SOLID FACTS.
OUR FIGURES.

FINANCIAL REPORT (HGB) HSH NORDBANK AG 2017

HSH NORDBANK

BASIS OF HSH NORDBANK AG

BUSINESS ACTIVITIES

Sale of HSH Nordbank AG on 28 February 2018

The federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. With the sale of HSH Nordbank AG, the federal state owners will meet the central commitment set out in the formal decision of 2 May 2016 in the EU state aid proceedings on the replenishment of the second loss guarantee issued by the federal states at that time in a timely manner, thus laying the foundation for the first successful privatisation of a Landesbank in Germany.

The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing) at least until the end of 2021. The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

The privatisation will relieve HSH Nordbank AG of a large part of the legacy burdens bundled in the Non-Core Bank. Within this context, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017.

The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time. The successful implementation of the portfolio transaction will significantly improve the Bank's financial profile, in particular by reducing the NPE ratio to around 2%, and its capital position.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of € 10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million. The signed cancellation agreement is subject, first of all, to the condition precedent of the successful closing of the share purchase agreement, second, to corresponding notification sent to the parties to the portfolio transaction and third, as a result, to the condition precedent of the closing of the portfolio transaction.

The signed share purchase agreement, the proposed portfolio transaction and the premature termination of the second loss guarantee will influence the structure and business activities of HSH Nordbank in a variety of ways. First of all, the Bank will undergo a far-reaching transformation process that will lay the necessary foundation for the sustainable further development of the Bank's business model. Second, the Bank's net results are influenced by significant privatisation effects as at the reporting date.

Details on the privatisation process, the portfolio transaction and the second loss guarantee, as well as the associated cancellation agreement, are provided in the following sections. The opportunities and risks associated with these transactions are described in the "Forecast, opportunities and risks report" section of this management report.

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, 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.

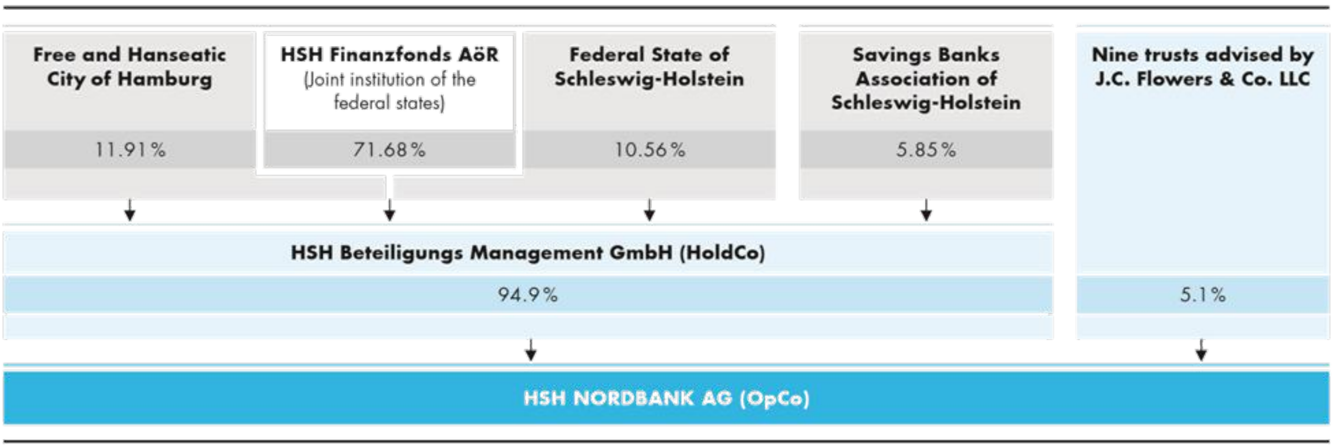
HSH Nordbank is one of the leading banking partners for upper medium-sized enterprises in the core region of Northern Germany. HSH Nordbank is also active throughout Germany primarily in the corporate and real estate clients business. The focus of the project financing business in the Corporate Clients division (Energy & Utilities and Logistics & Infrastructure business areas) is also 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 individual financing solutions and products 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 and the Non-Core Bank in line with the Bank's value creation structures. The Core Bank includes the long-term strategic business divisions. These include the Corporate Clients, Real Estate, Shipping and Treasury & Markets segments. The Non-Core Bank includes the non-strategic and predominantly non-performing legacy portfolios, most of which date back to the years prior to 2009 and which are being largely wound down as part of the privatisation process. The administrative divisions and overall bank positions are disclosed as segments not subject to reporting requirements in the "Other and Consolidation" division.

As part of the focusing 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 a representative office in Hong Kong 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, 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 2017 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.

In order to secure the Bank's survival, the federal states of Hamburg and Schleswig-Holstein issued via HSH Finanzfonds AöR a guarantee in favour of HSH Nordbank on 2 June 2009 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). In 2013, the guarantee facility 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 European Commission reached a formal decision on 2 May 2016 and thereby finally approved the replenishment of the second loss guarantee issued by the federal states. The decision is based on a catalogue of conditions and commitments provided by the Federal Republic of Germany, on behalf of the federal state owners of HSH Nordbank, to the EU Commission containing the fundamental aspects of the agreement, which include, among other things, the privatisation of HSH Nordbank AG by 28 February 2018 as a central requirement.

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.

With the sale of HSH Nordbank AG on 28 February 2018 to private investors that are independent of each other, the federal state owners meet the EU Commission's central commitment set out in the formal decision of 2 May 2016 in a timely manner.

Further details on the second loss guarantee are set out in Note 3 of the notes to the annual financial statements of HSH Nordbank AG. Details regarding the impact of the guarantee on the net assets, financial position and earnings in 2017 are set out in the "Economic report" section.

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".

FUTURE OWNERSHIP STRUCTURE

Funds initiated by **Cerberus Capital Management, L.P.**[1]			Funds initiated by **J.C. Flowers & Co. LLC**	Funds initiated by **GoldenTree Asset Management LP**	Funds initiated by **Centaurus Capital LP**	**BAWAG P.S.K.** Bank für Arbeit und Wirtschaft und Österreichische Postsparkasse Aktiengesellschaft
Promontoria Holding 221 B.V.	Promontoria Holding 231 B.V.	Promontoria Holding 233 B.V.	JCF IV Neptun Holdings S.à r.l.	GoldenTree Asset Management Lux S.à r.l.	Chi Centauri LLC	
17.0%	13.5%	12.0%				
42.5%			35.0%	12.5%	7.5%	2.5%

[1] Change of allocation of shares within the Cerberus initiated funds possible.

Membership in the German Savings Banks Finance Group

HSH Nordbank is a member institution of the German Savings Banks Finance Group. The German Savings Banks Finance Group has an institutional guarantee scheme: This scheme protects deposits held at a savings bank, Landesbank or a Landesbausparkasse. The objective of the protection scheme is to 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 designed its proven protection scheme to meet these statutory requirements, and the scheme has been recognised as a deposit guarantee fund under the EinSiG.

Due to the ongoing privatisation of HSH Nordbank AG, the guarantee scheme needs to be changed from the guarantee scheme of the German Savings Banks Finance Group to the guarantee scheme of private banks (BdB). Within this context, the Bank is aiming to achieve a seamless transition between the guarantee schemes. The closing of the privatisation process, for example, is subject to the provision that the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of 2021. At the same time, the Bank has applied for admission to the guarantee scheme of private banks. Further details can be found in the "Forecast, opportunities and risks report" section.

External influencing factors and processes

Besides the EU decision and the privatisation that was promised within this context, other relevant 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) or the real estate market, regulatory requirements and discretionary decisions made by the supervisory authorities, external ratings, assessments of capital market participants and other stakeholders, as well as the further course of the privatisation process up until the closing date.

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

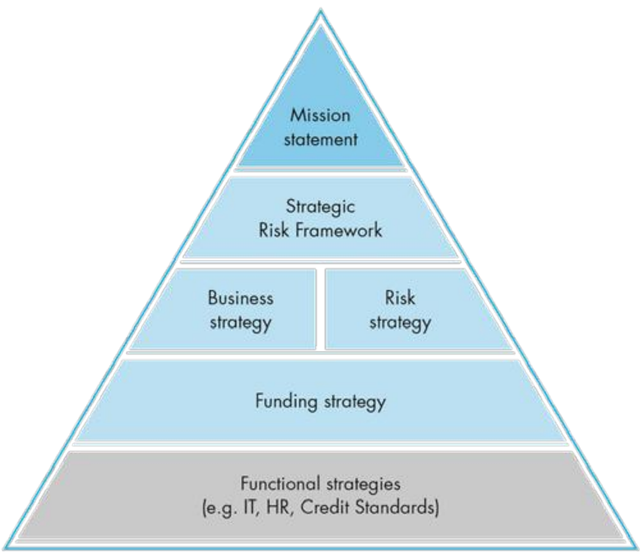
OBJECTIVES AND STRATEGY

HSH Nordbank's strategy is to be a Bank for Entrepreneurs in the larger medium-sized companies segment from the metropolitan regional base of Hamburg. Central to this perceived role is a focused and entrepreneurial approach that creates added value for clients, shareholders, the Bank and its employees.

In principle, the Bank's overarching goal is to continually develop its business model, which is firmly rooted in the northern German region. In doing so, it takes into account the requirements resulting from a rapidly changing banking environment, on the one hand. On the other hand, the Bank, which will be relieved of legacy burdens, EU restrictions and complex guarantee structures in the future, is focusing on its realignment, the aim being to create a risk-optimised and agile corporate structure. A needs-based service and product portfolio, which will be continually optimised to meet client needs, and a sustainable high-performance and efficient organisation structure of what will, in the future, be a private bank, will form the basis for this. The Bank's individual objectives are embedded in the strategic architecture.

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 the part of the Bank and the cornerstones of a sustainable risk culture. These provide the framework for the development of the Risk Appetite Statement (RAS) and the risk strategy.

Based on the risk inventory process, the RAS is split into Financial and Non-Financial RAS. It aims to provide a compressed overview of selected risk tolerance areas to determine the utilisation of the risk capacity based on various scenarios, in order to ensure that the Bank's overall objectives are met and to define the risk appetite for all major risks. Details of the bank-specific risk types are explained in the Risk report section.

The Financial RAS consists of a catalogue of key financial ratios, while the Non-Financial RAS includes qualitative requirements relating to risk culture. Operationalisation is achieved via the risk strategy and the limit system, with the risk strategy describing how risks are managed based on the risk inventory in accordance with the business strategy and RAS. It provides a framework for the sub-risk strategies (counterparty default risk, in each case for the performing and non-performing exposure, market risk, liquidity risk and NFR with reputation risk, operational and business strategy risks). The SRF forms the basis for the business strategy and provides the key basis for planning within the Bank.

Furthermore, tolerance ranges for the utilisation of risk capacity are determined on the basis of various scenarios and the risk appetite is defined for all material risks. Details of the bank-specific risk types are explained in the Risk report section.

The business strategy, which is defined by the Management Board, 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. With regard to the intended change of ownership, long-term objectives take the strategic vision of a bank that is established in a private-sector environment into account. The focal point of this strategic direction lies in ensuring sustainable profitability and a sustainable capital structure, ensuring a manageable risk profile, establishing long-standing and solid customer relationships, distributing high-quality financial products and services, as well as pursuing an active cross-selling approach.

