Securities, receivables and derivatives with a positive fair value are disclosed under Trading portfolio (assets) (item 6a); derivatives with a negative fair value are disclosed under Trading portfolio (liabilities) (item 3a). The criteria for allocation to the Trading portfolio remained unchanged during the financial year.

We value all financial instruments held in the Trading portfolio at fair value less a risk discount. Where no stock market or market prices are available for financial instruments, fair value is calculated on the basis of generally accepted valuation models (cf. also Note 8). In order to account for counterparty risks from derivatives held in the Trading portfolio we have created so-called credit valuation adjustments and have reduced the Trading portfolio (assets) accordingly. Furthermore, we have created debt valuation adjustments and have reduced the Trading portfolio (liabilities) accordingly.

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

The risk discount represents a potential loss (value at risk) determined by mathematical methods and is based on all positions held in HSH Nordbank AG's Trading portfolio. The value at risk (VaR) is

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

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

Each year that HSH Nordbank AG discloses net income in the trading portfolio, 10% of this net income is allocated to the special item Fund for General Banking Risks (liability item 10). Reversals of this item are only possible in order to balance net expenses in the Trading portfolio or as far as the item exceeds 50% of the average of the past five years net income in the Trading portfolio. Expenses from the addition to and income from the reversal of the item are stated respectively under the Net income or net expense of the trading portfolio. In the last financial year, € 9 million (previous year: € 0 million) were allocated from Net income in the trading portfolio to the special item.

11. BALANCE SHEET PRESENTATION ON A NET BASIS

We net the fair values of trading portfolio derivatives traded over the counter and cash collateral, for which measurement is performed and

collateral provided on a daily basis under a master agreement with collateral agreement. The netting has no effect on the disclosure of Net income from the trading portfolio. Cf. also Note 70.

12. DERIVATIVE FINANCIAL INSTRUMENTS

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

Income and expenses from option contracts held in the non-trading portfolio are disclosed under Other operating income or Other operating expenses in accordance with the disclosure requirements of IDW AcPS BFA 6. Income and expenses from interest rate cap agreements are disclosed under Interest income or Interest expenses.

We recognise credit derivatives held in the non-trading portfolio in accordance with IDW AcPS BFA 1. The rules for loan collateral provided apply in principle to credit default swaps in which HSH Nordbank AG takes the position of a collateral provider and which are not allocated to a valuation unit within the meaning of Section 254 HGB. A provision is recognised in the amount of the negative fair value to take account of the default risk as at the reporting date.

Guarantees in which HSH Nordbank AG takes the position of a collateral taker (cf. Note 3) are recognised in accordance with IDW AcPS BFA 1.

As at 31 December 2016, accounting for internal derivatives resulted in interest income in the amount of € 1,490 million (previous year: € 1,734 million), interest expense in the amount of € 1,253 million (previous year: € 1,501 million), Other operating income of

€ 16 million (previous year: € 11 million) and Other operating expense of € 7 million (previous year: € 11 million). Reverse effects are reported in the Net income from the trading portfolio.

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

To the extent a margin system is used in the case of financial instruments, the initial margin payments are recognised as assets or liabilities. Variation margin payments in the Trading portfolio are recognised for income purposes directly in Trading portfolio net income or loss. Variation margins outside of the Trading portfolio are recognised as assets or liabilities. We disclose both initial margins and variation margins arising from OTC derivatives under Other assets (cf. Note 33) or Other liabilities (cf. Note 45).

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

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

13. STRUCTURED PRODUCTS

We account for structured products in accordance with the IDW AcPS HFA 22 interpretation. Structured products valued at fair value or in accordance with the strict lower-of-cost-or-market principle are not subject to separate accounting. Structured assets that are valued in accordance with the moderate lower-of-cost-or-market principle are subject to separate accounting with regard to the derivative compo-

nents and the host instrument. As a matter of principle, the separated derivative components are included in valuation units (cf. also Note 14). Derivative components of equity-linked structured products, however, are valued individually under the recognition-of-loss principle (imparity principle).

14. HEDGE ACCOUNTING VIA VALUATION UNITS

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

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

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

for purposes of forming a portfolio valuation unit. We create portfolio valuation units for the corresponding securities portfolios included in the liquidity reserve.

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

The prospective and retrospective effectiveness of a hedging relationship is substantiated and documented at least once a year at the time the annual financial statements are prepared. In the case of micro hedges, the prospective documentation of effectiveness is made on the basis of the critical-terms-match method. As part of this substantiation it needs to be shown that the value parameters of the hedged item and the hedging instruments to be allocated to the hedged risk match. If they match, it is to be presumed that changes in value attributable to the hedged risk will be offset over the entire residual maturity/the

designated term of the transactions. In the case of portfolio hedges, prospective substantiation of effectiveness is accomplished by means of quantitative and maturity range-dependent sensitivity analyses in relation to the hedged risk. In the case of a corresponding offset of sensitivities of hedged items and hedging instruments in the relevant maturity ranges, it may be presumed that there will be a high degree of correlation between the changes in the value attributable to the hedged item and those attributable to the hedging instrument over the entire residual maturity of the transactions. The retrospective measurement of effectiveness is generally accomplished, not only for micro but also for portfolio hedges by mathematically determining the ratio of the cumulative changes in value on the part of the hedged item to be attributed to the hedged risk arising since the designation of the hedge to those of the hedging instruments.

Amount of hedged items and hedging instruments included in valuation units

The following table shows the carrying amount of assets and liabilities included in valuation units by balance sheet item. Derivative financial instruments included in valuation units are disclosed under the items Positive market value derivatives/Negative market values derivatives at their respective fair values.

HEDGED ITEMS

(€ k)	31.12.2016		31.12.2015	
	Micro valuation units	Portfolio valuation units	Micro valuation units	Portfolio valuation units
Assets				
Loans and advances to customers	861,469	–	861,517	–
Debentures and other fixed-interest securities	1,054,294	9,775,322	1,109,266	10,166,249
Liabilities				
Liabilities to banks	42,115	–	102,506	–
Liabilities to customers	1,458,950	–	1,554,192	–
Securitised liabilities	101,689	–	145,032	–
Positive market values of derivatives	68,610	–	169,308	–
Negative market values of derivatives	196,114	–	248,835	–

HEDGING INSTRUMENTS

(€ k)	31.12.2016		31.12.2015	
	Micro valuation units	Portfolio valuation units	Micro valuation units	Portfolio valuation units
Positive market values of derivatives	542,768	35	618,508	2,350
Negative market values of derivatives	1,125,636	603,877	1,183,730	657,061

In relation to the underlying nominal values, interest rate risk is being hedged in approximately 95% of the valuation units. The other risks largely involve currency risks.

Amount of the risks hedged in valuation units

The following table shows the effective portion of the changes in value to be allocated to the hedged risks on a cumulative basis since the designation of the valuation unit.

HEDGED ITEMS

(€ k)	31.12.2016				31.12.2015			
	Micro valuation units		Portfolio valuation units		Micro valuation units		Portfolio valuation units	
	Positive change in value	Negative change in value	Positive change in value	Negative change in value	Positive change in value	Negative change in value	Positive change in value	Negative change in value
Assets								
Loans and advances to customers	424,290	-	-	-	374,641	-	-	-
Debentures and other fixed-interest securities	532,789	363	415,773	-	534,978	633	434,854	-
Liabilities								
Liabilities to banks	-	3,137	-	-	82	5,644	-	-
Liabilities to customers	1,065	200,793	-	-	-	226,397	-	-
Securitised liabilities	-	5,415	-	-	30	4,583	-	-
Derivatives	43,693	50,137	-	-	109,017	65,048	-	-

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

offset by corresponding positive changes in value on the part of the hedging transactions.

15. ACCOUNTING FOR INTEREST-RELATED FINANCIAL INSTRUMENTS HELD IN THE BANKING BOOK

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

If a negative balance arises on comparing the present values to the carrying amounts, this amount is recognised in the income statement as a provision for contingent losses, which is disclosed under Other provisions on the balance sheet. Based on the results of the calculation no provisions needed to be created as at 31 December 2016.

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

16. EQUITY HOLDINGS IN NON-AFFILIATED COMPANIES AND INTERESTS IN AFFILIATED COMPANIES

We recognise equity holdings in non-affiliated companies and interests in affiliated companies at acquisition cost. In the case of impair-

ments expected to be permanent – usually induced by changes in the credit rating – we write them down to the lower fair value.

17. INTANGIBLE FIXED ASSETS

We account for internally-developed and purchased software under Intangible fixed assets. Internally developed software is recognised in the amount of the production costs incurred in its development. Production costs include expenses directly attributable to the development of the software (so-called development costs). Expenses which cannot be directly allocated to the development of the software (so-called research costs) are not included in production costs but are expensed against income for the year incurred. During the financial year, software development costs in the amount of € 2 million (previous year: € 3 million) and no research costs were incurred as in the previous year.

Purchased software is valued at acquisition cost.

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

18. TANGIBLE FIXED ASSETS

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

Tangible fixed asset category	Useful life in years
Buildings	50
Leasehold improvements	The useful life is determined on the basis of the remaining period of the lease.
Plant and equipment	3 to 15
Leasing assets	Customary useful life
Low-value items (€ 150.00 to € 1,000.00)	5

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

Any acquisition cost subsequently incurred is capitalised and depreciated in line with the adjusted depreciation schedule. Expenses for the

maintenance of tangible fixed assets are recognised as expenses in the appropriate accounting period.

Tangible fixed assets with a purchase price of up to € 150.00 are recognised as an expense in the year of acquisition in accordance with the applicable tax provisions.

19. DEFERRED TAXES

Deferred taxes are calculated based on the different carrying amounts of assets and liabilities in the balance sheet drawn up for accounting and tax purposes. We recognise deferred taxes on differences that are expected to offset in future financial years and will thereby lead to future tax expenses or reductions. Deferred tax assets are additionally attributed to tax losses carried forward to the extent the realisation of the tax benefit from the losses carried forward is expected to occur within the next five years. The Overall Bank is subject to an overall tax rate of 31.67%. Deferred taxes are not discounted in accordance with the regulations. Deferred tax assets and deferred tax liabilities are stated in the balance sheet on a gross basis (asset item 14 and liability item 6a).

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

20. LIABILITIES

We recognise liabilities at the amount repayable. Premiums and discounts are shown as deferred income or prepaid expenses, respectively, and are reversed over the term on a straight-line basis. We treat pro-

rata interest on an accrual basis and report it in the corresponding liabilities line item.

21. PROVISIONS

We value provisions at the expected call on the provisions in accordance with reasonable commercial judgment. Provisions with a residual maturity of more than one year are generally discounted on the basis of the average market rate determined and published by the Deutsche Bundesbank in accordance with the Regulations on the Determination and Disclosure of Discount Rates for Provisions (RückAbzinsV) in the version applicable as at the reporting date which corresponds to the residual maturity. We disclose income and expenses from the discounting or compounding of provisions under Other operating income (see also Notes 56 and 57); including the income effect of changes in the discount rate applied. The result due to the change in the discount interest rate in provisions for pensions and similar obligations is disclosed under Other operating result.