The operating business model of HSH Nordbank is undergoing targeted further development in the light of the privatisation process. The narrow framework provided to date by the guarantee structure, the EU proceedings and the catalogue of commitments and conditions will be redefined as a result of the Bank's transition from a public-sector institution to a private bank. This will create new business potential for the strategic areas of the Core Bank and provide opportunities for the Bank to further reduce the complexity of its structure. The business potential will be described for each business area in the context of the business area strategy and backed up by specific implementation measures in the various areas. 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 of the measures required to achieve these goals.

The funding strategy establishes the framework for the strategic orientation of the refinancing of HSH Nordbank. It is a core component of the Bank's business strategy. As part of this definition process, the requirements regarding liquidity resources are geared towards sustainability to ensure that regulatory and rating requirements are met at all times and that a liability structure that is optimised from a profitability perspective is achieved. Liquidity management, particularly with regard to the ongoing privatisation process, aims to achieve an above-average level of liquidity. The refinancing of the Bank is generally based on the use of various sources of refinancing. Within this context, the Bank has been tapping into a new source of financing since the fourth quarter of 2017 by offering private clients fixed-term deposit investments via the "Deposit Solutions" online platform. This new sales channel is allowing the Bank to prepare in a proactive manner for the period after the change of ownership.

Functional strategies are defined based 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 and the Bank's digitalisation strategy 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 Bank's sustainable development. When it comes to defining and implementing them, the employees of HSH Nordbank use fundamental rules of conduct summarised in the "Code of Conduct" as a guide. The "Code of Conduct" is a binding code of behaviour. As a normative basis, it provides employees of HSH Nordbank with reliable guidance for responsible action that meets the statutory requirements but also for ethical and social standards. This allows economic, ecological and social aspects to be taken into account in a balanced way.

Summarised Separate Non-financial Report pursuant to Sections 315b, 315c in conjunction with 289b to 289e of the German Commercial Code (*Handelsgesetzbuch* – HGB)

The summarised separate non-financial report can be found on the Bank's website at www.hsh-Nordbank.de/de/hsh-Nordbank/corporate-governance and does not form part of this management report.

Realignment of the Bank

As part of its realignment, according to the business plan the Bank is focusing on expanding its existing client relationships and business areas within a bank that will be free from EU restrictions. The regional business model will be developed further and the existing sector focus will be strengthened, particularly among clients from the medium-sized companies segment. There are also plans to further expand the real estate financing business (in Germany, but also on a selective basis abroad) and the international project financing business (in particular renewable energy and infrastructure), and to adopt a focused business approach in the ship financing segment. At the same time, the Bank is aiming to use a risk-optimised organisational structure that will be relieved of legacy burdens and the guarantee structure to reduce complexity considerably and achieve improvements in its business and operating model as a result.

The activities associated with the Bank's realignment are bundled in the Bank-wide transformation project "Reset & Go". This project involves reviewing cross-divisional products and processes, as well as organisational and cost structures, and adjusting them further to meet the needs of a medium-sized bank. Particular emphasis is being placed on establishing HSH Nordbank AG, which will be operating under a new brand with a new name after the successful closing of the privatisation process, as a client-focused and agile bank. The main focal points of the project include the development of profitable and risk-oriented growth strategies and the associated implementation plans. Collaboration between the product and customer departments is particularly important. At the same time, the Bank's operating business model is being realigned. Within this context, the reduction of complexity in processes and products, as well as in terms of the organisational structure, offers significant potential.

The strategic realignment is being combined with digital transformation. The focus in this regard is on the development of digitalised value-adding processes focusing on clients, products, the Bank's own internal business processes and corporate culture. The Bank will be pursuing a holistic and systematic approach within this context. This will mean that the Bank can design its products more efficiently and also tap into new customer groups and market potential. This will also allow processes to be streamlined on the basis of increasing automation, allowing further efficiency gains to be achieved.

The Bank's competitive realignment in the long term is characterised by strong and solid financial key figures. In this respect, the Bank has defined a strategic target vision. Within this context, the Bank is striving, as part of the realignment process, to achieve a CET1 capital ratio of at least 15 % and, following the implementation of the portfolio transaction, an NPE ratio of around 2 %. The strategic vision is that the realigned bank will have total assets of around € 55 billion, a cost-income ratio of approximately 40 % and profitability before taxes of more than 8 %. The key management indicators set out above relate, in each case, to the IFRS Group in line with the internal management system (for details, refer to the section "Management system").

Strategic targets of the Core Bank's business fields

The strategic divisions are being developed on an ongoing basis and their business portfolios and positioning are being adjusted to reflect the changing underlying conditions in the market and competitive environment.

The aim of HSH Nordbank in the planning period leading up to 2022 is to increase new business with risk-commensurate margins in accordance with the business and risk strategy. The successful completion of the privatisation process will provide numerous opportunities, taking into account the business potential that the Core Bank offers, to step up moves to expand new business and to broaden the Bank's client base. In addition to its business in the northern German core region, the Bank is planning to drive ahead with the expansion of its activities outside of Germany and across Europe for selected projects and sectors in the interests of ensuring a balanced portfolio structure. The sector focus on business with medium-sized clients is to be developed further, taking advantage of the high level of industry expertise.

Furthermore, product sales covering 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. This applies, in particular, to the intensification of syndication activities, which should result in an increase in non-interest-related income.

The aim 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 abroad is to be exploited in a focused manner. In particular with regard to conventional corporate clients, market access is being enhanced further by way of digitalisation strategies.

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 future, the Bank aims to expand cautiously its international activities with established internationally active clients of the Bank in European metropolitan regions.

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

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

The client divisions are 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.

Stringent winding-down of legacy burdens in the Non-Core Bank

The Bank significantly accelerated the operational winding-down of non-performing legacy portfolios in the reporting year and has wound down portfolios considerably. The focused winding-down strategy is a significant strategic step on the path towards a successful change of ownership. In line with the requirements that need to be met to achieve a sustainable business model in the long run, the Bank is aiming to systematically wind down the non-strategic and non-performing portfolios until it has reached a good NPE ratio of around 2%, in line with the German market average. The portfolio transaction agreed as part of the privatisation process should mean that this strategic objective can already be achieved in the current financial year.

COST REDUCTION AND INCREASE IN EFFICIENCY IN THE CONTEXT OF THE REALIGNMENT

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 2022 in view of the challenging banking environment with intensive competition and constantly increasing regulatory requirements. Within this context, it also takes into account the requirements resulting from the Bank's realignment. The objective is to achieve a sustainable, competitive cost-income ratio. As a result, HSH Nordbank is aiming to achieve a further reduction in administrative expenses and a cost/income ratio of around 40% in the medium term.

The extensive cost reduction programme implemented to date to cut administrative expenses is to be adjusted to include additional aspects in the context of the privatisation process and will continue to be implemented systematically. In this respect, the Bank is assuming the winding-down of a large part of the non-performing legacy burdens, the lifting of EU restrictions and the termination and full settlement of the second loss guarantee, allowing for substantial increases in efficiency and, as a result, the comprehensive optimisation of cost structures. This will allow the Bank to eliminate all of the expenses associated with the Non-Core Bank and the second loss guarantee, to further streamline the organisational structure and to noticeably reduce the complexity of the Bank's processes.

IT STRATEGY

Key elements of the IT strategy, which was adjusted in 2016, were successfully implemented by the end of 2017 in line with the plan. The renovated IT and telecommunications systems form the basis for innovative solutions and a continuous increase in the stability of the IT production. This means that IT has a scalable structure, meaning that it is prepared for business strategy realignment in general.

The central data platform was deployed in the reporting period and provides a consistent pool of data for key technical banking evaluations. Potential strategic courses of action for the period following a change of ownership were developed and are ready for implementation. The Bank forged ahead with the establishment of the security organisation, including necessary resource and competence enhancements.

Within the context of the further development of the business model as well as the streamlining of processes, the implementation of the digitalisation strategy will be a top priority.

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 – in line with the statutory requirements (SREP, BCBS 239). The Bank uses a risk-adjusted key indicator and ratio system for this purpose that ensures that the Bank is managed in a uniform and effective manner. The HSH Nordbank Group and HSH Nordbank AG (individual institution) is managed mainly on the basis of figures for the Group prepared in accordance with the International Financial Reporting Standards (IFRS)/the relevant prudential rules.

In addition, a multi-level contribution margin accounting system is also used to manage the individual business fields. 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".

Management indicators of the IFRS Group

The Bank's internal control system is based, also at the level of HSH Nordbank AG, on key management indicators relating to the individual value drivers of the IFRS Group. The development of these indicators is still compared, on the one hand, against the previous year and the prior-year forecast ("Economic report" section). On the other hand, their expected development in 2018 is also described ("Forecast, opportunities and risks report" section).

Compared with the previous year, the internal management indicators changed in the reporting year due to the gradual reduction in the regulatory relief effect of the second loss guarantee and its expected termination in connection with the privatisation process. As a result, the Bank is using the same-period CET1 ratio (at the level of the IFRS Group), without taking into account the regulatory relief effect of the second loss guarantee, as the key management indicator for internal control. The expression "without taking into account the regulatory relief effect" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements. The capital ratio that is calculated taking into account this hypothetical assumption is referred to as the pro forma CET1 ratio for the purposes of management reporting, and replaces the previously reported same-period CET1 ratio for management purposes (at the level of the IFRS Group).

In addition, the NPE ratio and the coverage ratio will be reported exclusively at Group level in the future. They will no longer be reported for the Non-Core Bank and Core Bank because, following the implementation of the portfolio transaction, an analysis of this ratio broken down into the Non-Core Bank and Core Bank compared with the Group will not provide any significant added informational value. With regard to the liquidity ratios, the Bank is focusing on the regulatory figures: liquidity coverage ratio (LCR) and net stable funding ratio (NSFR).

The minimum survival period in the combined stress scenario, which was previously shown among the most important key management indicators, is no longer used as the most important key management indicator within the context of internal control. As far as its most important indicators are concerned, the Bank's internal management of the liquidity situation focuses on the regulatory liquidity ratios LCR and NSFR.

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

DEFINITION OF THE MOST IMPORTANT MANAGEMENT INDICATORS

Most 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.
Pro forma 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). "Pro forma" means that the capital ratio is calculated based on the hypothetical assumption that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.
LCR **= Liquidity coverage ratio**	The LCR represents the security provided to the Bank in the event of a short-term acute liquidity stress scenario of more than 30 days by maintaining a liquidity buffer (short-term stress test ratio). The LCR is calculated as the ratio of highly liquid assets to net cash outflows over the next 30 days. It is calculated internally at subgroup level for the purposes of internal control. Unlike in the previous year, the LCR is calculated without taking the institutional protection into account, i.e. taking into account the limit on the deposit guarantee for client deposits of € 100,000 per client.
NSFR = Net stable funding ratio	The NSFR (QIS) 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). It is calculated at subgroup level for the purposes of internal control.

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	Pro forma 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, MOST 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 ensuring that the remuneration system complies with the guarantee agreement of the federal states as well as the catalogue of conditions and commitments 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 per year as long as HSH Nordbank AG is not capable of making dividend distributions is therefore implemented in the remuneration system. The options provided for in the EU decision of May 2016 regarding the adjustment of Management Board compensation were not used. The Management Board has unilaterally waived until further notice the granting of a success bonus following successful privatisation, which was granted to the Supervisory Board as part of 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 Management Board 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 the combined stress scenario, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), Core Bank's new business volume, net income before taxes of the Core Bank, net income before taxes and total assets of the Non-Core Bank – are not reconciled accordingly as these are not determined for the single entity.

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 of the single entity and the Group arise from the different accounting standards applied (HGB versus IFRS) and the fact that subsidiaries are accounted for in the Group.

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 statement 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 concerning measurement and realisation effects arising on securities and equity holdings, 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, the 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 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 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 addition, administrative expenses in the HGB financial statements contain the expenses for the bank levy and deposit guarantee which are disclosed separately in the IFRS Group financial statements.

Loan loss provisions

There are small differences in the amounts recognised for loan loss provisions due to the recognition of portfolio valuation allowances under HGB and general loan 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). Under HGB the second loss guarantee is uniformly recognised as loan collateral received within the meaning of IDW S BFA 1 for both partial guarantees. 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 (key management indicator)

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 capital ratio/pro forma CET1 capital ratio (key management indicator)

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

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). "Pro forma" means that the capital ratio is calculated based on the hypothetical assumption that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.

ECONOMIC REPORT

UNDERLYING MACROECONOMIC AND INDUSTRY SECTOR CONDITIONS

GLOBAL ECONOMIC RECOVERY BECOMING MORE BROADLY BASED, FINANCIAL MARKETS SHOW POSITIVE DEVELOPMENT

The global economy picked up speed in 2017. Whereas global growth came to only 3.2% in 2016, 2017 saw an expansion rate of 3.7%. Growth momentum in the US increased considerably in the course of the year. Economic output in the US increased by 2.3% in 2017 as a whole. Particularly in the eurozone, the economic upswing picked up more speed than expected, meaning that a growth rate of 2.3% was achieved in 2017, driven by rising investment and robust private consumption. China returned to stronger growth of almost 7% in a year-on-year comparison. In general, however, the trend towards a gradual slowdown in growth remains intact. Most other emerging markets also showed positive development.

In the eurozone, the Europe-friendly outcome of the elections in the Netherlands and in France in the first half of the year came as a source of relief and contributed to political stabilisation. On the other hand, there is increased uncertainty surrounding the Brexit process, with the negotiations between the EU and the United Kingdom proving to be tough. The uncertainty with regard to the political course of action in the US also remained high initially. The US Federal Reserve took advantage of the good economic situation to continue with its monetary policy normalisation. In this environment, the financial markets showed positive development on the whole, with the stock markets, in particular, making considerable gains worldwide. Yields on government bonds – with the exception of US short-term bonds – showed only a slight upward trend at best, and remained at a low level overall. On the other hand, the euro made significant gains against the US dollar, driven not least by the political and economic stabilisation in the eurozone.

SYNCHRONISED UPSWING WORLDWIDE

After a somewhat disappointing start to the year, the pace of growth in the US increased significantly, meaning that the economy expanded at a rate of 2.3% for the year as a whole, a significant acceleration compared with 2016. The main growth drivers were private consumption and investment – and particularly fixed capital investment. Exports also showed positive development, whereas government spending had a partly dampening effect. The labour market picked up and showed a further improvement, with an unemployment rate of 4.1% in December. Nevertheless, wage growth remained low, meaning that the inflation rate came to 1.5% (PCE core rate), below the Fed's price target of 2%.

China's GDP is expected to have increased by 6.9% in 2017, a rate that is up slightly on the previous year. The strong growth can be traced back, among other things, to state investment programmes and rising real estate prices. India's economy expanded by 6.7%, i.e. at almost the same pace. The Russian and Brazilian economies are showing signs of a revival again after two years of, in some cases, deep recession, even though the political situation in Brazil remains fragile.

In the eurozone, the economic upswing picked up more speed than expected. In the course of 2017, the eurozone economy grew by 0.6% and 0.7% on a quarter-on-quarter basis, meaning that GDP growth came to 2.3% for the year as a whole, the highest level in ten years. It is also encouraging to see that the upswing is broadly distributed among the EMU countries. The unemployment rate in the eurozone dropped back significantly from 9.6% to 8.7% in the course of the year, with inflationary pressure nevertheless remaining moderate. In December, the annual inflation rate came to 1.4%, well below the ECB's price target of just under 2%. The elections in the Netherlands and France led to a higher level of political stability, as populist parties failed to secure majorities contrary to widespread concerns. While the crisis surrounding independence for Catalonia resulted in an unsettled mood to begin with, it was ultimately resolved for the time being. The biggest source of uncertainty in Europe continues to stem from the United Kingdom, which applied to leave the EU at the end of March 2017. The current negotiations on the terms of the country's exit are proving tough.

The development of the German economy also exceeded expectations. The vigorous development in private consumption and investment, as well as exports, translated into strong growth momentum. Growth of 2.2% was achieved in 2017. The strength of private consumption is due to the very positive situation in the labour market, as well as the favourable income prospects. Wage development has remained moderate to date, although future bottlenecks in the labour market point towards rising wages.

STRONG EURO, DIFFERENCES IN MONETARY POLICY AND BARELY INCREASING GOVERNMENT BOND YIELDS

In the course of 2017, the US Federal Reserve continued to forge ahead with its normalisation of monetary policy. First, the target range for the Fed Funds Rate was increased in three steps, meaning that it closed the year at between 1.25% and 1.50%. Second, the Fed initiated a cautious reduction in its total assets, which had increased to 4.5 trillion US dollars as part of its asset purchase programme. Given the Fed's rate hikes, the yield on two-year T-Notes rose considerably to nearly 2%, while the yield on ten-year T-Notes hardly increased at all overall, despite the positive economic development. It came to around 2.40% at the end of the year, on a par with the level seen at the beginning of the year. This means that the US yield curve has flattened considerably from the short end.

The ECB kept its monetary policy stance largely unchanged for the time being despite the economic upswing, although the monthly asset purchases were reduced from € 80 billion to € 60 billion in the spring of 2017. The yields on German government bonds fluctuated within a narrow range in 2017 – the yield on ten-year bonds came to between 0.15% and 0.60% – meaning that there was no clear upward movement despite the dynamic economic development. This was largely due to geopolitical risks, such as the escalation of the conflict in North Korea, the very hesitant monetary stance taken by the ECB and the increasingly short supply of German government bonds.

The stock markets were on a clear upward trajectory in the course of the year. The DAX rose from 11,600 at the beginning of the year to a temporary high of 13,500 points. Germany's benchmark index closed the year at just shy of 13,000 points, an increase of 11%. The US share indices also climbed to one high after another: the S&P 500 index reported annual performance of 18%, with the Dow Jones rising by as much as 24%.

On the currency market, the euro made significant gains against the US dollar. Whereas the currency pair stood at 1.05 at the beginning of 2017, this figure surpassed the 1.20 mark at times. This is testimony to the very positive economic situation and the greater political stability in the eurozone, which is boosting confidence in the monetary union considerably.

UNEVEN TRENDS IN RELEVANT MARKETS

The **shipping markets** showed the first signs of a slight recovery in 2017. The market for container vessels and bulkers showed development that outstripped the low market expectations. The incipient recovery in charter rates was also reflected, albeit with some delay and to a lesser extent, in an increase in ship values. Second-hand prices increased slightly in the container vessel and bulker segments, in particular. On the oil tanker market, on the other hand, the downward trend in charter rates continued.

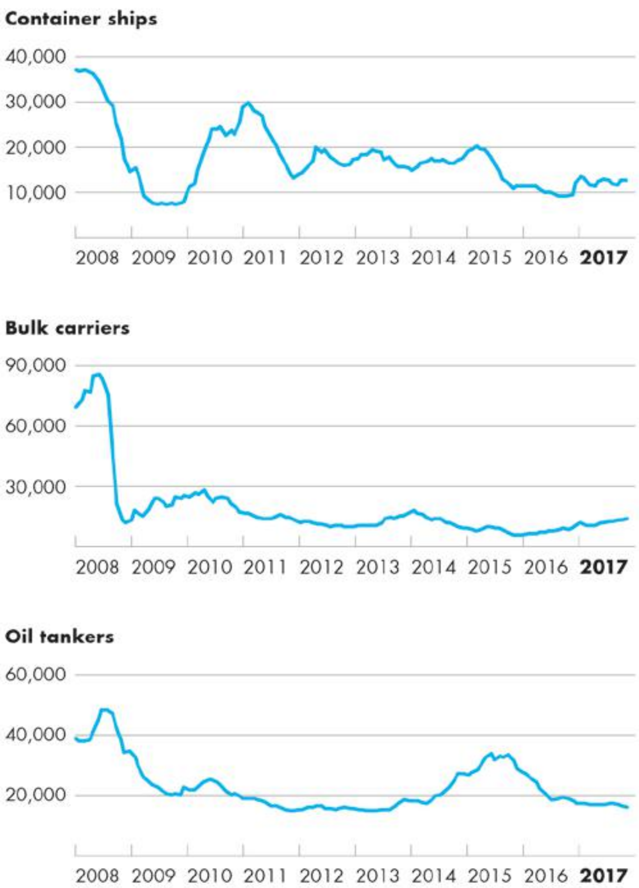
Charter rates on the market for **container vessels** showed a moderate increase in the course of the year, and were higher than operating costs in all sub-segments at the end of the year. Ship values also showed a positive trend and left the all-time lows behind them. In line with the improved macroeconomic environment, the demand for container transport showed very dynamic development in 2017 and was up considerably on the previous year. This applies, inter alia, both to the key Asia-Europe route and to transpacific trade. The continued consolidation among shipping lines and the new alliance landscape that was formed in April 2017 provided a new basis for networks and timetables in liner service, and will pave the way towards more efficient fleet utilisation. On the supply side, the initially weak fleet growth accelerated in the second half of the year, as scrapping activity decreased and the number of deliveries increased. Encouragingly, however, demand growth exceeded the increase in supply. In addition, the number of laid-up vessels fell considerably.

As far as **bulkers** are concerned, the upward trend continued in the course of 2017. After the seasonal decline in the spring, a rapid recovery was observed towards the middle of the year and both rates and prices had stabilised by the end of 2017. Charter rates in all sub-segments were higher than operating costs. The demand for iron ore and coal showed encouragingly positive development in Asia. One key factor in this respect is the high Chinese demand stemming from increasing steel production and the substitution of the country's own coal production. Bulker fleet growth is proving relatively constant due to moderate new orders, as well as scrapping levels that remained stable during the year. New ship ordering activity was stable throughout the year, meaning that the order book was only at a moderate level in 2017. The increase in transport volumes witnessed in the bulker segment since the beginning of the year, as well as the largely stable fleet development, resulted in increased utilisation levels among both smaller and larger vessels.

The charter rates for **oil tankers** were able to slow the downward trend significantly in the course of 2017. The production cuts by OPEC countries are still putting pressure on the demand side. In this respect, however, the expansion of oil production using fracking in the US is providing some relief. US exports are largely being shipped to Asia, tying up a considerable amount of tanker tonnage due to the long route. On the supply side, the strong fleet growth is putting pressure on charter rates. Nevertheless, signs of an imminent turnaround are starting to emerge: order activity slowed again in the second half of the year. In addition, a significantly larger number of ships are being scrapped due to the low rates and the increase in scrap prices.

TREND OF TIME CHARTER RATES IN THE SHIPPING INDUSTRY

(Market average, USD/day)



Once again, developments in the **real estate markets** in Germany were mostly very positive in 2017. The considerable increase in rent and property prices continued, particularly on housing markets in the cities. Thanks to the continued low interest rates against the backdrop of solid economic development at the same time, property prices once again increased at a faster rate than rent.