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

	2016	2015
Salary growth	2.0%	2.0%
Personnel growth	0.5%	0.5%
Pension growth		
Employment contract 1/ old pension provision rules	individual	individual
New pension provision rules	2.0%	2.0%
Employment contract 4	2.0%	2.0%
Staff turnover		
Age up to 30	6.0%	6.0%
Age 30–55	linear decline to zero	linear decline to zero
Age above 56	0.0%	0.0%
Retirement age	pursuant to the 2007 AGAnpassG	pursuant to the 2007 AGAnpassG

Provisions for pensions and similar obligations are discounted using the applicable average market interest rate which results from the assumption of a residual maturity of 15 years. The discount rate applied as at the balance sheet date was 4.01% p.a. (previous year: 3.94% p.a.). Due to the change in the statutory basis, the interest rate is now calculated on the basis of a ten-year mean, unlike in the previous year. The difference compared with the interest rate based on a seven-year mean that was used in the past amounts to € 86 million and is non-distributable (cf. Note 62). Due to the drop in market interest rates, i.e. the drop in the seven-year mean as against the previous year, expense of € 78 million was incurred at the same time. Overall, expenses for retirement pensions amount to income of € 16 million (previous year: € –73 million), which is largely due to collective wage agreements that were much lower than expected and other experience adjustments.

Assets, whose sole purpose is the fulfilment of pension obligations and to which no other creditors have access (fund assets) are recognised at their fair value of € 7 million (previous year: € 7 million), which is also equivalent to the acquisition cost of the assets. Fund assets in the same amount have been offset against provisions for pensions and similar obligations. The amount required to meet the resultant liability was € 10 million as at 31 December 2016 (previous year: € 10 million). Please refer to Note 8 for information concerning the determination of fair value.

22. CURRENCY TRANSLATION

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

Currency translation with regard to financial instruments included in the Trading portfolio is an implicit part of the valuation of such transactions (see comments under Note 10).

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

To the extent the assets, liabilities and pending transactions are specifically hedged by other assets, liabilities or pending transactions, all expenses and income from currency translation are reported through profit and loss. All assets, liabilities and pending transactions

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

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

23. ACCOUNTING TREATMENT APPLIED TO THE RESTRUCTURING

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

HSH Nordbank AG set up a restructuring programme in November 2014 with the aim of further reducing the cost of banking operations over the next few years. Further provisions were set up in the first half of 2016 for additional job cuts in the period leading up to 2019 as part of the further expansion of the ongoing cost reduction programme.

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

NOTES ON BALANCE SHEET ASSETS

24. LOANS AND ADVANCES TO ASSOCIATED SAVINGS BANKS

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

(€ k)	31.12.2016	31.12.2015
Loans and advances to associated savings banks	35,379	36,155

25. AFFILIATED COMPANIES

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

(€ k)	31.12.2016	31.12.2015
Loans and advances to banks	634,397	622,033
Loans and advances to customers	781,506	804,497
Debentures and other fixed-interest securities		
Bonds and debentures	739,508	871,266

26. NON-AFFILIATED COMPANIES

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

(€ k)	31.12.2016	31.12.2015
Loans and advances to banks	55	105
Loans and advances to customers	287,376	372,139

27. SUBORDINATED ASSETS

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

(€ k)	31.12.2016	31.12.2015
Loans and advances to banks		
Other receivables	112,438	108,223
Loans and advances to customers	153,520	182,840
Debentures and other fixed-interest securities		
Bonds and debentures	22,750	29,569

28. RESIDUAL MATURITIES

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

(€ k)	31.12.2016	31.12.2015
Loans and advances to banks		
Other receivables		
Up to 3 months	391,233	954,335
Between 3 months and 1 year	790,714	524,985
Between 1 year and 5 years	197,394	486,485
More than 5 years	465,693	717,828
Loans and advances to customers		
Up to 3 months	12,162,199	13,690,665
Between 3 months and 1 year	7,399,492	8,580,635
Between 1 year and 5 years	21,367,782	23,923,594
More than 5 years	12,008,010	14,819,084
Debentures and other fixed-interest securities		
Due in the following year	1,482,730	2,250,990

29. TRADING PORTFOLIO (ASSETS)

The trading portfolio is comprised of the following:

(€ k)	31.12.2016	31.12.2015
Derivative financial instruments	2,113,982	2,619,440
Loans and advances	10,212	10,015
Debentures and other fixed-interest securities	1,097,928	2,367,632
Shares and other non-fixed-interest securities	194	484
Other assets	13,601	12,600
Risk discount	-8,316	-8,774
Total	3,227,601	5,001,397

30. NEGOTIABLE SECURITIES

(€ k)	Listed		Unlisted		Total	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Debentures and other fixed-interest securities	14,777,468	16,592,615	1,872,693	2,467,648	16,650,161	19,060,263
Shares and other non-fixed-interest securities	6,180	9,420	39,400	150,366	45,580	159,786
Equity holdings in non-affiliated companies	42,593	40,212	3,576	3,576	46,169	43,788
Interests in affiliated companies	-	-	25,400	32,700	25,400	32,700

31. NEGOTIABLE SECURITIES NOT VALUED USING THE LOWER-OF-COST-OR-MARKET PRINCIPLE

(€ k)	31.12.2016	31.12.2015
Debentures and other fixed-interest securities		
Carrying amount of securities valued using the moderate lower-of-cost-or-market principle	3,400,882	3,950,752
Carrying amount of securities reported above their fair value	1,528,544	1,431,210
Market value of securities reported above their fair value	1,451,446	1,333,050
Unrealised losses	77,098	98,160
of which unrealised losses on securities which are not part of a valuation unit	75,835	94,178
Shares and other non-fixed-interest securities		
Carrying amount of securities valued using the moderate lower-of-cost-or-market principle	153,173	277,654
Carrying amount of securities reported above their fair value	-	-
Market value of securities reported above their fair value	-	-
Unrealised losses	-	-

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

Unrealised losses relating to securities held in valuation units, which are not to be allocated to the hedged risk (resulting for the most part from the creditworthiness of the issuer), amounted to € 124 million as at 31 December 2016 (previous year: € 110 million). The unhedged risk is not recorded as the valuation is based on the moderate lower-of-cost-or-market principle. These also include unrealised losses on

securities relating to the unhedged risk, which would show an unrealised income without taking the valuation unit into account.

If there is not a permanent, but rather only a temporary impairment of securities to be expected, which generally is not induced by changes in the credit rating, a write-down to fair value is not undertaken (cf. Note 9).

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

(€ k)	Securities rating	31.12.2016	31.12.2015
No trigger events have occurred		27,052	64,285
	Rating investment grade or better	17,440	47,027
	Rating lower than investment grade	9,612	17,258
Trigger events have occurred		50,047	33,875
	Rating investment grade or better	37,987	26,816
	Rating lower than investment grade	12,060	7,059
Total		77,099	98,160

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

32. TRUST ASSETS

Trust assets are comprised of the following balance sheet items:

(€ k)	31.12.2016	31.12.2015
Loans and advances to customers	5,147	6,848
Total	5,147	6,848

33. OTHER ASSETS

The major components of other assets are:

(€ k)	31.12.2016	31.12.2015
Initial and variation margins from OTC derivatives (cf. Note 12)	2,236,015	2,007,366
Receivables on fiscal authorities	34,541	65,197
Tenant loans	33,019	29,522
Premiums paid from options trading and from interest limitation agreements	17,291	18,436
Receivables from profit and loss transfer agreements and from dividends	15,056	8,331
Adjustment item for currency translation	14,545	126,702

34. PREPAID EXPENSES

The major items disclosed here are:

(€ k)	31.12.2016	31.12.2015
Discount accruals from issuing business	61,735	83,841
Premium accruals from claims	21,571	38,466
Prepaid expenses from derivatives	26,338	32,409
Accrual of the one-off payment to HSH Finanzfonds AöR for the replenishment of the guarantee (cf. Note 3)	–	22,034
Discount accruals from liabilities	4,170	5,518

35. DEFERRED TAX ASSETS

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

(€ k)	31.12.2016	31.12.2015
Assets		
Loans and advances to customers	305,681	344,312
Debentures and other fixed-interest securities	18,759	41,363
Equity holdings in non-affiliated companies	6,658	4,891
Interests in affiliated companies	287	186
Intangible fixed assets	53	115
Tangible fixed assets	9,643	10,676
Other assets	2,149	2,267
Prepaid expenses	1,110	1,611
Liabilities		
Other liabilities	48	491
Prepaid expenses	6,423	718
Provisions	163,303	181,446
Losses carried forward	95,005	91,367
Total	609,119	679,443

The deferred tax assets fell by € 70 million in the financial year.

Deferred tax assets on losses carried forward in the amount of approximately € 5 million are attributable to losses carried forward for the Singapore branch. Deferred taxes of € 89 million are attributable to losses carried forward for the New York branch, a permanent establishment for tax purposes, although this is offset by the same amount of deferred tax liabilities recognised on temporary differences.

Impairment testing of deferred tax assets results in a valuation allowance in the amount of € 64 million (previous year: € 22 million).

36. GENUINE REPURCHASE AGREEMENTS

As a borrower under genuine repurchase agreements, we have sold assets with a carrying amount of € 2,140 million (previous year: € 2,358 million) and simultaneously contracted to repurchase the same assets. The assets continue to be carried on our balance sheet; the consideration received in return for the assets is disclosed under the corresponding liability items.

37. ASSETS TRANSFERRED AS COLLATERAL

In addition to assets sold under repurchase agreements (cf. Note 36) and the receivables serving as the cover pool for bonds issued (cf. Note 72), we have transferred further assets as collateral. These are mainly securities lodged with central banks and Eurex as collateral for participation in stock exchanges and clearing organisations and for funding as well as loan notes and loan receivables assigned as collateral for borrowings at central banks and other banks. Further securities were furnished as collateral for a cash deposit as part of the synthetic securitisation transaction (cf. remarks under Note 3 II).

(€ k)	31.12.2016	31.12.2015
Assets transferred as collateral	7,806,566	12,077,041
thereof for Liabilities to banks	5,245,517	9,606,424
Liabilities to customers	325,034	463,251
Trading portfolio (liabilities)	2,236,015	2,007,366

38. STATEMENT OF CHANGES IN FIXED ASSETS

DEVELOPMENT IN FIXED ASSETS

(€ k)	01.01.2016	2016				31.12.2016	31.12.2016	31.12.2016	31.12.2015
	Historical cost of acquisition	Additions	Disposals	Transfers	Exchange rate differences	Historical cost of acquisition	Accumulated depreciation	Carrying amount	Carrying amount
Securities	4,406,112	78,743	877,761	-	-21,745	3,585,349	58,305	3,527,044	4,205,873
Equity holdings in non-affiliated companies	225,871	-	4	-	-	225,867	136,419	89,448	87,756
Interests in affiliated companies	1,360,503	4,000	335	-	20,613	1,384,781	689,856	694,925	686,782
Land and buildings	84,347	-	1,115	-	-	83,232	8,108	75,124	77,439
Plant and equipment	58,386	1,785	2,427	1,137	-	58,881	46,107	12,774	12,784
Assets under construction	1,137	479	-	-1,137	-	479	-	479	1,138
Leasing assets	-	-	-	-	-	-	-	-	-
Intangible fixed assets	168,423	3,999	47	-	-	172,375	162,253	10,122	10,337
Total	6,304,779	89,006	881,689	-	-1,132	5,510,964	1,101,048	4,409,916	5,082,109

DEVELOPMENT IN DEPRECIATION/AMORTISATION

(€ k)	01.01.2016		2016					31.12.2016
	Accumulated depreciation	Depreciation in the financial year	Write-ups in the financial year	Change in total depreciation in connection with additions	Change in total depreciation in connection with disposals	Change in total depreciation in connection with transfers	Exchange rate differences	Accumulated depreciation
Securities	200,239	3,549	-	-	145,371	-	-112	58,305
Equity holdings in non-affiliated companies	138,115	1,975	3,667	-	4	-	-	136,419
Interests in affiliated companies	673,721	16,215	-	-	229	-	149	689,856
Land and buildings	6,908	1,631	-	-	431	-	-	8,108
Plant and equipment	45,601	2,557	-	-	2,051	-	-	46,107
Assets under construction	-	-	-	-	-	-	-	-
Leasing assets	-	-	-	-	-	-	-	-
Intangible fixed assets	158,086	4,169	-	-	2	-	-	162,253
Total	1,222,670	30,096	3,667	-	148,088	-	37	1,101,048

Real estate includes land and buildings used for the Bank's own business activities at a carrying amount of €75 million (previous year: €77 million).