Construction activity remained very buoyant in 2017. The number of building permits issued, however, dropped, particularly in the construction of owner-occupied homes, and only continued to show strong growth in the **rental housing segment**. This means that in the country's large cities, the supply of housing is increasingly moving in line with demand, which remains high. As a result, the reduction in home vacancy levels, which were already very low, slowed. The large urban markets, however, remained characterised by excess demand. In the **office real estate markets,** the demand for space, which was already high to begin with, continued to increase in 2017. This was due to the considerable increase in the number of office employees. Office completions failed to keep up with demand, meaning that the vacancy levels continued to drop significantly. As a result, and especially in the second half of the year, rent levels in major cities rose considerably again, also increasing in secondary locations. The increase was more moderate in medium-sized cities. On the retail real estate markets, on the other hand, rent growth remained largely weak, with rent stagnation a far from rare occurrence. This also applied to top rents in central top locations of major cities. Al-though retail stores continued to benefit from strong levels of private consumption and retail sales increased significantly in the course of the year, the structural shift in favour of e-commerce, a segment that is showing sustained above-average growth, continued. Despite the comparatively low level of rent growth, **retail real estate** also benefited from the high demand among investors in the second half of the year. This resulted in what was, in some cases, a marked increase in real estate prices for all usage types in 2017.

Trends in **European office real estate markets** in foreign markets were mixed in 2017. Whilst some markets such as Madrid and Amsterdam continued to recover, rent levels stagnated in many other regions due to the persistent high level of vacancies. While the demand for space increased slightly on the London office real estate market, it remained weak due to the looming impact of Brexit. The increasing number of completions exceeded this demand by far, meaning that vacancy rates continued to rise. This resulted in a drop in rent and market values at the end of the year. In the majority of other European markets, on the other hand, market values increased significantly due to continued high investor demand.

The German economy also continued its strong recovery in 2017: in the **manufacturing sector**, production growth was up considerably in a year-on-year comparison. While all industries showed positive development, the extent of the upswing varied: whereas the chemical industry and the mechanical engineering segment had still reported a slight dip in production volumes in the previous year, both industries made considerable gains in 2017. The electrical engineering and metal industry, as well as companies in the pharmaceutical industry, reported fairly strong growth. Similarly, the automotive industry increased the significant production growth seen in the previous year even further. The food industry reported increased production again, albeit only at a moderate level and on a par with the previous year.

Wholesalers reported a marked increase in sales in 2017 as against the previous year period, which was still marked by a slight decline. The German **retail sector** is also benefiting from the consumption-driven economic growth in Germany and continued to report positive sales development: both the food retail industry and the other key segments of the retail sector were able to increase their sales. While (real) growth remained dynamic, however, it was slightly less pronounced than in the previous year. The clothing retail sector also reported a pronounced increase in sales following a downward trend in the previous year.

The **health market** is growing constantly, as is the hospital market, as a result of demographic trends and medical advances. With € 336 billion in gross value added, one in eight euros of German gross domestic product was earned in the healthcare sector in the previous year. The financial situation of many hospitals remains strained despite increasing revenues. The profitability of hospitals is, however, expected to increase in the medium term thanks to the entry into force of the Hospital Structure Act (*Krankenhausstrukturgesetz*) at the beginning of 2016.

In the **logistics sector**, revenues in 2017 were significantly stronger than in the previous year period. The business climate in the German logistics industry improved noticeably in the fourth quarter of 2017 and companies are more confident about developments over the next six months, pushing the corresponding indicator up to a new high. The measured economic climate remains above the long-term average, meaning that it is still in expansive territory overall.

The global **project financing volume** fell significantly in 2017 and was down by 14.1% on the volume seen in the prior-year period (according to Thomson Reuters). The downward trend was particularly noticeable in the Europe, Middle East and Africa (EMEA) region, although in Europe, the countries of Greece, the UK, Poland, Portugal and Turkey bucked the trend by reporting a higher project financing volume than in the previous year. North and South America, as well as the Asia-Pacific region, reported significant increases.

Investments in **transport infrastructure** accounted for 19.7% of the project financing volume in the EMEA region in 2017. The major institutional investors include pension funds and insurance companies, which consider infrastructure investments to be an investment alternative in the low interest rate environment.

The expansion of **renewable energies** made further progress in both Europe as a whole and Germany in 2017. The expansion in the European wind energy market focused on the core markets of France, the UK and Germany. The conversion to bidding procedures passed in the amendment to the Renewable Energies Act (EEG) for the transitional year of 2017 resulted in an increase in demand in Germany, in particular. New installations of onshore wind energy turbine generators were up by around 15% year-on-year, with new installations in the offshore segment also increasing very considerably in 2017, at a rate of over 50%, following a downward trend in the previous year.

The expansion in the solar segment also continued in Europe. In Germany alone, new installations in the photovoltaics segment came to nearly 1,753 megawatts in 2017, around 200 megawatts higher than the new installation figures for the two previous years. New installations in 2017 nevertheless once again fell well short of the political target corridor of 2,500 megawatts of new photovoltaic output a year, due among other things to the cuts under the Renewable Energies Act (EEG) in recent years.

ENVIRONMENT FOR BANKS STILL CHARACTERISED BY CHALLENGES

IMPROVEMENT IN THE MARKET ENVIRONMENT IN THE COURSE OF THE YEAR

In light of the overall favourable macroeconomic development, the market environment for banks also improved considerably in the course of 2017. A whole number of sources of geopolitical uncertainty remain, in particular regarding how to handle the situation in North Korea and Iran, as well as the outcome of Brexit within the context of the British EU exit negotiations. Nevertheless, fears of increased protectionism or political destabilisation in Europe have failed to materialise, even though considerable uncertainty remains about the political course pursued by the US, particularly in early 2018. In particular, the encouraging results of the elections in the Netherlands and France provided a more stable outlook for Europe. In addition, the broad-based upswing in the global economy and the gradually increasing signs of a steeper yield curve based on the normalisation of monetary policy initiated by the Fed and the ECB provided the basis for a recovery in the bank earnings outlook – even though steps towards a monetary policy turnaround in Europe have yet to be taken. Within this context, share prices for European banks also continued to recover in the reporting year, albeit more moderately than their US counterparts due to profitability levels that are still lower.

In addition to the low interest rate period, which is persisting for longer in Europe than in the US and is resulting in lower net interest income at banks, structural weaknesses are still putting pressure on the European banking sector. Especially in southern Europe – and among the larger countries, particularly in Italy and Spain – these include portfolios of non-performing loans that, while on the decline, are still substantial. Although the direct burden resulting from loan loss provisions has now eased considerably in the light of the gradual economic recovery, large volumes of problem loans are still putting pressure on profitability and bank capital positions and – given the associated uncertainty for investors – could hamper consolidation efforts.

Within this context, and with regard to the management of legacy burdens, a trend emerged in the course of the year showing that both the European banking supervisory authority and the political players want to promote the winding-down of problem loans within the context of specific requirements for the banks affected, but not least also as part of constructive consolidation solutions. In both Italy and Spain, for example, resolution solutions resulted in takeovers of smaller banks by larger institutions. At the same time, financial investors, in particular, would also appear to be expressing more of an interest in playing an active role in the consolidation process. After all, from an investor perspective, the challenging market environment resulting from the low interest rates, weak earnings and intense competition creates not only risks, but also opportunities that can be exploited by ongoing consolidation. This applies both to the purchase of problem loan portfolios, as well as to takeovers of smaller institutions. All in all, these solutions have the potential to significantly strengthen the European banking market in the future.

Despite the positive macroeconomic situation in Germany, the ongoing challenging situation with regard to ship financing is one of the key issues facing the German banking market in addition to sustained weak earnings. Even after the significant need for loan loss provisions in the previous year, German ship financing banks were once again faced with burdens as, despite the gradual improvement in parts of the shipping market, the duration of the crisis is sapping borrowers' financial energy.

In light of ongoing weak profitability, German banks, in particular, feel pressed to review their strategic focus. The considerable earnings pressure in the banking sector is associated with an increasing risk that loan financing will not be priced on a risk-commensurate basis. At the same time, expenses for the high regulatory requirements and the need for investments in the future viability of institutions (keyword: digitalisation) are leaving their mark on the cost side in the form of high project and IT costs. Against this backdrop, many banks initiated comprehensive cost and efficiency programmes in order to be able to generate adequate returns on a sustained basis. Consolidation within the sector could also be an option.

KEY TOPICS OF BANKING SUPERVISION

Monitoring of institutions by the banking supervisory authority has also been intensified by the expansion of the Banking Union. This applies, in particular, to the Supervisory Review and Evaluation Process (SREP) for banks directly supervised by the ECB. At the end of 2016, the ECB had already set out its priorities for the topics to be examined in greater detail in the 2017 SREP process, based on its experience. The three priorities identified by the supervisory authorities included, first, a review of bank business models and earnings drivers, second, credit risk, in particular in connection with non-performing portfolios and existing concentrations and the implications of the new IFRS 9 accounting standards and third, risk management. Within the context of risk management, the ECB used elements from the reviews conducted in 2016 for some of the key initiatives. These related, in particular, to the aggregation of risk data (BCBS 239), the use of internal risk models (TRIM), the adequacy of capital and liquidity management (ICAAP and ILAAP), as well as a review of IT risks in connection with outsourcing.

At the same time, the EBA announced a new stress test for European banks for the beginning of 2018, in which the institutions supervised by the ECB will also take part.

In addition to the challenging market environment, the banking market was also characterised, particularly in the first half of 2017, by discussions regarding the application and implementation of the European Bank Recovery and Resolution Directive (BRRD), which had already been introduced on 1 January 2016. This was largely due to different approaches to restructuring and resolution measures at Spanish and, in particular, Italian banks. Within this context, calls are being made for the harmonisation of national insolvency regulations, not least in order to boost transparency from an investor perspective and create a uniform set of rules in the European banking sector in the future. Nevertheless, the current examples tend to point more to a pragmatic interpretation of the BRRD, in particular when it comes to the treatment of legacy burdens.

A decision on the harmonisation of the European regulations concerning the design of the national liability cascades within the context of the BRRD for MREL-eligible liabilities (Minimum Requirements for Eligible Liabilities) was made in November. The arrangement provides for the introduction of a new class of instruments, non-preferred senior unsecured liabilities, which can count towards the requirements for bank MREL ratios, meaning that they contribute to the liability buffers in the event of insolvency. In Germany, the new scheme, which will have to be transposed into national law in the course of 2018, resulted in an extensive rating operation performed by Moody's with regard to the existing German senior unsecured liabilities.

The comprehensive and stricter regulatory requirements have made a significant contribution in their entirety to further strengthening the stability of the European banking system. Against the backdrop of stricter capital requirements through the gradual implementation of Basel III and the introduction of additional regulatory capital buffers, German banks on average are likely to have further strengthened their capital base in 2017. The reform of the Basel III regulations ("Basel IV") adopted in December is likely to increase the capital requirements for banks in the future. 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 are 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 but also on the ongoing need for consolidation – even though the increase in capital requirements driven by the regulatory side appears to be reaching a plateau.

HSH NORDBANK'S BUSINESS IMPACTED BY UNDERLYING CONDITIONS

The highly competitive environment, which remains challenging for banks, was also reflected in HSH Nordbank's business performance. Trends in the markets relevant for the Bank were uneven in 2017. While the real estate environment in Germany was largely positive, the situation in the shipping markets remained challenging despite signs of improvement. In the Corporate Clients division, the solid liquidity base of clients and the low level of interest rates had a tangible impact in an environment that remained competitive. 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. The volume of new business concluded was only slightly lower than in the previous year overall, despite the additional challenges faced by the Bank in the privatisation process. Margin development remains under pressure due to the intense competition. The intense competition and increase in liquidity costs, for example, resulted in a significant decline in the new business margin year-on-year and also meant that the Bank fell short of its planned ambition level.

The easing of the situation on the financial markets had an impact on the Bank's net assets and financial position and, in particular, on its net trading income. The significant depreciation and increased volatility of the US dollar against the euro in the course of the year had an impact on the Bank's earnings, net assets and financial position overall, even though the Bank's reliance on the EUR/USD exchange rate development has since been reduced considerably as a result of the significant winding-down of legacy burdens.

The uneven trends in the relevant markets were also reflected not least in loan loss provisions. Due to the ongoing difficult sector development in shipping, the Bank once again recognised high loan loss provisions for the legacy portfolios in question in 2017 (even without taking into account the additional unplanned loan loss provisions for the portfolio transaction within the context of privatisation). On the other hand, the strong earnings with regard to Real Estate Clients enabled the Bank to reverse loan loss provisions in this segment.

The Bank also responded to the continuing challenge regarding a cost base appropriate for the market environment. Controllable personnel and operating expenses were reduced considerably again 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 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 DEVELOPMENT – SIGNIFICANT DEVELOPMENTS AND EVENTS IN THE 2017 REPORTING YEAR

2017: POSITIVE BUSINESS DEVELOPMENT OVERSHADOWED BY ONE-OFF EFFECTS RELATING TO PRIVATISATION

In the 2017 financial year, HSH Nordbank showed positive development overall, making a significant contribution to the positive development of the privatisation process. Operating business development was characterised first and foremost by the significant winding-down of legacy burdens, positive earnings and cost development, and satisfactory key management indicators. At the same time, significant one-off effects arose in the context of the privatisation process, overshadowing the business results at the reporting date. In particular, HSH Nordbank will be relieved of a large part of the non-performing legacy burdens in connection with the portfolio transaction concluded as part of the privatisation process. This will result, on the one hand, in a fundamental improvement in credit quality. On the other hand, the portfolio transaction results in considerable burdens in loan loss provisions as at the reporting date. In addition, new assessments of interest and principal repayments for the hybrid instruments had to be taken into account.

The purchase agreement signed on 28 February 2018 provides the basic prerequisite for the successful conclusion of the privatisation process, which has been ongoing for around 2.5 years. The Bank contributed to this process with its systematic restructuring strategy and its solid operating development, laying the necessary foundation for its successful privatisation.

In the 2017 reporting year, the following aspects are particularly noteworthy:

- Good operating development within the Core Bank: The new business volume developed largely in line with the plan in the reporting year and amounts to € 8.5 billion (around € 2.3 billion with new clients), down only slightly on the value for the previous year (€ 8.9 billion). In 2017, the Bank once again succeeded in operating successfully on the basis of existing and new client relationships in an environment characterised by intense competition over all, concluding new business with an appropriate risk profile.
- Significant reduction in wind-down portfolio: Even without the portfolio transaction, the Bank wound down around € -11.6 billion EaD in the Non-Core Bank, taking currency effects into account, i.e. more than planned, winding down non-performing legacy loans in the amount of € -7.0 billion. The NPE ratio in the Group fell considerably as a result to 10.4 % as at the reporting date (31 December 2016: 17.5 %).
- Portfolio transaction agreed: In order to achieve the final elimination of a large part of its legacy burdens, the Bank sold further largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity

(SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. This means that the NPE ratio is expected to drop to around 2% (after the closing of the transaction).
- Systematic implementation of the cost programme: Planned potential for cost savings was exploited in line with the requirements, with administrative expenses being cut considerably from € -573 million in 2016 to € -521 million in 2017.
- Capital and liquidity ratios at a high level: Key management indicators for capital and liquidity were still at a very solid level. The pro forma CET1 ratio, which is calculated excluding the regulatory RWA relief effect of the second loss guarantee (for explanatory information, see the section entitled “Management system”) showed very positive development. It came to 15.4% as at 31 December 2017 (31 December 2016: 12.6%). The LCR came to 169% (31 December 2016: 172%).

PRIVATISATION PROCESS ON THE HOME STRETCH

The signing of the share purchase agreement satisfied in a timely manner the central commitment set out in the formal decision of 2 May 2016 in the EU state aid proceedings.

In light of the share purchase agreement that has been concluded, the Bank expects the privatisation process to be finalised in the third quarter of 2018 at the latest, once all of the necessary conditions have been met. Within this context, the Bank is confident that it can forge ahead intensively with the necessary realignment of the Bank by continuing with its current restructuring course, allowing it to do everything in its power to contribute to an ultimately successful change of ownership. In addition, the Bank will provide constructive support in all matters that are to be discussed further among the relevant stakeholders in order to systematically promote the transformation process initiated by the Management Board to create a new bank that is geared to the private sector.

In connection with an imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, as well as other risks, such as a further increase in capital requirements due to more stringent regulatory standards, HSH Nordbank AG expects, from today's perspective, that, contrary to past plans, it will only be possible to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2024 financial year for the 2023 financial year.

SATISFACTORY NEW BUSINESS

During the reporting period, the Bank worked intensively on forging ahead with its operating business activities. The focus was on generating new business with an appropriate risk profile in a market environment that remains challenging. The Core Bank’s new business showed positive development in the reporting year and falls only just short of the ambitious target. It amounted to € 8.5 billion, only just shy of the prior-year level (€ 8.9 billion). A total of around € 2.3 billion in new business was concluded with new clients. Further details on new business, in particular regarding the development of the individual segments, can be found in this Group management report in the section entitled “Segments”.

The ratio of new loans disbursed to new business concluded (disbursement ratio) is more or less on a par with the prior-year level. The interest margins achieved are falling significantly due to the competitive environment and fall short of the ambition level due to higher liquidity costs. Cross-selling net income generated by various banking services over and above loan financing showed encouraging development in the reporting year. Investment products, loan commission and income from derivative business transacted with clients made a key contribution to this trend.

SUCCESSFUL REDUCTION OF LEGACY ASSETS DUE TO BANK’S REGULAR WINDING-DOWN STRATEGY

The Bank significantly accelerated the implementation of its focused winding-down strategy in the 2017 reporting year and implemented it successfully. This is largely due to three factors:

- after a pronounced market slump in 2016, developments on the shipping markets have been pointing for several quarters now towards a recovery trend that is better than expected. This trend was particularly evident in the container vessel and bulker segments in 2017 and is based first and foremost on a revival in demand for transportation capacities, brisk scrapping activities and the consolidation of shipping lines.
- Taking the favourable market environment in 2017 into account, the Bank has been adjusting its restructuring principles since the second half of 2017 and is focusing its restructuring strategies more on specific recovery prospects for each individual commitment. The implementation of the winding-down strategy, which has been accelerated by the factors set out above, also serves to reduce historical concentration risks and was facilitated mainly by the high coverage ratio of the non-performing legacy portfolio.
- The development of the EUR/USD exchange rate also had a pronounced positive impact on the marked reduction in the portfolio of legacy burdens. This effect contributed € -0.7 billion in the reporting period.

The Bank wound down a total of € -11.6 billion EaD in non-performing and non-strategic loans in the Non-Core Bank in 2017. € -7.0 billion of this amount is attributable to the NPE legacy portfolio. The winding-down measures continued to focus on reducing non-performing ship financing transactions dating from the years before 2009 that were secured by the second loss guarantee of the federal state owners. As well as reducing the portfolio by implementing recovery strategies, receivables with a volume of € 2.7 billion EAD relating to continental European real estate financing, as well as aircraft, solar and shipping financing, were sold in the reporting period as part of market portfolio transactions. The winding-down measures reduce the NPE ratio significantly to 10.4% (31 December 2016: 17.5%). In addition to the market portfolio transactions described above, the legal transfer of the loan portfolio sold to hsh portfoliomanagement AöR in the 2016 financial year ("federal state portfolio transaction") was largely concluded as a structural measure in connection with the EU decision.

ADDITIONAL SUBSTANTIAL WINDING-DOWN OF LEGACY BURDENS AS PART OF PRIVATISATION PROCESS

In light of the future viability of the Bank and the good portfolio quality that it is aiming to achieve in this regard, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) within the context of the privatisation process. Broken down by asset classes, € 4.3 billion of the portfolio is attributable to shipping, € 1.0 billion to real estate, € 0.6 billion to corporate clients and € 0.4 billion to other loans. This allows the Bank to continue with its stringent winding-down strategy and to achieve, as a result of the sale, far-reaching relief from a large part of the non-performing legacy loans, as well as a smaller volume of other legacy portfolios of the Non-Core Bank.

The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In light of the portfolio transaction, the Bank has changed its commitment strategy for the individual loan receivables in the transaction portfolio from the previous individual single commitment-specific strategy (e.g. Realisation of collateral and workout) to a strategy involving the short-term sale of the loan receivable in question as part of a loan portfolio sale. On the basis of these sale strategies, the loan loss provisions for the loan receivables in the transaction portfolio were calculated on the basis of an independent expert opinion based on the IDW S1 principles, which formed the basis for the agreed purchase price of the portfolio for the Bank. This resulted, in particular, in additional unplanned specific loan loss provisions in an amount of € 1.1 billion..

STRINGENT COST PROGRAMME

The increasing pressure on earnings and margins in the highly competitive banking market and increasing costs for regulatory requirements are being countered by the ongoing cost reduction programme. In addition, substantial additional expenses were incurred in connection with the privatisation process (e.g. for legal and advisory services, data rooms) and the restructuring of major commitments in the Non-Core Bank.

In the course of 2017, the Bank made the progress it planned to make in implementing measures for controllable operating expenses. The potential for cost savings expected, based on the optimisation of the organisation and processes that has been implemented, was largely realised accordingly and, in some cases, actually exceeded slightly. The targeted management of operating expenses has resulted in a reduction in project costs, building costs and other personnel-related operating expenses in particular. As far as personnel expenses are concerned, 90% of the planned reduction has already been contractually agreed with employees as part of the 2018PLUS programme, and the Bank continued to implement its ambitious targets for personnel expenses in a systematic manner.

EARNINGS, NET ASSETS AND FINANCIAL POSITION

Net income of HSH Nordbank AG characterised by special effects

HSH Nordbank AG disclosed a net loss for the year of € -754 million in 2017 (previous year: € 0 million). Net operating income after loan loss provisions/valuation amounted to € -968 million (previous year: € 207 million).

In particular, very high loan loss provision expense in connection with the portfolio transaction, among other things, contributed to this result. Within the context of the privatisation process, the Bank will be relieved of a large part of the non-performing legacy burdens (portfolio transaction). Within this context, € 1.1 billion in individual valuation allowances have been recognised in particular, with a significant negative impact on the Bank's net result.

By contrast, there is non-recurring income from the realisation of unrealised gains in connection with the sale of receivables resulting from promissory note loans classed as fixed assets in the amount of € 298 million (previous year: € 136 million) and non-recurring income from the disposal of securities classified as financial fixed assets in the amount of € 55 million which made a considerable positive contribution to the net result. Income from the reversal of portfolio valuation allowances and write-ups relating to interests in affiliated companies had a corresponding effect

The restructuring and privatisation expenses amounted to € 77 million in the reporting year (previous year: € 112 million). They are disclosed under the extraordinary result. The result was also adversely impacted by a further decrease compared to the previous year in the interest-bearing loan volume, which the Bank had accordingly included in its planning. The reason for the drop in the interest-bearing loan volume is the accelerated portfolio winding-down strategy that the Bank has implemented systematically over the last few quarters. This is the Bank's way of doing everything in its power to support the privatisation process and make a significant contribution to the winding-down of historical cluster risks and the optimisation of financial key figures. Moreover, the low level of interest rates and intense competition continued to have a negative effect on the Bank's earnings situation. The intense competition and increase in liquidity costs, for example, resulted in a drop in the new business margin year-on-year and also meant that the Bank fell short of its planned ambition level.