NOTES ON BALANCE SHEET LIABILITIES

39. LIABILITIES TO ASSOCIATED SAVINGS BANKS

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

(€ k)	31.12.2016	31.12.2015
Liabilities to associated savings banks	153,272	269,303

40. AFFILIATED COMPANIES

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

(€ k)	31.12.2016	31.12.2015
Liabilities to banks	816,280	802,755
Liabilities to customers	1,615,100	2,096,009

41. NON-AFFILIATED COMPANIES

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

(€ k)	31.12.2016	31.12.2015
Liabilities to banks	6	117
Liabilities to customers	180,920	137,333

42. RESIDUAL MATURITIES

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

(€ k)	31.12.2016	31.12.2015
Liabilities to banks		
With an agreed maturity or notice period		
Up to 3 months	2,045,917	7,204,754
Between 3 months and 1 year	1,492,367	1,307,199
Between 1 year and 5 years	3,457,564	3,775,719
More than 5 years	1,828,602	1,982,393
Liabilities to customers		
Other liabilities with an agreed maturity or notice period		
Up to 3 months	10,444,673	12,088,743
Between 3 months and 1 year	6,480,864	4,315,316
Between 1 year and 5 years	6,195,329	6,185,062
More than 5 years	6,099,665	6,673,677
Securitised liabilities		
Debentures issued		
Due in the following year	3,553,244	4,263,726
Other securitised liabilities		
Up to 3 months	57,742	19,536
Between 3 months and 1 year	11,336	-

43. TRADING PORTFOLIO (LIABILITIES)

The trading portfolio is comprised of the following:

(€ k)	31.12.2016	31.12.2015
Derivative financial instruments	1,738,483	2,011,355
Liabilities	32,256	114
Total	1,770,739	2,011,469

44. TRUST LIABILITIES

Trust liabilities are reported under the following balance sheet items:

(€ k)	31.12.2016	31.12.2015
Liabilities to banks	48	132
Liabilities to customers	5,099	6,716
Total	5,147	6,848

45. OTHER LIABILITIES

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

(€ k)	31.12.2016	31.12.2015
Security deposits for assumption of debt	656,841	720,187
Variation margin from OTC derivatives	165,732	352,781
Adjustment item for currency valuation	108,493	105,781
Pro rata interest on subordinated debt, profit participation rights and silent participations	93,906	56,099
Outstanding payments for the second loss guarantee	46,565	102,222
Premiums received from options trading and from interest limitation agreements	10,815	10,653
Tax liabilities	6,839	152,179
Liabilities from profit and loss transfer agreements and from dividends	3,303	3,135

46. DEFERRED INCOME

The major components of deferred income are the following:

(€ k)	31.12.2016	31.12.2015
Deferrals from advance loan fees	59,078	83,553
Prepaid expenses from derivatives	39,160	46,763
Discount deferrals from receivables	4,169	8,606
Premium deferrals from issuing business	13,282	5,708

47. DEFERRED TAX LIABILITIES

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

The deferred tax liabilities fell by € 6 million in the financial year.

(€ k)	31.12.2016	31.12.2015
Assets		
Loans and advances to customers	43,953	60,094
Interests in affiliated companies	1,365	1,041
Intangible fixed assets	607	829
Tangible fixed assets	44,979	46,755
Liabilities		
Other liabilities	-	13
Provisions	83,452	71,420
Total	174,356	180,152

48. OTHER PROVISIONS

Other provisions primarily relate to the following items:

(€ k)	31.12.2016	31.12.2015
Credit business	110,861	110,570
Restructuring measures	79,356	90,070
Securities transactions and financial derivatives	69,644	82,693
Personnel expenses	43,617	47,901
Outstanding invoices	38,903	44,640
Litigation risks and costs	31,416	34,756
Interest on corporate tax and trade tax	27,659	21,395
Expected back payment from tax audit	13,615	–
Assumption of costs of associated companies and discretionary benefits in the customer business	12,262	15,060
Archiving costs	5,500	5,500
Reimbursement of loan processing fees	1,550	3,000

€ 49 million (previous year: € 50 million) of the provisions for restructuring measures relate to personnel expenses and € 30 million (previous year: € 40 million) to operating expenses.

49. SUBORDINATED DEBT

Subordinated debt was issued in the form of promissory notes, registered or bearer bonds and is denominated in EUR, JPY and USD. The original maturities range from under three years to 40 years and the interest rates payable are between 0.018 % p.a. and 6.51 % p.a.

Individual items exceeding 10% of total subordinated debt:

(€ m)	Currency	Interest rate	Maturity	Cancellation possibilities
430	EUR	3M Euribor + 0.84 %	14.02.2017	Issuer cancellation right ¹⁾
498	EUR	3M Euribor + 0.8 %	14.02.2017	Issuer cancellation right ¹⁾

¹⁾ Initially until the expiry of the third TARGET business day before 14 February 2012, thereafter quarterly on 14 May, 14 August, 14 November and 14 February with a notice period of three TARGET business days in each case.

In principle subordinated debt meets the requirements of Article 63 of the Capital Requirements Regulation (CRR) for recognition as Tier 2 capital. Subordinated debt in the amount of € 1,020 million (previous year: € 1,020 million) will mature in less than two years.

For the 2016 financial year, interest expense on subordinated debt amounted to € 26 million (previous year: € 82 million).

50. PROFIT PARTICIPATION CAPITAL

The terms and conditions of the profit participation capital also fulfil the requirements of Article 63 CRR for recognition as Tier 2 capital. This includes in particular that the claims of profit participation certificate holders to repayment of capital are subordinate to other claims. Profit participation capital in the amount of € 14 million (previous year: € 14 million) will mature in less than two years.

Registered profit participation certificates with a total nominal value of € 26 million have original maturities between 15 and 17 years and bear interest between 6.68 % p.a. and 7.35 % p.a. Payment of interest on the profit participation capital is tied to the distributable profits of HSH Nordbank AG. No current interest was payable for the 2016 financial year due to the balanced net income.

51. FUND FOR GENERAL BANKING RISKS

Amounts from the trading portfolio totalling € 9 million (previous year: € 0 million) and other amounts totalling € 258 million were

allocated in the reporting period to the fund for general banking risks in accordance with Section 340g HGB (previous year: € 0 million).

52. EQUITY CAPITAL

Pursuant to Section 25 (1) of the German Bank Accounting Regulation (RechKredV), Subscribed capital consists of the share capital of HSH Nordbank AG and silent participations.

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

As at the reporting date, HSH Beteiligungs Management GmbH, Hamburg, was the largest shareholder with 94.90% of the voting rights (previous year: 0%). HSH Finanzfonds AöR – Gemeinsame Anstalt der Freien und Hansestadt Hamburg und des Landes Schleswig-Holstein – holds an interest of 68.03% (previous year: 65.00%), the Free and Hanseatic City of Hamburg, including the interest held indirectly via HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH holds an interest of 11.30% (previous year: 10.80%), the Federal State of Schleswig-Holstein holds an interest of 10.02% (previous year: 9.58%) and Sparkassen- und Giroverband für Schleswig-Holstein holds an interest of 5.55% (previous year: 5.31%) in HSH Nordbank AG, with all of these interests being held indirectly via HSH Beteiligungs Management GmbH. As at 31 December 2016, the nine groups of investors advised by J.C. Flowers & Co LLC held 5.10% of the voting rights (previous year: 9.31%).

HSH Beteiligungs Management GmbH, with its registered offices in Hamburg, notified us in June 2016 in accordance with Section 20 (1)/(4) of the German Stock Corporation Act (AktG) that it directly owns more than one-quarter of the shares of HSH Nordbank AG, and

at the same time owns a direct majority interest within the meaning of Section 16 (1) AktG.

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

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

If a net loss is incurred for the current financial year, no distributions related to the silent participations can be made. In addition, these equity instruments must participate in the net loss for the year. In the previous year, silent participations participated in the loss of the Bank in the amount of € 39 million. The Silent participations have been placed on the international capital markets (€ 921 million) as well as with the Bank's domestic institutional investors (€ 321 million).

NOTES ON THE INCOME STATEMENT

53. BREAKDOWN OF INCOME ITEMS BY GEOGRAPHICAL MARKETS

(€ k)	2016				2015			
	Germany	Rest of Europe	Asia	America	Germany	Rest of Europe	Asia	America
Interest income	3,432,236	113,053	48,054	–	4,513,148	177,501	62,551	17,752
Current income from shares and other non-fixed-interest securities, equity holdings in non-affiliated companies and interests in affiliated companies	53,000	5,736	–	–	63,864	9,879	–	–
Income from profit pooling, profit and loss transfer or partial profit transfer agreements	6,452	–	–	–	–	–	–	–
Commission income	111,701	4,020	900	–	143,308	4,663	1,697	1,136
Net income from the trading portfolio	79,883	–	2,654	–	–40,391	–	1,153	1,836
Other operating income	132,244	25,990	444	–	208,421	21,902	1,664	787

54. NET INTEREST INCOME

Net interest income includes one-time expenses from the disposal of receivables in the amount of €136 million (previous year: € 9 million in expenses).

55. NET COMMISSION INCOME

Net commission income is comprised of the following:

(€ k)	2016	2015
Lending business	49,368	69,391
Payment transactions and foreign business, documentary business	19,707	19,396
Securities business	1,356	585
Guarantee business	–216,586	–459,382
Other	4,563	7,602
Total	–141,592	–362,408

Net commission income for the year ended 31 December 2016 includes expenses for the guarantee from HSH Finanzfonds AöR in the amount of € 227 million (previous year: € 475 million).

€ 22 million of the one-off payment for the replenishment of the second loss guarantee was recognised on a pro rata temporis basis in the reporting year (previous year: € 69 million).

The premium expense resulting from the synthetic securitisation transaction (cf. Note 3 II) is also shown under Net commission income.

56. OTHER OPERATING INCOME

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

(€ k)	2016	2015
Cost allocations and reimbursement of expenses	36,570	32,911
Income from legal disputes	35,021	7,950
Income from the reversal of other provisions	21,934	29,667
Income from option premiums received as well as compensation payments received for options held in the non-trading portfolio	19,381	15,015
Income on exchange from transactions not specifically hedged	10,680	74,410
Income from the reversal of provisions for contingent losses from valuation units (cf. Note 14)	7,686	29,871
Net income from the change in the interest rate for pension provisions	7,501	-
Income from the reversal of provisions for processing fees in the lending business	2,235	28,600
Interest income from claims against tax authorities	1,268	17

The income effect of the change in the interest rate for pension provisions comprises the change in the interest rate to a ten-year mean (income € 86 million) and the changes in the seven-year mean interest rate between the previous year and the current year (expense € 78 million). In the previous years, the latter effect was recognised in personnel expenses.

57. OTHER OPERATING EXPENSES

Other operating expenses primarily include the following items:

(€ k)	2016	2015
Expenses relating to option premiums paid as well as compensation payments for options held in the investment portfolio	64,833	17,413
Expenses for the compounding of provisions outside the lending business	33,465	34,199
Expenses from additions to other provisions	11,826	10,557
Interest expenses pursuant to Section 233 AO	4,120	-
Expenses from the creation of provisions for litigation risks	3,562	2,181
Loss on the sale of receivables	-	106,465
Expenses for tax risks	-	22,500
Loss on exchange from transactions not specifically hedged	-	3,864

58. EXTRAORDINARY RESULT

The Extraordinary result includes restructuring expenses connected to the strategic realignment of the Bank in the amount of € 112 million (previous year: € 37 million). € 3 million (previous year: € 0 million) of this amount relates to expenses for the privatisation of the Bank. These were offset by income arising from the reversal of

provisions from previous restructuring programmes. Please refer to Note 23 for information concerning the accounting treatment applied to the restructuring.