A further significant reduction in operationally 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 in the "Earnings, net assets and financial position" section.

EARNINGS SITUATION

INCOME STATEMENT (HGB SINGLE ENTITY)

(€ m)	**2017**	2016	Change in %
Net interest income	771	874	– 12
Net commission income	– 88	– 142	38
of which: Fees for the second loss guarantee	– 154	– 227	32
Net income from the trading portfolio	126	83	52
Administrative expenses	– 521	– 573	– 9
of which: Personnel expenses	– 202	– 207	– 2
of which: Operating expenses	– 319	– 366	– 13
Other operating income	– 90	– 8	>– 100
Operating result before loan loss provisions/valuation	**198**	**234**	**– 15**
Loan loss provisions/valuation	– 1,166	– 27	> 100
Operating result after loan loss provisions/valuation	**– 968**	**207**	**>– 100**
Extraordinary result	– 69	– 106	35
Income tax expenses	– 2	– 101	– 98
Income from the assumption of losses	285	–	>100
Result for the year	**– 754**	**–**	**>-100**

HGB total income down within the context of expectations

The Group's total IFRS income rose considerably in the 2017 reporting year to € 1,572 million compared with € 921 million in the previous year. The total income exceeds the plan. Interest income from operating activities and effects resulting from the planned realisation of unrealised gains totalling € 356 million in total made a key contribution in this regard. In addition, the remeasurement of the hybrid capital instruments had a positive impact on IFRS total income of € 413 million.

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.

HGB total income of the single entity is composed of the Net interest income, Net commission income, Net income from the trading portfolio as well as Other operating income line items. It amounted to € 718 million at the 2017 year end and was therefore moderately below the previous year's level as expected (€ 807 million). The individual income line items contributed to total income under HGB as follows:

Net interest income of the single entity amounted to € 771 million compared to € 874 million in the previous year. In addition to interest income from operating activities, the net interest income, which is on target overall, included non-recurring income arising on the sale of receivables from promissory note loans classed as fixed assets in the amount of € 298 million (previous year: € 136 million). By contrast, there are expenses resulting from the partial closing out of interest rate hedging transactions in the amount of € 173 million. What is more, there were further external interest rate swaps relating to the disposals, but which were not closed out, with negative market values. These were included in the measurement of the banking book pursuant to IDW RS BFA 3.

The average interest-bearing loan volume decreased overall on the basis of the extensive winding-down of legacy portfolios and higher loan repayments. In addition, new business margins have declined, falling short of the planned level, due to the competitive situation and the Bank's liquidity costs.

Net commission income of HSH Nordbank AG in the amount of € -88 million (previous year: € -142 million) was adversely impacted by the fees for the second loss guarantee of € -154 million in particular (previous year: € -227 million). Cross-selling of services in connection with new business in addition to loan financing had a positive impact.

HSH Nordbank AG's net commission income of € 66 million adjusted for expenses for government guarantees decreased sharply compared to the previous year (€ 85 million). The drop is due to the premium expenses resulting from the synthetic securitisation transaction.

Net income from the trading portfolio amounted to € 126 million (previous year: € 83 million). The significant increase is mainly attributable to net operating income from interest rate transactions. Net income from foreign currency and the valuation result of credit default swaps posed a particular burden. € 14 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: € 9 million).

Other operating income amounted to € -90 million (previous year: € -8 million). This was mainly due to income from the reversals of other provisions (€ 46 million), cost allocations and reimbursements of expenses (€ 41 million) and income from option premiums received (€ 36 million), expenses from the compounding of provisions outside of the lending business (€ -66 million), expenses from option premiums paid and compensation payments for options held in the investment portfolio (€ -66 million). In addition, € -61 million in expenses for the creation of provisions for litigation risks and € -25 million in losses resulting from the sale of loans were incurred in the reporting year, and were largely responsible for the loss reported under Other operating result.

Cost savings take effect

The IFRS administrative expenses amounted to € -515 million in the 2017 financial year (previous year: € -634 million). Savings realised in excess of the plan under the ongoing cost reduction programme for operationally controllable personnel and operating expenses were offset by unplanned special depreciation allowances of € -25 million. These relate to tangible assets at consolidated subsidiaries and also put considerable strain on administrative expenses in the previous year (€ 66 million).

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. 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.

In the year under review, administrative expenses of the single entity (HGB) amounted to € -520 million after taking the expenses for the bank levy and the deposit guarantee scheme in the amount of € -41 million into account (previous year: € -573 million). This reduces the administrative expenses at individual institutional level considerably.

Personnel expenses, which decreased from € -207 million to € -202 million, were mainly affected by the number of employees, which was reduced even further according to plan. Compared to the end of 2016, the number of employees within the Bank declined by 211 to 1,690 (calculated on a full-time equivalent (FTE) basis).

Operating expenses amounted to € -319 million compared with € -366 million in the previous year. Savings were made in particular with regard to IT costs due to lower costs for external service providers and project costs. The positive development in cost-cutting measures was offset in part by contrary effects relating to strategic projects, in particular (for example for the accelerated portfolio reduction). In addition, considerable expenses were still incurred to implement regulatory and accounting requirements.

Very high loan loss provisions affected by portfolio transaction

Loan loss provisions in the 2017 financial year were characterised, on the one hand, by amounts allocated for legacy loan exposures. On the other hand, the unplanned additional loan loss provision expense in connection with the portfolio transaction had a significantly negative impact. The loan loss provisions were recognised primarily for legacy transactions in the shipping portfolio to continue to reflect the ongoing difficult market developments, despite slight recovery trends. In addition, loan loss provisions were recognised in the energy portfolio for commitments dating from the years prior to 2009. The risk trend in the other divisions, on the other hand, was unremarkable. The Real Estate Clients portfolio was characterised not only by additions relating to the portfolio transaction, but also by the reversal of loan loss provisions due to loan repayments and improved risk assessments.

In total, the IFRS loan loss provisions, excluding the compensation effect of the guarantee and before foreign exchange effects, came to € -1,402 million as at the reporting date (previous year: -1,577 million), outstripping the Bank's expectations in the previous year due to the considerable additional loan loss provisions in connection with the portfolio transaction, but down on the prior-year value.

The loan loss provisions recognised, once again, for legacy portfolios in particular were no longer compensated for in full as at the reporting date – due to the full balance sheet utilisation of the second loss guarantee in the first quarter of 2017. Allowing for the hedging effect resulting from the credit derivative in the amount of € 810 million (previous year: € -475 million) and including foreign exchange rate effects and the compensation effect provided by the second loss guarantee, IFRS loan loss provisions came to a total of € -1,276 million (previous year: € 156 million), putting significant pressure on the Group net result.

Compensation under the second loss guarantee for the guaranteed portfolio, which is disclosed within the IFRS loan loss provisions, amounted to € -684 million (previous year: € 2,208 million) after taking account of currency effects. Taking into account the current loan loss provision expense, IFRS loan loss provisions amounted to € -2,086 million (previous year: € 631 million) after the compensation effect of the second loss guarantee. Taking account of the expenses resulting from changes in the hedging effect of the credit derivative of € 810 million (previous year: € -475 million), IFRS loan loss provisions after the guarantee effect would amount in total to € -1,276 million (previous year: € 156 million).

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, taking into account the guarantee effect, a negative amount of € -1,166 million (previous year: € -27 million) in the loan loss provision/valuation line item of the HGB single entity, comprising loan loss provision income after compensation (€ -1,256 million), the valuation result in the securities business (€ 22 million) and the valuation result from equity holdings (€ 68 million). This value is much higher than expected. It includes allocations to individual valuation allowances in an amount of € 1.1 billion as a result of the portfolio transaction.

Loan loss provisions recognised once again in the reporting year, particularly for legacy portfolios, were only compensated for to a minor extent if they related to portfolios covered by the guarantee due to the full balance sheet utilisation of the guarantee in the first quarter of 2017.

Loan loss provision expense recognised in the reporting year before taking account of the compensation effect of the guarantee amounted to € 1,344 million as at 31 December 2017 (previous year: € 1,718 million). Compensation under the second loss guarantee for the guaranteed portfolio, which is disclosed within loan loss provisions, amounted to € 88 million (previous year: € 1,811 million) after taking account of currency effects. Taking into account the current loan loss provision expense, loan loss provisions amounted to € -1,256 million (previous year: € 92 million) after the compensation effect of the second loss guarantee. Due to the full balance sheet utilisation of the second loss guarantee in the first quarter of 2017, the loan loss provisions recognised in 2017 as a whole were no longer compensated for in full. This made a significant contribution to the loss reported.

The second loss guarantee of € 10 billion has been utilised in full in the balance sheet as at the reporting date. The cash drawdowns of the guarantee exceed the Bank's first loss piece (€ 3.2 billion) by € 4.1 billion. Losses submitted for settlement amount to € 0.4 billion. This means that the guarantee utilisation is gradually increasing due to the invoicing of losses under the guarantee.

The loan loss provisions/valuation result in the securities business fell considerably to € 44 million (previous year: € 153 million). This result reflected the positive effects of the sale and valuation of securities. Income of € 134 million was generated in the reporting year from the sale of securities held in the banking book. € 55 million of this amount is attributable to securities positions sold as part of the sale programme to realise unrealised gains. Moreover, gains were realised on the sale of positions in the credit investment portfolio carried out to further reduce high-risk portfolios. The result was hit by impairment losses and by price gains on investment securities.

The loan loss provisions/valuation result from equity holdings amounted to € 68 million (previous year: € -15 million). The result is essentially due to write-ups on interests in affiliated companies and equity holdings, as well as to profits from disposals of equity interests.

Operating result after loan loss provisions/valuation

The operating result after loan loss provisions/valuation amounted to € -968 million compared to € 207 million in the previous year. This mainly reflects the increase in loan loss provisions, in particular due to the portfolio transaction, which was not compensated for because of the full balance sheet utilisation of the second loss guarantee. Non-recurring income from the sale of receivables from promissory note loans and securities in the amount of € 353 million had the opposite effect.

The extraordinary result decreased to € -106 million compared to € -69 million in the previous year. This result was adversely impacted by restructuring expenses incurred in connection with the Bank's realignment (€ -26 million) and privatisation expenses (€ -52 million). This was offset by the reversal of provisions recognised as part of previous restructuring programmes (€ 9 million).

High negative net result

The IFRS Group net result before taxes (key management indicator) amounts to € -453 million as at 31 December 2017 (31 December 2016: € 121 million). This result is due, in addition to operational development that was largely in line with the plan, in particular to unplanned special effects that have arisen in the context of the privatisation process.

The return on equity for the Group (key management indicator) calculated on the basis of net income before taxes (IFRS Group) is much lower than the planned value and is in negative territory at -9.7% (31 December 2016: 2.5%). The cost-income ratio (key management indicator) comes to 32.3% (31 December 2016: 64.8%). It is up considerably on both the plan and the prior year in light of the stringent cost management. Irrespective of the special effects relating to privatisation, both values (RoE and CIR) contain effects resulting from the planned implementation of the realisation of unrealised gains, meaning that they are overstated within this context, too.

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.

At the level of the single entity, net income before taxes under HGB amounted to € -1,037 million (previous year: 101 million). After taking account of income taxes of € -2 million (previous year: € -101 million) and income from the transfer of losses of € 285 million (previous year: € 0 million), HSH Nordbank AG reports a negative net result of € -754 million that falls clearly short of expectations (previous year: € 0 million).

HSH Nordbank AG's income tax expenses mainly comprise current tax expense for 2017. The income tax expense line item also includes income from deferred taxes of € 27 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. Taking the current and deferred taxes into account, this results in an overall tax result of € -2 million (previous year: € -101 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. No loss participation was required in the previous year due to the break-even results. Silent participations shared in the Bank's losses in the amount of € 285 million in the 2017 financial year. Silent participations are placed in the international capital markets (€ 661 million) and with domestic institutional investors (€ 248 million).

The carrying amounts of the hybrid instruments, which are listed on the capital markets, correspond to 39.7% of the original nominal amount due to the attributed losses.

NET ASSETS AND FINANCIAL POSITION

BALANCE SHEET (HGB SINGLE ENTITY)

(€ m)	**2017**	2016	Change in %
Assets			
Cash reserve, debt instruments issued by public authorities, bills eligible for rediscount	6,617	3,477	90
Loans and advances to banks	2,770	2,240	24
Loans and advances to customers	40,349	52,937	–24
Securities	15,035	16,821	–11
Trading portfolio	2,696	3,228	–16
Equity holdings in non-affiliated companies and interests in affiliated companies	631	784	–20
Other assets	2,232	3,238	–31
Total assets	**70,330**	**82,725**	**–15**
Liabilities			
Liabilities to banks	8,891	10,275	–13
Liabilities to customers	36,822	41,495	–11
Securitised liabilities	14,086	17,554	–20
Trading portfolio	1,414	1,771	–20
Subordinated liabilities and profit participation capital	1,048	2,106	–50
Fund for general banking risks	2,362	2,348	1
Equity capital	3,250	4,337	–25
Other liabilities	2,457	2,839	–13
Total liabilities	**70,330**	**82,725**	**–15**
Contingent liabilities	2,022	2,399	–16
Other obligations	6,724	6,738	–0
Derivatives held in the banking book (credit equivalents)	616	791	–22
Total off-balance sheet business	**9,362**	**9,928**	**–6**
Business volume	**79,692**	**92,653**	**–14**

Decrease in total assets

In the reporting year, total assets in the HGB single-entity financial statements fell considerably to € 70,330 million, due in particular to the accelerated winding-down of legacy burdens (31 December 2016: € 82,725 million).

The movement in items on the asset side of the balance sheet was as follows: Loans and advances to banks increased – bucking the negative trend in total assets – to € 2,770 million (31 December 2016: € 2,240 million). While call deposits held at other banks continued to decline, the repurchase agreements business and time deposits at other banks more than compensated for the drop. In addition, the cash reserve increased from € 3,477 million to € 6,617 million. In particular, balances at central banks were considerably higher than at the previous year-end due to liquidity inflows from the winding-down of legacy burdens.

Loans and advances to customers came to € 40,349 million which was significantly below the level at the end of the previous year (31 December 2016: € 52,937 million). The legacy portfolios were reduced considerably by moves to push ahead with portfolio sales (market portfolio transactions) and the targeted winding-down of legacy portfolios in the reporting year, which more than compensated for the encouraging new business in the Core Bank. The securities portfolio decreased due to the disposals to realise unrealised gains and the winding-down of legacy portfolios (sale of substantial parts of the credit investment portfolio) from € 16,821 million to € 15,035 million. Trading portfolio assets decreased to € 2,696 million (31 December 2016:
€ 3,228 million). Whereas both the volume and the market values of debentures and other fixed-interest securities in the trading portfolio increased slightly, the positive fair values of the derivatives position were lower than at the end of the previous year.

All material line items on the liability side of the balance sheet decreased. Liabilities to banks declined to € 8,891 million compared to € 10,275 million as at 31 December 2016. In particular, call deposits at other banks were down as against the end of the previous year and time deposits declined, whereas the repurchase agreements business had the opposite effect. Liabilities to customers decreased to € 36,822 million (31 December 2016: € 41,495 million). Both demand and time deposits decreased. Securitised liabilities stood at € 14,086 million (31 December 2016: € 17,554 million) which was significantly below the level of the previous year. The reduction was attributable to a higher volume of maturities than new issues. The "subordinated liabilities and profit participation capital" item was down considerably (31 December 2017: € 1,048 million, previous year: € 2,106 million). This was once again due to a high volume of maturities.

At € 3,250 million as at 31 December 2017, reported equity was significantly lower than at the end of the previous year (31 December 2016: € 4,337 million). In addition to the group net loss for the 2017 financial year, this is due to the loss distribution attributable to the silent partners, which resulted in a lower carrying amount.

Business volume also down

The business volume decreased in line with the decreasing total assets and amounted to € 79,692 million (31 December 2016: € 92,653 million). Contingent liabilities, which essentially comprise guarantees and warranties, also fell to € 2,022 million (31 December 2016: € 2,399 million), whereas other commitments, which mainly consist of irrevocable loan commitments, were more or less on a par with the prior year at € 6,724 million (31 December 2016: € 6,738 million).

Capital and funding

RWA AND CAPITAL RATIOS

(SAME PERIOD)

	31.12.2017	31.12.2016
Risk-weighted assets (RWA) (€ bn)	22.2	28.6
Overall capital ratio	30.6 %	24.8 %
Tier 1 capital ratio	23.5 %	18.7 %
CET1 capital ratio	18.5 %	14.1 %
CET1 capital ratio (full implementation of Basel III)	18.1 %	13.4 %
Pro forma CET1 capital ratio[2]	15.4 %	12.6 %

1) Same period: ceteris paribus calculation taking full account of the balance sheet amounts as at the reporting date.

2) "Pro forma" means that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, valuation allowances that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.

CET1 ratio at a good level despite burdens from winding-down of legacy burdens within the context of privatisation

As part of the privatisation of HSH Nordbank, the second loss guarantee provided by the federal state owners is to be settled in full and terminated in 2018. This means that the regulatory relief effect of the guarantee will cease to apply as of the beginning of March 2018. A corresponding cancellation agreement for the second loss guarantee was signed on 28 February 2018. It is subject, among other things, to the condition precedent of the successful closing of the share purchase agreement. For further details, reference is made to the section entitled "Sale of HSH Nordbank AG on 28 February 2018". As a result, HSH Nordbank is using a same-period pro forma CET1 ratio, excluding the regulatory RWA relief effect of the second loss guarantee, as the key management indicator. Taking into account this hypothetical assumption (for details, refer to the "Management system" section of this Group management report) – and based on pro forma RWA in an amount of € 26.2 billion (31 December 2016: € 36.2 billion) – this produces a pro forma CET1 ratio (key management indicator) of 15.4 %, which is considerably higher than both the value as at 31 December 2016 of 12.6% and the ambition level of around 13% that was planned for the end of 2017. Against the backdrop of the share purchase agreement signed on 28 February 2018, the agreement on the portfolio transaction and the cancellation agreement for the second loss guarantee, which was also signed on 28 February, the regulatory CET1 capital ratio is expected to no longer be recognised as a securitisation arrangement taking into account the regulatory relief effect as of March 2018.

The same-period core Tier 1 capital ratio (CET1 ratio, phase-in), which also includes the regulatory relief effect of the second loss guarantee, amounts to 18.5% as at 31 December 2017, meaning that, despite the considerable burdens resulting from the portfolio transaction agreed within the context of privatisation, it is significantly above the value at the end of 2016 (14.1%) and the ambition level of around 13.0% planned for the end of 2017.

The significant increase in the capital ratios is due, in particular, to the marked drop in RWA. The drop was higher than planned, with RWA falling by around € 6.4 billion compared with 31 December 2016 to € 22.2 billion. This development is due, in particular, to the significantly accelerated reduction of legacy burdens in the 2017 financial year. In addition, the active management of currency risks and a strong EUR/USD exchange rate, which exceeded the Bank's expectations, also resulted in a drop in RWA, which had a marked impact on the development in the capital ratios.

Assuming the full implementation of the Basel III rules (fully loaded), HSH Nordbank's same-period CET1 ratio increased compared to 31 December 2016 (13.4%) to 18.1%

As was the case on 31 December 2016, there is no free regulatory guarantee buffer for the second loss guarantee (free capacity for expected and unexpected losses) as at 31 December 2017 either. Part of the regulatory RWA burden for the portfolio secured under the federal state guarantee is reflected as a deduction from the regulatory equity capital. There is no capital deduction item as at 31 December 2017, meaning that this item is down by around € 0.6 billion as against 31 December 2016. The reduction is due to the additional loan loss provisions recognised in connection with the planned portfolio transaction, which had already had an impact on the Bank's reported equity on the reporting date. The RWA attributable to the senior tranche of the federal state guarantee also fell considerably in 2017 due to the active winding-down of the legacy portfolio, which made an additional contribution to the increase in CET1 ratios.

SREP requirements met

As part of the supervisory process in the Banking Union, HSH Nordbank was assigned an individual minimum capital ratio by the ECB that is reviewed annually as part of the SREP process. This capital ratio was adhered to at all times during the reporting period. Since 1 January 2017, an SREP minimum requirement of around 8.9% (Pillar 2 Requirement "P2R" incl. the combined capital buffer requirements) has applied to HSH Nordbank.

REGULATORY CAPITAL RATIOS
(NOT SAME PERIOD)[1]

(%)	**31.12.2017**	31.12.2016
Overall capital ratio	31.4%	24.2%
Tier 1 capital ratio	23.2%	18.5%
CET1 capital ratio	18.7%	13.9%
CET1 capital ratio (full Basel-III implementation)	17.8%	13.1%
Leverage ratio	7.7%	6.9%

1) Not same period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only included in part).

REGULATORY CAPITAL
(NOT SAME PERIOD)[1]

(€ bn)	**31.12.2017**	31.12.2016
Regulatory capital	7.0	6.9
of which: Tier 1 capital	5.2	5.3
of which: CET1 capital	4.2	4.0
of which: additional Tier 1 capital	1.0	1.3
of which: supplementary capital	1.8	1.6
Risk-weighted assets (RWA)	22.2	28.6
of which: risk assets counterparty default risk	18.6	23.4
Leverage exposure	67.0	77.0

1) Not same period: regulatory disclosure pursuant to the CRR (balance sheet amounts as at the reporting date only included in part).

The financial holding group, which arose in 2016 as a result of the establishment of HSH Beteiligungs Management GmbH as a holding company in connection with the measures set out in the EU catalogue of conditions and commitments, has also been assigned a minimum capital ratio by the ECB as part of the supervisory process in the Banking Union which is in line with the statutory regulations and is reviewed annually as part of the SREP process. In this regard, a core Tier 1 capital ratio of 4.5%, plus capital buffer requirements that then amount to around 5.8% in total, has applied to the financial holding group since 1 January 2017. The CET 1 capital ratio (not same period) came to 10.2% as at 31 December 2017 (31 December 2016: 6.5%). The increase in the CET1 capital ratio is essentially due to the fact that the provisions for regular future guarantee premiums under the federal state guarantee at the level of HSH Beteiligungs Management GmbH were reversed due to the significantly shorter settlement period. On the other hand, provisions for the supplementary premium had to be recognised, although these are not likely to result in a same-period CET1 capital ratio of less than 10% due to the capital protection clause.

HSH Nordbank's leverage ratio was a very solid 7.7% as at 31 December 2017 (31 December 2016: 6.9%). The development takes into account the drop in the relevant business volume during the reporting period. A statutory binding minimum leverage ratio value has not yet been defined. With the amendment of the CRR, the leverage ratio, based on the Tier 1 capital, is likely to be set at a binding level of 3% for all institutions as a minimum requirement.

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. For details, as well as for details on the differences between the pro forma CET1 capital ratio (key management indicator) and the CET1 capital ratio in the Group, refer to the section entitled "Management System".