59. INCOME TAX EXPENSES

Income tax expense comprises the following:

(€ k)	2016	2015
Deferred income taxes	64,527	154,418
on temporary differences	68,166	172,642
on loss carryforwards	-3,639	-18,224
Current income taxes	36,251	27,107
Total	100,778	181,525

The deferred tax expense in the reporting year is determined largely by the reduction in temporary differences due to slight valuation differences between the balance sheet drawn up for accounting purposes and the balance sheet drawn up for tax purposes. The change in deferred tax assets on losses carried forward results from deferred tax assets set up for the Singapore branch.

The current income tax expense of € 36 million comprises tax expense attributable to the current financial year in the amount of € 38 million, and tax income attributable to previous years in the amount of € 2 million.

60. INCOME FROM THE ASSUMPTION OF LOSSES

The income from the assumption of losses in the previous year relates to the participation in prior-year losses attributable to silent participations (€ 39 million).

61. FEES FOR WORK BY THE STATUTORY AUDITORS

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

62. NON-DISTRIBUTABLE AMOUNTS

A total of € 522 million (previous year: € 502 million) of the reserves available for distribution are barred from being distributed. Of this amount, € 1 million (previous year: € 2 million) relates to the recognition of internally generated intangible fixed assets less the Deferred tax liabilities created in relation thereto. € 435 million (previous year: € 500 million) represents the amount by which the Deferred tax assets

recognised on the balance sheet exceed the other Deferred tax liabilities. € 86 million is attributable to the difference between the amount recognised under provisions for retirement pensions based on the ten-year average interest rate that now applies and the interest rate that applied in the past, which was based on a seven-year mean.

OTHER DISCLOSURES

63. LEASING BUSINESS

Assets related to the leasing business include € 98 million (previous year: € 106 million) shown under Loans and advances to customers. Liabilities from the leasing business amount to € 30 million (previous year: € 32 million) and are disclosed under Liabilities to customers.

64. CONTINGENT LIABILITIES AND OTHER COMMITMENTS

Contractually agreed obligations the realisation of which is unlikely as at the reporting date constitute contingent liabilities. This item mainly contains financial guarantees provided in the course of our lending business which contain a legally possible call right and it is unlikely that they will be drawn upon. Irrevocable loan commitments are reported under Other commitments. Credit guarantees and irrevocable loan commitments are subject to the Bank's loan loss provisions process (cf. Note 7). As part of this process, the relevant commitments are continually monitored on the basis of certain criteria with respect to exposure to any acute default risk. In the event there are indications that the borrower's financial situation makes the full repayment of the loan unlikely and there is a threat of a call on the guarantee, the default risk is covered by the recognition of a provision. Provisions are additionally recognised for irrevocable credit commitments where a drawdown is likely and the borrower is not expected to repay the agreed loan amount, in full or in part, due to financial difficulties. Provisions are disclosed on the liability side of the balance sheet.

Contingent liabilities or other commitments are reduced accordingly. To this extent, there is no acute credit risk for the Bank with regard to the contingent liabilities and other commitments disclosed on the balance sheet as at the reporting date.

Contingent liabilities do not include any material liabilities.

Irrevocable credit commitments mainly relate to domestic clients in the amount of € 4,674 million (previous year: € 4,459 million) and to foreign clients in the amount of € 2,063 million (previous year: € 1,947 million).

As was the case in the previous year, there were no placement or underwriting commitments as at 31 December 2016.

We also refer, with regard to future premium expense under guarantees received, to our statements in Note 3.

65. LETTERS OF COMFORT

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

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

66. OTHER FINANCIAL OBLIGATIONS

The transactions listed below include payment obligations under pending contracts or on-going debts that cannot be recognised in the balance sheet as well as other financial obligations that could have a material effect on the future financial position of HSH Nordbank AG.

As in the previous year, there are shareholder liabilities of less than € 1 million for outstanding payments on subscribed nominal capital that have not yet been called in. These liabilities are due to affiliated companies.

A new calculation methodology for determining target volumes in the guarantee scheme was approved as part of the implementation of the German Law on Deposit Insurance (EinSiG) that came into effect on 3 July 2015. The target amount to be calculated annually on the basis of the data as at 31 December of the previous year is to be raised by the member institutions by 3 July 2024 (build-up phase). The annual premium required for this is calculated by 31 May of the current year by the German Savings Banks Association (DSGV) as the association responsible for the guarantee scheme. The premium is collected before 30 September of each year. HSH Nordbank AG contributed 30% of its premium obligation for 2016 (€ 4 million) as an irrevocable payment obligation. Special or additional contributions over and above those already paid may be levied, for instance, as part of a compensation case where support is provided. The obligation to pay contributions until 2024 and any special or additional contributions represent a risk with regard to HSH Nordbank AG's financial position.

With the transposition of the Bank Recovery and Resolution Directive (BRRD) into German law a new legal basis for determining the bank levy came into force as at 1 January 2015. The target amount of the EU-wide Single Resolution Fund (SRF) is to be achieved by 1 January 2024 through contributions paid by European banks. The current levy is determined by the supervisory authorities as at 31 May of each year and is payable by 30 June. Subsequent payments are not provided for.

Further obligations in the amount of € 47 million (previous year: € 42 million) result from long-term leases for land and buildings used for business purposes. Additional obligations amounting to € 89 million (previous year: € 127 million) result from leasing agreements for IT services.

Long-term rental agreements for office space result in annual obligations of approximately € 5 million (previous year: € 8 million).

The sale of an equity holding results in obligations for the Bank to purchase fund units at the market price up to a nominal amount of € 8 million (previous year: € 8 million) and no obligation to provide indemnities (previous year: € 47 million).

The obligation to bear costs entered into by HSH Nordbank AG in connection with a loan restructuring arrangement expired in the financial year (previous year: € 8 million).

By way of a decision made on 24 June 2016, BVV Versicherungsverein des Bankgewerbes a.G. and BVV Versorgungskasse des Bankgewerbes e. V. reduced the pension payments to employees. By way of a decision made on 1 November 2016, the Management Board of HSH Nordbank AG decided to make additional pension plan contributions to BVV Versorgungskasse des Bankgewerbes e. V. in order to maintain the original benefit amount based on the individual pension commitments for these employees and prevent any pension gaps. This voluntary obligation is expected to result in additional annual contributions of less than € 1 million. As a result, the estimated payments made to BVV Versorgungskasse des Bankgewerbes e. V. amount to € 2 million.

With regard to tax risks in connection with the tax audits that are ongoing at present, there is particular uncertainty surrounding how the tax authorities will interpret current trends in the court decisions made by the fiscal courts on various tax-related issues. The Bank, however, deems its legal positions to be correct, meaning that there is no need to set up corresponding provisions in this regard.

As part of its former guarantor function the Bank also has a general liability towards Deka Bank Deutsche Girozentrale together with other former shareholders. It applies to liabilities entered into until 18 July 2001 regardless of their term.

For premium obligations resulting from the provision of guarantee facilities (second loss guarantee and synthetic securitisation transaction), we refer to our comments in Note 3.

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

67. OTHER TRANSACTIONS NECESSARY FOR AN ASSESSMENT OF THE BANK'S FINANCIAL SITUATION

As a supplemental measure to provide protection against risks, the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg granted HSH Nordbank AG a guarantee in the amount of

€ 10 billion via HSH Finanzfonds AöR. The guarantee takes effect as soon as risks in defined portfolios exceed the Bank's agreed first loss piece of € 3.2 billion (cf. Note 3).

68. NOTES ON SHAREHOLDINGS

The following list contains information on the companies in which HSH Nordbank AG holds either a direct or indirect interest:

AFFILIATED COMPANIES – FOREIGN BANKS

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
1	HSH Nordbank Securities S.A., Luxembourg, Luxembourg	100.00	100.00	EUR	198,622,729.84	7,650,121.82

AFFILIATED COMPANIES – OTHER DOMESTIC COMPANIES

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
2	BINNENALSTER-Beteiligungsgesellschaft mbH, Hamburg	100.00	100.00	EUR	269,741.15	-7,349.50
3	Bu Wi Beteiligungsholding GmbH, Hamburg	100.00	100.00	EUR	17,887.96	958.40
4	CAPCELLENCE Dritte Fondsbeteiligung GmbH, Hamburg ¹⁾	100.00	100.00	EUR	8,051,161.30	1,700,761.48
5	CAPCELLENCE Erste Fondsbeteiligung GmbH, Hamburg ¹⁾	100.00	100.00	EUR	899,332.89	-408,301.65
6	CAPCELLENCE Holding GmbH & Co. KG, Hamburg ¹⁾	100.00	100.00	EUR	121,900,969.76	-629,638.96
7	Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG, Hamburg ¹⁾	83.33	99.91	EUR	305,542.03	-153,120.52
8	Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG, Hamburg ¹⁾	83.33	99.99	EUR	1,344,327.26	-321,407.48
9	CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG, Hamburg ¹⁾	83.33	99.99	EUR	15,450,701.68	369,579.05
10	CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG, Hamburg ¹⁾	83.33	99.47	EUR	1,156,481.58	-104,459.37
11	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG, Hamburg ¹⁾	83.33	99.99	EUR	⁴⁾	⁴⁾
12	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH (formerly: CAPCELLENCE Vintage Year 12 Beteiligungen GmbH) ^{1) 7)}	100.00	100.00	EUR	13,966.97	-1,850.45
13	CAPCELLENCE Zweite Fondsbeteiligung GmbH, Hamburg ¹⁾	100.00	100.00	EUR	8,020,758.84	2,175,955.98
14	GmbH Altstadt Grundstücksgesellschaft, Mainz ^{1) 13)}	50.00	50.00	EUR	-65,200.16	107,696.20
15	GODAN GmbH, Hamburg	100.00	100.00	EUR	-1,124,839.50	-178,367.99
16	Grundstücksgesellschaft Porstendorf mbH & Co. KG, Hamburg	100.00	100.00	EUR	-2,020,716.09	-1,032.29
17	HGA New Office Campus-Kronberg GmbH & Co. KG, Hamburg	56.44	56.44	EUR	10,329,220.34	-10,893,822.20
18	HSH Auffang- und Holdinggesellschaft mbH & Co. KG, Hamburg	100.00	100.00	EUR	37,551,389.69	1,186,800.93
19	HSH Care+Clean GmbH, Hamburg ^{1) 3)}	51.00	51.00	EUR	25,000.00	-3,389.30
20	HSH Facility Management GmbH, Hamburg ²⁾	100.00	100.00	EUR	205,600.00	-39,202.31
21	HSH Gastro+Event GmbH, Hamburg ^{1) 3)}	100.00	100.00	EUR	25,000.00	-658,027.49
22	HSH Move+More GmbH, Kiel ^{1) 3)}	51.00	51.00	EUR	25,000.00	188,733.63
23	HSH Private Equity GmbH, Hamburg ²⁾	100.00	100.00	EUR	550,000.00	-921,717.94
24	Ilex Integra GmbH, Hamburg ¹⁾	100.00	100.00	EUR	-20,976,000.01	-129,009.97
25	Lyceum Capital Fund 2000 (Number Five) GmbH & Co. KG, Stuttgart ¹⁾	80.00	0.00	EUR	-233,402.29	-
26	PERIMEDES GmbH, Hamburg	100.00	100.00	EUR	26,253.53	3,204.83
27	Unterstützungs-Gesellschaft der Hamburgischen Landesbank mit beschränkter Haftung i. L., Hamburg	100.00	100.00	EUR	24,533.52	-921.07

AFFILIATED COMPANIES – OTHER FOREIGN COMPANIES

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
28	2200 Victory LLC, Dover (Kent County), USA	100.00	100.00	USD	50,729,726.00	7,119,854.00
29	Asian Capital Investment Opportunities Limited, Hong Kong, Hong Kong ¹⁾	51.00	51.00	USD	115.00	–
30	Avia Management S.à r.l., Luxembourg, Luxembourg	100.00	100.00	EUR	–26,833.03	7,077.69
31	Aviation Leasing OpCo France III, Paris, France ¹⁾	100.00	100.00	EUR	–140,320.00	–26,617.00
32	Aviation Leasing OpCo France IV, Paris, France ¹⁾	100.00	100.00	EUR	–39,145.00	–17,872.00
33	DEERS Green Power Development Company, S.L., Madrid, Spain ¹⁾	100.00	100.00	EUR	–32,004,545.00	–1,528,998.00
34	European Capital Investment Opportunities Limited, St. Helier, Jersey ¹⁾	51.00	51.00	EUR	110.00	15.00
35	FSL Asset Management Pte. Ltd., Singapore, Singapore ¹⁾	100.00	100.00	USD	813,685.00	–111,083.00
36	FSL Holdings Pte. Ltd., Singapore, Singapore ¹⁾	100.00	100.00	USD	–2,664,602.00	1,975,821.00
37	FSL Trust Management Pte. Ltd., Singapore, Singapore ¹⁾	100.00	100.00	USD	1,716,341.00	1,216,817.00
38	HSH N Finance (Guernsey) Limited, St. Peter Port, Guernsey	100.00	100.00	EUR	669,139.00	–85,811.00
39	HSH N Funding II, George Town, Cayman Islands	56.33	100.00	USD	654,305,988.00	36,276,800.00
40	HSH N Residual Value Ltd., Hamilton, Bermuda	100.00	100.00	USD	3,576,064.00	–110,438.00
41	HSH N Structured Situations Limited, St. Helier, Jersey ⁶⁾	100.00	100.00	USD	351,241.00	10,805.00
42	ISM Agency, LLC, New York, USA ¹⁾	100.00	100.00	USD	⁵⁾	⁵⁾
43	Neptune Finance Partner II S.à.r.l., Luxembourg, Luxembourg ¹⁰⁾	100.00	100.00	USD	2,462,763.63	2,440,763.63
44	Neptune Finance Partner S.à.r.l., Luxembourg, Luxembourg	100.00	100.00	USD	73,894.70	73,519.63
45	Next Generation Aircraft Finance 2 S.à.r.l., Findel, Luxembourg ^{1) 14)}	49.00	49.00	EUR	–9,194,273.00	–2,510,795.00
46	Next Generation Aircraft Finance 3 S.à.r.l., Findel, Luxembourg ^{1) 14)}	49.00	49.00	EUR	–10,671,955.00	–2,442,221.00
47	NORDIC BLUE CONTAINER V LIMITED, Majuro, Marshall Islands	100.00	100.00		⁵⁾	⁵⁾
48	RESPARCS Funding Limited Partnership I, Hong Kong, Hong Kong ¹⁾	0.01	100.00	USD	–7,240,612.00	–1,225,325.00
49	RESPARCS Funding II Limited Partnership, St. Helier, Jersey ¹⁾	0.01	100.00	EUR	–243,646,987.00	–683,677.00
50	Solar Holdings S.à r.l., Luxembourg, Luxembourg	100.00	100.00	EUR	–26,581,986.26	–4,640,871.13

EQUITY HOLDINGS IN NON-AFFILIATED COMPANIES

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
51	4Wheels Management GmbH, Düsseldorf ^{1) 8)}	68.75	40.00	EUR	13,733,996.12	-106,160.06
52	AGV Irish Equipment Leasing No. 4 Limited, Dublin, Ireland ¹²⁾	100.00	100.00	USD	500.00	-17,382.00
53	AGV Irish Equipment Leasing No. 7 Limited, Dublin, Ireland ¹⁾	49.00	49.00	USD	76,804.00	4,813,588.00
54	AKA Ausfuhrkredit-Gesellschaft mbH, Frankfurt am Main	1.33	1.33	EUR	212,967,103.15	16,035,000.00
55	Amentum Aircraft Leasing No. Five Limited, Dublin, Ireland ¹⁾	49.00	49.00	USD	-17,098,100.00	-3,127,784.00
56	Amentum Aircraft Leasing No. Seven Limited, Dublin, Ireland ¹⁾	49.00	49.00	USD	3,862,089.00	1,317,576.00
57	Amentum Aircraft Leasing No. Six Limited, Dublin, Ireland ¹⁾	49.00	49.00	USD	-10,141,899.00	595,120.00
58	Amentum Aircraft Leasing No. Ten Limited, Dublin, Ireland ^{1) 7)}	49.00	49.00	USD	-6,521,915.00	-2,858,784.00
59	Amentum Aircraft Leasing No. Three Limited, Dublin, Ireland ¹⁾	49.00	49.00	USD	-15,046,554.00	-1,175,030.00
60	Aprel Shipping (MI) Inc., Majuro, Marshall Islands	15.00	15.00	USD	4,953,000.00	5,548,000.00
61	Arzel Shipping (MI) Inc., Majuro, Marshall Islands	15.00	15.00	USD	14,343,000.00	6,258,000.00
62	Börse Düsseldorf AG, Düsseldorf	0.89	0.89	EUR	52,746,704.62	472,746.76
63	BRINKHOF Holding Deutschland GmbH, Erfurt ¹⁾	100.00	0.00		¹¹⁾	¹¹⁾
64	CapVis Equity III L.P., St. Helier, Jersey ¹⁾	2.50	0.00	EUR	408,156,000.00	43,738,000.00
65	Concardis GmbH, Eschborn	2.82	2.82	EUR	74,914,467.89	24,201,836.30
66	CVC European Equity Partners V (A) L.P., George Town, Cayman Islands ¹⁾	0.45	0.00		⁵⁾	⁵⁾
67	Deutsche WertpapierService Bank AG, Frankfurt am Main	2.51	2.51	EUR	182,463,038.56	11,127,973.52
68	EURO Kartensysteme GmbH, Frankfurt am Main	2.82	2.82	EUR	329,788,080.07	65,637.36
69	First Ship Lease Trust, Singapore, Singapore ¹⁾	25.19	25.19	USD	278,182,000.00	14,147,000.00
70	FSP CAPCELLENCE Beteiligungs GmbH, Hamburg ¹⁾	100.00	40.00	EUR	⁴⁾	⁴⁾
71	GB Deutschland Fund GmbH & Co. KG, Hamburg ¹⁾	4.69	0.00	EUR	17,688,000.00	-6,517,000.00
72	GLB GmbH & Co. OHG, Frankfurt am Main	15.77	15.77	EUR	5,423,813.50	729,100.85
73	GLB-Verwaltungs-GmbH, Frankfurt am Main	15.80	15.80	EUR	49,752.16	2,263.60
74	Global Format GmbH & Co. KG, Munich	28.57	28.57	EUR	1,821,428.72	300,491.75
75	Hamburgische Grundbesitz und Anlage GmbH & Co. Objekte Hamburg und Potsdam KG, Hamburg	5.15	5.16	EUR	9,999,359.85	1,059,994.97
76	Hapag-Lloyd Aktiengesellschaft, Hamburg	1.63	1.63	EUR	5,046,200,000.00	113,900,000.00
77	HCI Hammonia Shipping AG, Hamburg	6.60	6.60	EUR	1,864,000.00	1,768,000.00
78	HGA Objekt Frankfurt GmbH & Co. KG, Hamburg	5.97	5.97	EUR	16,071,951.06	14,471,536.75
79	HGA Objekt München GmbH & Co. KG, Hamburg	5.23	5.23	EUR	9,934,058.53	-1,468,807.32
80	HGA Objekt Stuttgart GmbH & Co. KG, Hamburg	7.25	7.26	EUR	10,169,843.94	471,406.64
81	HGA Objekte Hamburg und Hannover GmbH & Co. KG, Hamburg	5.10	5.09	EUR	4,832,393.52	4,613,393.42
82	Hines European Development Fund Limited Partnership, Houston, USA ¹⁾	9.90	9.90	EUR	65,879,000.00	152,574,000.00
83	Kontora Family Office GmbH, Hamburg ¹³⁾	51.00	51.00	EUR	1,256,715.81	330,618.83
84	Liquiditäts-Konsortialbank GmbH i.L., Frankfurt am Main ⁹⁾	1.68	1.68	EUR	230,536,114.28	-5,996,151.33
85	RSU Rating Service Unit GmbH & Co KG, Munich	13.60	13.60	EUR	14,279,529.49	1,158,674.44
86	Scan Energy, Frederikshavn, Denmark	7.61	7.61		¹¹⁾	¹¹⁾
87	Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T. SCRI), La Hulpe, Belgium	0.04	0.04	EUR	387,876,000.00	19,498,000.00
88	True Sale International GmbH, Frankfurt am Main	7.69	7.69	EUR	4,763,001.53	70,864.16
89	UNI-ASIA HOLDINGS LIMITED, Grand Cayman, Cayman Islands	2.66	2.66	USD	140,174,000.00	3,520,000.00
90	Vofü-Fonds I Hamburgische Grundbesitz und Anlage GmbH & Co. KG, Hamburg	5.10	5.09	EUR	-802,385.90	1,223,488.33

¹⁾ Indirect holding.

²⁾ A profit transfer agreement with the company is in place.

³⁾ There is a profit transfer agreement with HSH Facility Management GmbH.

⁴⁾ No information available due to newly established company.

⁵⁾ No data available.

⁶⁾ Only data as at 31 December 2010 is available.

⁷⁾ Only data as at 31 December 2014 is available.

⁸⁾ Only data as at 31 July 2015 is available.

⁹⁾ Only data as at 2 November 2015 is available.

¹⁰⁾ Only data as at 9 December 2015 is available.

¹¹⁾ No information available due to insolvency of the company.

¹²⁾ Based on the contractual arrangement this is not an affiliated company, although HSH Nordbank AG holds 100% of the voting rights.

¹³⁾ This is not an affiliated company due to the requirement for a qualified majority of voting rights for important decisions.

¹⁴⁾ Based on the contractual arrangement this is an affiliated company, although HSH Nordbank AG does not hold the majority of the voting rights.

**FOREIGN EXCHANGE RATES FOR € 1 AS AT
31 DECEMBER 2016**

USA	USD	1.0541

HSH Nordbank AG is the general partner of GLB GmbH & Co. OHG, Frankfurt am Main.

There are no equity holdings exceeding five per cent of the voting rights in large corporations.

69. NOTES ON FOREIGN CURRENCIES

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

(€ k)	31.12.2016	31.12.2015
Assets	25,027,952	32,880,808
Liabilities	14,714,173	11,699,702

70. INFORMATION ON THE NET BALANCE SHEET PRESENTATION

The netting of the fair values of trading portfolio derivatives traded over the counter against the cash collateral provided and received had the following impact with regard to the transactions included in the netting process:

(€ k)	31.12.2016			31.12.2015		
	Value before netting	Netting	Value after netting	Value before netting	Netting	Value after netting
Trading portfolio (assets)						
of which: derivative financial instruments	3,413,400	3,397,673	15,727	3,245,006	3,228,042	16,964
Other assets	3,053,242	966,415	2,086,827	3,551,482	1,707,420	1,844,062
Total assets	6,466,642	4,364,088	2,102,554	6,796,488	4,935,462	1,861,026
Trading portfolio (liabilities)						
of which: derivative financial instruments	4,127,185	4,111,654	15,531	4,817,545	4,757,469	60,076
Other liabilities	411,097,239	252,434	410,844,805	444,560,624	177,993	444,382,631
Total equity and liabilities	415,224,424	4,364,088	410,860,336	449,378,169	4,935,462	444,442,707

71. DERIVATIVES BUSINESS

The following section presents the business conducted by HSH Nordbank AG in the area of derivative financial instruments (forward transactions within the meaning of Section 36 RechKredV) as at the reporting date.

Transactions held in the non-trading portfolio serve mainly to hedge interest, currency exchange rate or market price fluctuations. The following overview of the non-trading portfolio does not include derivatives that are a component of accounting valuation units (the nominal volume of these derivatives amounted to € 4,555 million as at 31 December 2016, previous year: € 5,790 million).

The following tables show, in addition to the nominal amounts of the contracts with counterparties outside of HSH Nordbank AG, the term structure and counterparty classification, broken down into interest rate risk, interest rate and foreign exchange risks, foreign exchange risks and other price risks. In addition, the following tables contain information on non-concluded foreign-currency-related, interest-dependent and other forward transactions as defined under Section 36 RechKredV.

I. Presentation of volumes and market values

TRADING PORTFOLIO

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Interest rate swaps	165,402	180,967	4,730	5,063	3,609	4,468
FRA	-	-	-	-	-	-
Interest rate options	-	-	-	-	-	-
Swaptions						
Long positions	2,847	3,381	150	131	24	31
Short positions	3,564	4,305	2	4	217	222
Caps, floors	7,569	7,653	40	54	27	36
Exchange-traded contracts	383	1,115	-	-	-	-
Other forward interest rate transactions	217	326	15	15	33	32
Interest rate risks	179,982	197,747	4,937	5,267	3,910	4,789
Interest rate/currency swaps	15,152	19,992	230	209	270	247
Interest rate and foreign exchange risks	15,152	19,992	230	209	270	247
Forward exchange transactions	2,158	2,068	61	45	58	50
Currency options						
Long positions	494	633	28	30	-	-
Short positions	685	905	-	-	19	50
Foreign exchange risks	3,337	3,606	89	75	77	100
Equity options						
Long positions	58	88	51	23	-	-
Short positions	60	91	-	-	51	23
Forward equity transactions	-	-	-	-	-	-
Exchange-traded contracts	6	5	-	-	-	-
Equity/index-based swaps	-	-	-	-	-	-
Commodity-based transactions	-	10	-	36	-	36
Equity and other price risks	124	194	51	59	51	59
Collateral provider	23	23	-	-	-	-
Collateral taker	168	186	26	30	-	-
Credit derivatives	191	209	26	30	-	-
Structured products	2,003	2,504	156	163	249	155
Total	200,789	224,252	5,489	5,803	4,557	5,350

NON-TRADING PORTFOLIO

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Interest rate swaps	4,403	5,401	207	247	829	925
FRA	-	-	-	-	-	-
Interest rate options	-	-	-	-	-	-
Swaptions						
Long positions	-	-	-	-	-	-
Short positions	-	-	-	-	-	-
Caps, floors	143	142	-	-	-	-
Exchange-traded contracts	2,509	1,121	-	-	-	-
Other forward interest rate transactions	-	42	-	-	-	-
Interest rate risks	7,055	6,706	207	247	829	925
Interest rate/currency swaps	164	254	-	-	125	151
Interest rate and foreign exchange risks	164	254	-	-	125	151
Forward exchange transactions	9,309	10,369	18	132	74	24
Currency options						
Long positions	73	73	29	29	-	-
Short positions	100	100	-	-	40	40
Foreign exchange risks	9,482	10,542	47	161	114	64
Equity options						
Long positions	13	19	1	3	-	-
Short positions	-	-	-	-	-	-
Equity/index-based swaps	84	-	11	-	-	-
Commodity-based transactions	-	-	-	-	-	-
Equity and other price risks	97	19	12	3	-	-
Collateral provider	13	65	-	-	-	-
Collateral taker	-	-	-	-	-	-
Credit derivatives	13	65	-	-	-	-
Structured products	1,569	1,260	33	40	243	233
Total	18,380	18,846	299	451	1,311	1,373

II. Breakdown by counterparty**TRADING AND NON-TRADING PORTFOLIO**

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
OECD banks	115,582	150,064	2,745	3,179	4,109	5,246
Non-OECD banks	87	215	3	4	-	-
Non-banks (incl. stock exchanges)	97,964	87,008	2,760	2,838	1,421	1,187
Public authorities	5,536	5,811	280	233	338	290
Total	219,169	243,098	5,788	6,254	5,868	6,723

III. Breakdown by maturity

TRADING AND NON-TRADING PORTFOLIO

(€ m)	Interest rate risks		Credit risks		Foreign exchange risks		Equity and other price risks		Structured products	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
Residual maturity										
Up to 3 months	17,070	19,076	-	-	10,689	11,726	9	8	45	123
Up to 1 year	46,385	29,795	45	50	1,937	1,547	4	66	334	305
Up to 5 years	90,205	122,849	38	90	193	875	198	132	1,220	1,468
Over 5 years	48,693	52,979	121	134	-	-	10	7	1,973	1,868
Total	202,353	224,699	204	274	12,819	14,148	221	213	3,572	3,764

Carrying amounts of derivative financial instruments held in the non-trading portfolio

Derivatives held in the non-trading portfolio are in principle not recognised as they are pending transactions. There are exceptions in cases where HSH Nordbank AG has paid option premiums as a purchaser or has received option premiums as the seller. These are capitalised under Other assets/are expensed under Other liabilities. In

addition, the recognition of provisions for contingent losses may be necessary where the individual valuation of derivatives results in negative market values. Furthermore, reconciliation items are recorded for currency transactions. As of 31 December 2016, the net amount of reconciliation items shown under Other assets amounted to € 15 million (previous year: € 127 million) and the reconciliation items shown under Other liabilities amounted to € 108 million (previous year: € 106 million).

(€ m)	Option premiums paid		Option premiums received	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Interest rate contracts	-	-	-	-
Currency contracts	10	10	11	11
Equity and other contracts	7	9	-	-
Total	17	19	11	11

We have created provisions for contingent losses in the amount of € 28 million (previous year: € 29 million) for derivative financial

instruments outside of the trading portfolio with regard to which an effective hedging relationship could not be shown.

72. INFORMATION IN ACCORDANCE WITH SECTION 28 OF THE MORTGAGE BOND ACT (PFANDBRIEFGESETZ)

The total amount of mortgage bonds, public-sector bonds and ship mortgage bonds in circulation, and the corresponding cover funds, stated in terms of the nominal value, net present value and risk-adjusted present value in accordance with PfandBarwert¹⁾ are as follows:

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Mortgage bonds	5,067	5,048	5,308	5,303	5,308	5,358
Cover funds	5,703	5,443	6,117	5,845	6,098	5,855
thereof: derivatives	-	-	-	-	-	-
Surplus coverage	636	395	809	542	790	497

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Public-sector mortgage bonds	3,802	4,397	4,684	5,322	4,358	4,912
Cover funds	4,222	4,752	5,475	5,976	4,873	5,287
thereof: derivatives	-	-	-	-	-	-
Surplus coverage	420	355	791	654	515	375

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Ship mortgage bonds	1,553	2,730	1,581	2,778	1,549	2,749
Cover funds	2,248	3,157	2,393	3,330	2,109	2,883
thereof: derivatives	-	-	-	-	-	-
Surplus coverage	695	427	812	552	560	134

COMPOSITION OF THE ADDITIONAL COVER ASSETS

(€ m)	Equalisation claims	Receivables within the meaning of Section 19 (1) No. 2 PfandBG			Mortgage bonds
		Total	thereof covered debentures	Receivables within the meaning of Section 19 (1) No. 3 PfandBG	Total
Registered receivables 2016					
Germany	-	20	-	906	926
Total	-	20	-	906	926

As in the previous year, there were no receivables that exceeded the limits set out in Section 19 (1) of the German Mortgage Bonds Act (Pfandbriefgesetz PfandBG).

¹⁾ Statutory Order on the Provision of Collateral for the Current Coverage of Mortgage Bonds, Public-sector Mortgage Bonds and Ship Mortgage Bonds according to Net Present Value and its Calculation at Mortgage Credit Banks dated 14 July 2005.

(€ m)	Receivables within the meaning of Section 19 (1) No. 2 PfandBG			Receivables within the meaning of Section 19 (1) No. 3 PfandBG	Mortgage bonds
	Equalisation claims	Total	thereof covered debentures		Total
Registered receivables 2015					
Germany	–	108	–	750	858
Total	–	108	–	750	858

(€ m)	Receivables within the meaning of Section 20 (2) No. 2 PfandBG			Public-sector mortgage bonds
	Equalisation claims	Total	thereof covered debentures	Total
Registered receivables 2016				
Germany	–	9	–	9
Total	–	9	–	9

As in the previous year, there were no receivables that exceeded the limits set out in Section 20 (2) of the German Mortgage Bonds Act (Pfandbriefgesetz PfandBG).

(€ m)	Receivables within the meaning of Section 20 (2) No. 2 PfandBG			Public-sector mortgage bonds
	Equalisation claims	Total	thereof covered debentures	Total
Registered receivables 2015				
Germany	–	9	–	9
Total	–	9	–	9

(€ m)	Receivables within the meaning of Section 26 (1) No. 3 PfandBG			Receivables within the meaning of Section 26 (1) No. 4 PfandBG	Ship mortgage bonds
	Equalisation claims	Total	thereof covered debentures		Total
Registered receivables 2016					
Germany	–	–	–	75	75
Austria	–	–	–	–	–
Total	–	–	–	75	75

As in the previous year, there were no receivables that exceeded the limits set out in Section 26 (1) of the German Mortgage Bonds Act (Pfandbriefgesetz PfandBG).

(€ m)	Receivables within the meaning of Section 26 (1) No. 3 PfandBG			Receivables within the meaning of Section 26 (1) No. 4 PfandBG	Ship mortgage bonds
	Equalisation claims	Total	thereof covered debentures		
Registered receivables 2015					
Germany	-	-	-	130	130
Austria	-	-	-	-	-
Total	-	-	-	130	130

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

(€ m)	Mortgage bonds		Cover funds	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Nominal value				
Up to 6 months	545	644	508	198
Between 6 and 12 months	142	186	529	432
Between 12 and 18 months	9	545	235	407
Between 18 months and 2 years	585	143	554	513
Between 2 years and 3 years	898	594	495	832
Between 3 years and 4 years	716	898	796	599
Between 4 years and 5 years	646	716	734	746
Between 5 years and 10 years	1,526	1,322	1,795	1,591
More than 10 years	-	-	57	125
Total	5,067	5,048	5,703	5,443

(€ m)	Public-sector mortgage bonds		Cover funds	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Nominal value				
Up to 6 months	216	873	130	261
Between 6 and 12 months	199	131	176	348
Between 12 and 18 months	108	266	38	130
Between 18 months and 2 years	624	149	168	138
Between 2 years and 3 years	322	733	218	326
Between 3 years and 4 years	219	320	195	285
Between 4 years and 5 years	602	218	194	164
Between 5 years and 10 years	800	756	905	626
More than 10 years	712	951	2,198	2,474
Total	3,802	4,397	4,222	4,752

(€ m)	Ship mortgage bonds		Cover funds	
	31.12.2016	31.12.2015	31.12.2016	31.12.2015
Nominal value				
Up to 6 months	247	300	398	675
Between 6 and 12 months	143	200	179	411
Between 12 and 18 months	515	239	294	346
Between 18 months and 2 years	540	393	158	321
Between 2 years and 3 years	35	1,255	380	530
Between 3 years and 4 years	15	235	393	388
Between 4 years and 5 years	30	15	204	289
Between 5 years and 10 years	28	93	236	184
More than 10 years	-	-	6	13
Total	1,553	2,730	2,248	3,157

The proportion of fixed-interest-bearing cover assets in the corresponding cover funds and the ratios of fixed-interest-bearing bonds to the liabilities to be covered are as follows:

(in %)	Mortgage bonds	
	31.12.2016	31.12.2015
Proportion of fixed interest-bearing cover funds	36	37
Ratio of fixed interest-bearing bonds	97	93

(in %)	Public-sector mortgage bonds	
	31.12.2016	31.12.2015
Proportion of fixed interest-bearing cover funds	88	84
Ratio of fixed interest-bearing bonds	96	96

(in %)	Ship mortgage bonds	
	31.12.2016	31.12.2015
Proportion of fixed interest-bearing cover funds	-	2
Ratio of fixed interest-bearing bonds	56	33

The following tables show the net present value for each foreign currency:

(€ m)	Mortgage bonds	
	31.12.2016	31.12.2015
Foreign currency		
CHF	9	17
GBP	86	100
JPY	5	7
SEK	18	22
USD	-	103

(€ m)	Public-sector mortgage bonds	
	31.12.2016	31.12.2015
Foreign currency		
CHF	-135	45
JPY	161	152

(€ m)	Ship mortgage bonds	
	31.12.2016	31.12.2015
Foreign currency		
CHF	16	26
JPY	-	3
USD	1,873	2,705

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

(A) MORTGAGE BOND REGISTER

(€ m)	Covering mortgages	
	31.12.2016	31.12.2015
Nominal value		
Up to € 300,000	25	25
Between € 300,000 and € 1 million	119	122
Between € 1 million and € 10 million	1,541	1,491
Over € 10 million	3,092	2,947
Total	4,777	4,585

(B) SHIP REGISTER

(€ m)	Covering mortgages	
	31.12.2016	31.12.2015
Nominal value		
Up to € 500,000	5	3
Between € 500,000 and € 5 million	270	353
Over € 5 million	1,898	2,671
Total	2,173	3,027

(C) PUBLIC-SECTOR MORTGAGE BOND

(€ m)	Covering mortgages	
	31.12.2016	31.12.2015
Nominal value		
Up to € 10 million	146	179
Between € 10 million and € 100 million	1,038	627
Over € 100 million	3,029	3,937
Total	4,213	4,743

The breakdown of loans and advances used to provide ordinary cover for mortgage bonds by the country in which the mortgaged property is located, as well as the use to which the property is put, is as follows:

(€ m)	31.12.2016	31.12.2015
Used for residential purposes	985	884
Used for commercial purposes	3,792	3,701

(€ m)		Single and semi-detached dwellings	Multiple dwellings	Office buildings	Retail properties	Industrial premises	Other commercial properties	Unfinished new-buildings	Building plots	Total
2016	Apartments									
Germany	-	3	982	1,246	1,099	2	605	263	35	4,235
France	-	-	-	363	-	-	-	-	-	363
Great Britain/ Northern Ireland/ Brit. Channel Islands	-	-	-	83	-	-	-	-	-	83
Netherlands	-	-	-	70	-	-	-	-	-	70
Austria	-	-	-	11	-	-	-	-	-	11
Sweden	-	-	-	-	15	-	-	-	-	15
Total	-	3	982	1,773	1,114	2	605	263	35	4,777

(€ m)		Single and semi-detached dwellings	Multiple dwellings	Office buildings	Retail properties	Industrial premises	Other commercial properties	Unfinished new-buildings	Building plots	Total
2015	Apartments									
Germany	-	4	880	1,250	958	2	622	99	-	3,815
Finland	-	-	-	8	-	-	-	-	-	8
France	-	-	-	373	-	-	-	-	-	373
Great Britain/ Northern Ireland/ Brit. Channel Islands	-	-	-	97	-	-	-	-	-	97
Netherlands	-	-	1	148	12	-	1	-	-	162
Austria	-	-	-	11	-	-	-	-	-	11
Sweden	-	-	-	-	18	-	-	-	-	18
USA	-	-	-	101	-	-	-	-	-	101
Total	-	4	881	1,988	988	2	623	99	-	4,585

(€ m)	31.12.2016	31.12.2015
Total of payments at least 90 days in arrears	-	-
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	-	-

Other key figures relating to the regular cover assets of the mortgage bonds:

		31.12.2016	31.12.2015
Total amount of receivables that exceed the limits set out in Section 13 (1) PfandBG	€ m	-	-
Volume-weighted average age of the receivable	in years	5	5
Average weighted loan-to-value ratio	in %	56	55

The following tables show the breakdown of the total amount of loans and advances used to cover public sector mortgage bonds based on borrowers and the countries in which the borrowers are domiciled:

(€ m)	Country		Regional public authority		Local public authority		Other		Total	thereof guarantees received for export promotion reasons
	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed		
2016										
Germany	-	15	2,184	86	311	82	140	516	3,334	137
Belgium	250	-	-	11	-	-	-	-	261	-
Great Britain/ Northern Ireland/ Brit. Channel Islands	-	-	-	-	-	-	10	-	10	-
Italy	-	-	15	-	-	-	-	-	15	-
Luxembourg	-	-	-	-	-	-	13	-	13	-
Poland	24	-	-	-	-	-	-	-	24	-
Switzerland	-	-	98	-	-	-	-	-	98	-
Austria	275	174	-	-	-	-	-	9	458	-
Total	549	189	2,297	97	311	82	163	525	4,213	137

2015	Country		Regional public authority		Local public authority		Other		Total	thereof guarantees received for export promotion reasons
	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed		
	Germany	50		2,297		283		1,061		
Belgium	250		13		-		-		263	-
Great Britain/ Northern Ireland/ Brit. Channel Islands	10		-		-		-		10	-
Italy	-		18		-		-		18	-
Luxembourg	13		-		-		-		13	-
Poland	23		-		-		-		23	-
Switzerland	-		236		-		-		236	-
Slovenia	40		-		-		-		40	-
Austria	449		-		-		-		449	-
Total	835		2,564		283		1,061		4,743	151

The following amounts are in arrears concerning these loans and advances:

2016	Country		Regional public authority		Local public authority		Other		Total
	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed	
Total of payments at least 90 days in arrears	-		-		-		-		-
Total amount of these receivables provided that the amount in arrears accounts for at least 5% of the receivable	-		-		-		-		-

2015	Country		Regional public authority		Local public authority		Other		Total
	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed	
Total of payments at least 90 days in arrears	-		-		-		-		-
Total amount of these receivables provided that the amount in arrears accounts for at least 5% of the receivable	-		-		-		-		-

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

(€ m)	31.12.2016		31.12.2015	
	Ocean-going vessels	Inland water vessels	Ocean-going vessels	Inland water vessels
Bahamas	64	–	72	–
Germany	684	–	1,021	–
Greece	120	–	139	–
Hong Kong	52	–	126	–
Liberia	365	–	491	–
Malta	168	–	257	–
Marshall Islands	439	–	600	–
Norway	2	–	4	–
Panama	94	–	130	–
Singapore	85	–	79	–
Cyprus	100	–	108	–
Total	2,173	–	3,027	–

(€ m)	31.12.2016	31.12.2015
Total of payments at least 90 days in arrears	–	–
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	–	–

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

Number 2016	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Pending foreclosures and judicially enforced receiverships	–	–	–	–	–
Foreclosures completed	–	–	–	–	–
Land and ships acquired to prevent losses	–	–	–	–	–

Number 2015	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Pending foreclosures and judicially enforced receiverships	–	–	–	–	–
Foreclosures completed	–	–	–	–	–
Land and ships acquired to prevent losses	–	–	–	–	–

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

(€ m) 2016	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Total amount of arrears on interest to be paid	-	-	-	-	-

(€ m) 2015	Commercial	Residential	Ocean-going vessels	Inland water vessels	Total
Total amount of arrears on interest to be paid	-	-	-	-	-

Of loans and advances to banks, the amount of € 377 million (previous year: € 447 million) and € 14,388 million of loans and advances to customers (previous year: € 15,793 million) are used to cover debentures issued.

73. FINANCIAL TRANSACTIONS ENTERED INTO WITH SELECTED STATES

The following overviews show our exposures to states for which an increased economic risk is assumed. They present the risk directly attributable to the listed European countries. The income statement

effects are only shown for the original positions, i.e. without taking the measurement results of the hedging derivatives into account.

(€ m)				
	Gross carrying amount of financial assets	Accumulated valuation allowance affecting P&L	Carrying amount of financial assets following valuation allowance	Fair value of assets
31.12.2016				
Portugal	253	7	246	238
Public sector	231	-	231	224
Corporates/Other	22	7	15	14
Italy	876	100	776	888
Public sector	295	-	295	426
Corporates/Other	581	100	481	462
Greece	1,428	291	1,182	1,108
Corporates/Other	1,428	291	1,182	1,108
Russia	73	-	73	73
Corporates/Other	73	-	73	73
Spain	1,369	126	1,242	1,250
Public sector	158	-	158	159
Banks	18	-	18	18
Corporates/Other	1,193	126	1,066	1,073
Cyprus	1,145	524	621	520
Corporates/Other	1,145	524	621	520
Croatia	100	-	100	102
Corporates/Other	100	-	100	102
Turkey	389	7	382	344
Banks	10	-	10	10
Corporates/Other	379	7	372	334
Total	5,633	1,055	4,622	4,523

(€ m)				
	Gross carrying amount of financial assets	Accumulated valuation allowance affecting P&L	Carrying amount of financial assets following valuation allowance	Fair value of assets
31.12.2015				
Portugal	261	6	255	262
Public sector	231	–	231	241
Banks	5	–	5	4
Corporates/Other	25	6	19	17
Italy	909	93	816	954
Public sector	298	–	298	446
Banks	8	–	8	8
Corporates/Other	603	93	510	500
Greece	1,114	99	1,015	1,016
Corporates/Other	1,114	99	1,015	1,016
Russia	95	17	78	78
Corporates/Other	95	17	78	78
Spain	1,469	102	1,367	1,351
Public sector	163	–	163	165
Banks	17	–	17	17
Corporates/Other	1,289	102	1,187	1,169
Cyprus	1,393	447	946	944
Corporates/Other	1,393	447	946	944
Croatia	106	–	106	104
Corporates/Other	106	–	106	104
Turkey	482	133	349	347
Banks	10	–	10	10
Corporates/Other	472	133	339	337
Total	5,829	897	4,932	5,056

74. AVERAGE NUMBER OF EMPLOYEES

The average number of employees as of the reporting date is calculated based on quarterly levels and on a per capita basis:

	2016			2015		
	Male	Female	Total	Male	Female	Total
Full-time employees	1,147	435	1,582	1,265	486	1,751
Part-time employees	113	477	590	116	491	607
Total	1,260	912	2,172	1,381	977	2,358
Apprentices/trainees	20	14	34	24	12	36

75. CORPORATE GOVERNANCE

HSH Nordbank AG supports the aims of the German Corporate Governance Code and has recognised the Code's rules on a voluntary basis as an unlisted company. The Management Board and Supervisory Board of HSH Nordbank AG have given a declaration of con-

formity pursuant to Section 161 AktG and have made it available to the shareholders. The declaration of conformity is published on HSH Nordbank AG's website and printed in the 2016 Annual Report.

76. REMUNERATION PAID TO MEMBERS OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD

In accordance with the decision of the EU Commission of 20 September 2011 concerning state aid the remuneration of the members of the Management Board of HSH Nordbank AG is limited for each board member to a maximum of € 500,000 per annum (total fixed remuneration). Remuneration payable for secondary employment undertaken at the request of the Supervisory Board is set off against the remuneration entitlement set out in the employment contract. Furthermore, each board member receives pension benefits in the amount of 20% of the annual fixed income, as well as reasonable benefits in kind.

It is planned to add a variable remuneration component to the Management Board's remuneration system as soon as the Bank is able to pay dividends again and the reorganisation phase pursuant to the decisions of the EU Commission of 20 September 2011/2 May 2016 has been successfully completed. The Bank does not offer additional long-term incentives such as share option schemes.

The following table shows the remuneration of active and former members of executive bodies. Total remuneration for members of the Management Board includes short-term benefits as well as payments to pension schemes.

REMUNERATION OF EXECUTIVE BODIES

(€ k)	2016	2015
Total remuneration of active members of executive bodies		
Management Board	3,024	3,420
Supervisory Board	477	467
Total	3,501	3,887
Total remuneration of former members of executive bodies and their surviving dependants		
Management Board	3,708	2,751

As at 31 December 2016, a total amount of €k 42,673 (previous year: €k 43,979) was shown in provisions for pension obligations relating to former members of the Management Board and their surviving dependants.

As was the case in the previous year, there were no advances, loans and other liabilities to members of the Management Board as at 31 December 2016. Advances, loans and other liabilities to members of the Supervisory Board amounted to €k 150 (previous year: €k 469). In the 2016 reporting year no new loans were granted to members of the Supervisory Board.

The loans granted to members of the Supervisory Board relate to real estate financings. Loans to members of the Supervisory Board were granted with maturities from variable to final maturity in 2036. Loans to members of the Supervisory Board were at arm's length conditions with interest rates between 4.45% and 6.90%.

Collateral for loans is in the form of land charges for real estate financing. Repayments of loans by members of the Supervisory Board amount to €k 319 in total in 2016 (previous year: €k 30).

The members of the Supervisory Board receive remuneration for their service during a financial year in an amount determined by the Annual General Meeting of the following year. The remuneration for the Supervisory Board for the 2015 financial year was therefore paid in the 2016 reporting period. Appropriate provisions have been recognised in the 2016 Annual Accounts for the 2016 reporting year.

The remuneration system is based on the requirements of the German Corporate Governance Code and is organised as follows after the resolution of the Annual General Meeting of HSH Nordbank AG on 23 May 2014 and applies to the term of office of the Supervisory Board that has started on 23 May 2014:

(€)			
Executive body	Function	Fixed component	Attendance fee
Supervisory Board	Chair	25,000	250
	Deputy Chair	18,000	250
	Member	11,000	250
Risk Committee	Chair	15,000	250
	Member	7,000	250
Executive Committee	Chair	15,000	250
	Member	7,000	250
Audit Committee	Chair	15,000	250
	Member	7,000	250
Remuneration Monitoring Committee	Chair	12,000	250
	Member	5,000	250

The Mediation Committee to be formed under the German Co-determination Act of 1976 (*Mitbestimmungsgesetz*) does not receive any separate remuneration. Members of the Supervisory Board are also reimbursed for any value-added tax payable and for their expenses.

€k 550 of the amount provided for in the 2015 financial year (€k 556, thereof value-added tax: €k 89), was paid to the members of the Supervisory Board in the reporting period. This includes €k 82 of value-added tax.

€k 567 have been provided for activities of the Supervisory Board (thereof value-added tax: €k 91), which will be disbursed after the Annual General Meeting provided a corresponding resolution is

passed by the Annual General Meeting 2017. Remuneration (excluding value-added tax) is expected to be distributed among the members of the Supervisory Board as follows:

(€)	Fixed remuneration		Attendance fee		Total	
	2016	2015	2016	2015	2016	2015
Members of the Supervisory Board						
Dr Thomas Mirow, Chair	59,000	59,000	7,250	6,000	66,250	65,000
Olaf Behm, Deputy Chair	44,000	44,000	8,000	7,000	52,000	51,000
Stefanie Arp	18,000	18,000	2,750	3,250	20,750	21,250
Sabine-Almut Auerbach ¹⁾	2,712	11,000	500	2,250	3,212	13,250
Peter Axmann ²⁾	18,000	7,540	3,000	1,500	21,000	9,040
Simone Graf	30,000	30,000	7,250	6,000	37,250	36,000
Silke Grimm	16,000	16,000	2,000	2,500	18,000	18,500
Torsten Heick ³⁾	–	8,926	–	1,750	–	10,676
Cornelia Hintz ⁴⁾	6,841	–	1,500	–	8,341	–
Stefan Jütte	26,000	26,000	3,250	3,000	29,250	29,000
Dr Rainer Klemmt-Nissen	30,000	30,000	7,250	6,000	37,250	36,000
Rieka Meetz-Schawaller	18,000	18,000	3,750	3,000	21,750	21,000
Dr David Morgan ⁵⁾	25,000	25,000	5,250	4,500	30,250	29,500
Dr Philipp Nimmermann	30,000	30,000	6,500	5,250	36,500	35,250
Stefan Schlatermund	18,000	18,000	3,500	3,250	21,500	21,250
Klaus-Dieter Schwetscher ⁵⁾	11,000	10,699	2,250	2,000	13,250	12,699
Elke Weber-Braun	26,000	26,000	3,500	3,250	29,500	29,250
Jörg Wohlers	25,000	24,118	5,750	4,750	30,750	28,868
Total	403,553	402,283	73,250	65,250	476,803	467,533

¹⁾ Until 31 March 2016.

²⁾ From 14 July 2015.

³⁾ Until 30 June 2015.

⁴⁾ From 18 May 2016.

⁵⁾ From 10 January 2015.

⁶⁾ Amounts before deduction of Supervisory Council tax and solidarity surcharge.

The members of the Supervisory Board have not provided any advisory or brokerage services or any other personal services to the Bank

in the year 2016. Accordingly no additional remunerations were granted.

77. SEATS ON SUPERVISORY BODIES

On the reporting date, the following seats were held on statutorily required supervisory bodies of large corporations or financial institutions:

(a) Members of the Management Board

Ulrik Lackschewitz

HSH Nordbank Securities S.A., Luxembourg
Chairman of the Administrative Board

(b) Number of employees

Peter Axmann

Sprinkenhof GmbH, Hamburg
Member of the Supervisory Board

Patrick Miljes

Buss Investment GmbH, Hamburg
Member of the Supervisory Board

Thomas Rabehl

HSH Nordbank Securities S.A., Luxembourg
Member of the Administrative Board

Katrin Wächter

Technosis AG, Hamburg
Member of the Supervisory Board

78. THE SUPERVISORY BOARD OF HSH NORDBANK AG

Dr Thomas Mirow, Hamburg

Chair
Former President of the European Bank for Reconstruction and Development, London

Olaf Behm, Hamburg

Deputy Chair
Employee of HSH Nordbank AG

Stefanie Arp, Norderstedt

Employee of HSH Nordbank AG

Sabine-Almut Auerbach, Neumünster

(until 31 March 2016)
District secretary, ver.di Southern Holstein district

Peter Axmann, Hamburg

Employee of HSH Nordbank AG

Simone Graf, Altenholz

Employee of HSH Nordbank AG

Silke Grimm, Reinbek

Member of the Board of Euler Hermes Deutschland AG

Cornelia Hintz, Dortmund

(from 18 May 2016)
Federal state secretary ver.di district North Rhine-Westphalia

Stefan Jütte, Bonn

Former Chairman of the Management Board of Deutsche Postbank AG

Dr Rainer Klemmt-Nissen, Hamburg

Managing Director, HGV Hamburger Gesellschaft für Vermögens- und Beteiligungsmanagement mbH

Rieka Meetz-Schawaller, Kiel

Employee of HSH Nordbank AG

Dr David Morgan, London

Managing Director J.C. Flowers & Co UK Ltd.

Dr Philipp Nimmermann, Kiel

Secretary of State at the Schleswig-Holstein Ministry of Finance

Stefan Schlatermund, Hamburg

Employee of HSH Nordbank AG

Klaus-Dieter Schwettscher, Reinbek

Representative of ver.di's federal management board

Elke Weber-Braun, Hamburg

Independent chartered accountant

Jörg Wohlers, Rellingen

Former Member of the Board of Hamburger Sparkasse AG and HASPA Finanzholding

(a) Members of the Risk Committee**Stefan Jütte**

Chair

Olaf Behm**Simone Graf****Dr Rainer Klemmt-Nissen****Rieka Meetz-Schawaller****Dr Thomas Mirow****Dr David Morgan**

(until 31 December 2016)

Dr Philipp Nimmermann

(as of 1 January 2017)

Stefan Schlatermund**(b) Members of the Audit Committee****Elke Weber-Braun**

Chair

Stefanie Arp**Peter Axmann****Olaf Behm****Dr Philipp Nimmermann****Jörg Wohlers****(c) Members of the Executive/
Nominating Committee****Dr Thomas Mirow**

Chair

Olaf Behm**Simone Graf****Dr Rainer Klemmt-Nissen****Dr David Morgan****Dr Philipp Nimmermann****Jörg Wohlers****(d) Members of the Remuneration Monitoring
Committee****Dr Thomas Mirow**

Chair

Olaf Behm**Simone Graf****Silke Grimm****Dr Rainer Klemmt-Nissen****Dr Philipp Nimmermann****(e) Members of the Mediation Committee****Dr Thomas Mirow**

Chair

Olaf Behm**Dr Rainer Klemmt-Nissen****Rieka Meetz-Schawaller**

79. THE MANAGEMENT BOARD OF HSH NORDBANK AG

Stefan Ermisch

Born in 1966
Chairman of the Management Board (as of 10 June 2016)
CFO (until 30 June 2016)

Oliver Gatzke

(since 1 July 2016)
Born in 1968
Chief Financial Officer

Ulrik Lackschewitz

Born in 1968
Chief Risk Officer

Torsten Temp

Born in 1960
Management Board member responsible for the Market divisions

Constantin von Oesterreich

(until 9 June 2016)
Born in 1953
Chair

Matthias Wittenburg

(until 9 June 2016)
Born in 1968
Corporates & Markets

Hamburg/Kiel, 14 March 2017



Stefan Ermisch



Oliver Gatzke



Ulrik Lackschewitz



Torsten Temp

AUDITOR'S REPORT

We have audited the annual financial statements - comprising the balance sheet, the income statement and the notes to the financial statements - together with the bookkeeping system, and the management report of HSH Nordbank AG for the business year from 1 January to 31 December 2016. The maintenance of the books and records and the preparation of the annual financial statements and management report in accordance with German commercial law are the responsibility of the Company's management. Our responsibility is to express an opinion on the annual financial statements, together with the bookkeeping system, and the management report based on our audit.

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

Our audit has not led to any reservations.

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

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

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

(ii) the operating company, HSH Nordbank AG, is sold at a positive sales price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge during the privatisation period, it could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

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

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

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

Hamburg, 15 March 2017

KPMG AG
Wirtschaftsprüfungsgesellschaft



Leitz
Wirtschaftsprüfer



Thiede
Wirtschaftsprüfer

RESPONSIBILITY STATEMENT BY THE MANAGEMENT BOARD

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

Hamburg/Kiel, 14 March 2017



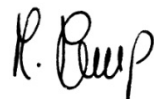
Stefan Ermisch



Oliver Gatzke



Ulrik Lackschewitz



Torsten Temp