The regulatory not same-period CET1 ratio of HSH Nordbank AG (including Basel III transitional rules) in the single entity under HGB amounted to 21.2% as at 31 December 2017 (previous year: 15.4%). In particular, reductions in the aggregate RWA had a positive impact in this respect.

HSH Nordbank AG's not same-period Tier 1 capital ratio came to 25.4% (previous year: 19.7%) and the overall capital ratio of HSH Nordbank AG amounted to 30.7% (previous year: 23.5%) (not same-period in each case).

Detailed information regarding HSH Nordbank's capital and RWA forecast is set out in the "Forecast, opportunities and risks report" of this management report in the section entitled "Forecast report including opportunities and risks".

Funding activities expanded further

HSH Nordbank continued to successfully implement its funding strategy, using various sources of refinancing, over the past year. In the reporting period, the raising of funding (with a volume of € 5.0 billion) was comfortably higher than the planned volume (€ 4.1 billion). The lower volume of bond issues in the retail segment was more than compensated for through placements to institutional investors.

The Bank successfully placed a public-sector Pfandbrief in the second half of the year, marking the continuation of its Pfandbrief benchmark strategy. The bond has a volume of € 500 million and a term of three years.

In addition, further long-term USD funds were raised via the ABF platform. First, an existing transaction, backed by corporate loans, was increased by € 150 million. In addition, a new issue was concluded with a volume of USD 400 million. The transaction is secured using real estate loans and has a term of four years.

Since the fourth quarter of 2017, the Bank has been offering fixed-term deposit investments to retail customers via the "Deposit Solutions" platform, allowing it to open up a further funding channel. This move has been taken to counteract the significantly lower retail funding volume due to the low interest rate environment. This new funding channel means that the Bank is very well-prepared for the period after the change of ownership. In addition, the private client deposits have a positive effect on the funding structure.

The level of deposits also contributed to the implementation of the funding strategy. Total deposits amounted to € 25.0 billion as at 31 December 2017 (31 December 2016: € 29.7 billion). Furthermore, as at 31 December 2017, the Bank held liquidity reserves in the form of credit balances at central banks in the total amount of around € 6.6 billion and collateral eligible for refinancing at central banks in the amount of € 9.3 billion, which the Bank can access at any time. The high level of deposits allows the Bank to continue with its funding strategy and take account of the uncertainty that is inevitably linked with the complex privatisation process. The Bank is prepared to accept a significant negative impact on its earnings situation in this regard, which will be reflected in temporarily increased interest expense.

In addition to the successful implementation of the raising of funding, the market portfolio sales concluded at the beginning of 2017 and in the course of 2017 and inflows from the settlement of losses also contributed to the further improvement in the Bank's liquidity situation.

The regulatory requirements governing the liquidity ratios and the assumptions applied by the Bank as part of its forecasts were adhered to during the reporting period. The liquidity ratio as defined in the German Liquidity Regulation (LiqV) came to 1.79 as at 31 December 2017 at individual institutional level (31 December 2016: 1.92), which is still significantly above the minimum regulatory requirements. The liquidity coverage ratio (LCR, short-term minimum liquidity ratio, key management indicator) was calculated for the first time without taking the institutional protection into account (for details, refer to the section entitled "Management system"), and reached a very good level of 169% as at 31 December 2017 (31 December 2016: 172%), which was also significantly above the minimum requirements. The NSFR (structural liquidity ratio, key management indicator) came to 114% at 31 December 2017 (31 December 2016: 111%), putting it above the 100% mark and therefore above the anticipated future regulatory requirements.

The liquidity development report as at 31 December 2017 shows a survival period in the combined stress scenario of more than twelve months (31 December 2016: ten months). The regulatory requirement of one month was therefore clearly exceeded.

The two rating agencies, Moody's and Fitch, regard the conclusion of the EU proceedings as an important milestone and assess the structural measures leading to an improvement in the financial and risk profile as positive in principle. This applies in particular to the portfolio transaction, which is designed to relieve HSH Nordbank AG of non-performing loans and ultimately also strengthen its capital position. Nevertheless, the agencies consider the uncertainty during the change of ownership and the planned smooth transition with regard to the deposit guarantee fund to be particular challenging. As expected, adjustments were made to the rating position after the signing on 28 February 2018. While the two agencies agree with regard to the prospective impact of privatisation on the Bank's financial and risk profile (in particular, solid capital position and considerably improved asset quality), they currently take different views with regard to the effects on the Bank's long-term rating. While Moody's expects the Bank's rating position to improve in light of the significant improvement in its financial profile, Fitch believes that the rating position could deteriorate, in particular due to the planned change in the deposit guarantee fund (exit from the German Savings Banks Association (DSGV)), the associated impact on refinancing and the future shareholder structure (no controlling majority owner) if the improvement in the individual rating is not sufficient to compensate for these aspects. The two agencies will reach a final decision on the future rating position based on the closing of the privatisation transaction.

FINAL ASSESSMENT OF HSH NORDBANK'S POSITION

In the 2017 financial year, the Bank showed positive operational development, meaning that it made a significant contribution to the positive development of the privatisation process. New business activities developed satisfactorily overall, the significantly accelerated winding-down of legacy burdens was implemented successfully and cost potential was exploited as planned. This means that, in particular, the pro forma CET1 capital ratio, the cost-income ratio and new business, as well as other key management indicators are at a satisfactory level overall, allowing the Bank to largely achieve its relevant targets in the reporting year, exceeding them in a number of sub-segments. At the same time, the Bank and its employees have done everything in their power to support the privatisation process and showed considerable commitment in the extremely labour-intensive phase leading up to the signing and beyond. This laid the foundation required for the share purchase agreement, which was signed on 28 February 2018.

In the future, HSH Nordbank AG will become a commercial bank with exclusively private owners. The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. The new group of owners is characterised by a high level of expertise and many years of experience with commitments in the international financial sector. The federal states of Hamburg and Schleswig-Holstein and Sparkassen- und Giroverband für Schleswig-Holstein have concluded a corresponding share purchase agreement for all of their indirectly held HSH shares (a total of 94.9 percent), achieving the first successful privatisation of a Landesbank in Germany. At the same time, an agreement was reached within the context of the privatisation to relieve HSH Nordbank of large parts of the non-performing legacy loans, as well as to cancel the second loss guarantee prematurely. The closing of the share purchase agreement, the portfolio transaction and the cancellation agreement for the second loss guarantee are subject to certain conditions. The closing of the privatisation agreement (share purchase agreement) is scheduled for the second or third quarter of 2018.

The portfolio transaction agreed in connection with the privatisation process caused significant negative valuation effects within loan loss provisions as at the reporting date, resulting in a substantial loss and overshadowing the otherwise positive development. The HGB net result before taxes amounts to € -453 million as at 31 December 2017 (31 December 2016: € 121 million). This result is due, above all, to unplanned loan loss provision burdens in the Non-Core Bank which were recognised in connection with the complete sale of the largely non-performing Non-Core Bank portfolios on the reporting date and relate, in particular, to additional individual specific loan loss provisions in an amount of € 1.1 billion.

In light of its operational progress and the privatisation process, which has been successful so far, HSH Nordbank considers its development to be positive overall. The measures implemented within the context of privatisation will contribute to a business model for the Bank that is sustainable in the long run and will facilitate the sustainable realignment of its activities.

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

EMPLOYEES OF HSH NORDBANK AG

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 successful implementation of the programmes initiated by the Management Board in 2015/2016 to permanently reduce administrative expenses continued in 2017. The target for the planned workforce reduction in 2017 was almost reached in a socially responsible manner with the help of the arrangements agreed with the Works Council. The number of employees had decreased to 1,926, based on full-time equivalents (FTE), by the 2017 year-end in the course of the ongoing reduction in staff within the HSH Nordbank Group (31 December 2016: 2,164). Changes to the scope of consolidation also had an impact on the headcount. The number of employees (FTE) at HSH Nordbank AG (single entity) had fallen to 1,690 by the end of 2017 (31 December 2016: 1,902).

FOCUS ON MODERN HR DEVELOPMENT

The development of all employees is the focal point of human resource functions for HSH Nordbank. In 2017, the offering was aimed, in particular, at meeting the requirements of a changing bank in an agile market.

Emphasis was placed on the further development of sales skills using targeted training sessions, workshops, meetings, conferences and dialogue at in-house events in all customer departments. There are also programmes for the further development of managers with the focus on change and implementation skills. An interesting range of occupational and health-oriented seminars rounds off the HR development programme of HSH Nordbank.

YOUNG PROFESSIONALS PROGRAMME EXPANDED FURTHER

In addition to the development of all employees, measures were taken again in 2017 to further strengthen the recruitment and promotion of our young professionals. HSH Nordbank offers 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 29 students/trainees were employed in 2017.

In the past year, twelve students completed their dual studies at HSH Nordbank with a very good or good overall score and received a permanent job offer. These young professionals now have further promotion possibilities following their training.

For new entrants to the profession, HSH Nordbank offers a 24-month trainee programme covering a wide range of topics. High-quality training is hereby ensured by comprehensive and in-depth insights into each of the Bank's fields of activity. A total of 17 trainees were employed in 13 business units in 2017.

Due to its exceptional young professionals programme, HSH Nordbank was again honoured in 2017 by Absolventa GmbH as a provider of a career-enhancing and fair trainee programmes and was recognised 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 and the increasing average age of HSH Nordbank's employees. Last year, 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 – as far as possible – are filled by young professionals. HSH Nordbank had adopted new approaches for this purpose and has successfully used social media and Internet platforms to recruit.

FURTHER EXPANSION OF EXEMPLARY HEALTH CARE AND SOCIAL MANAGEMENT SERVICES

Employees are provided with extensive health care and social management services in an integrated approach. Besides in-house seminars, these also include individual counselling for employees, managers and whole teams. 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", "childcare" and "caring for relatives". The services offered are regularly reviewed and flexibly tailored to employee requirements.

CLEAR COMMUNICATION STRATEGY PREREQUISITE FOR A SUCCESSFUL CHANGE OF OWNERSHIP

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. Managers at HSH Nordbank have made it their responsibility to enter into open dialogue with all employees on the privatisation process, and also on the associated uncertainties. Ultimately, a clear communication culture creates trust and is a prerequisite for the success of the Bank.

REMUNERATION TO EMPLOYEES

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

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

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

In accordance with the specific requirements of the InstitutsVergV, 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 in line with the regulatory requirements, among other things.

The InstVergV, which has applied since 2010 and sets out provisions on the regulatory requirements that the remuneration systems of institutions have to meet, has been implemented on an ongoing basis - most recently in 2015 – in the Bank's collective agreements. The negotiations with the Bank's co-determination bodies on the new requirements set out in the InstitutsVergV 3.0, which was published in August 2017, commenced at the end of 2017. As well as updating the remuneration system to reflect the regulatory requirements, there are also plans to adjust the system to reflect the new parameters of HSH Nordbank in 2018.

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

MANAGEMENT DECLARATION PURSUANT TO SECTION 289F (2) NOS. 4 AND 6 OF THE GERMAN COMMERCIAL CODE (HANDELSGESETZBUCH – HGB)

EQUAL OPPORTUNITIES AND WOMEN IN MANAGEMENT POSITIONS AND DIVERSITY CONCEPT

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. The Bank set the following quotas in line with the law, which came into force in May 2015, regarding equal representation of women and men in management positions in the private sector and public services and the resulting introduction of Section 76 (4) of the German Stock Corporation Act (AktG):

At the level of managers reporting directly to the Management Board, HSH Nordbank was aiming to achieve a ratio of 16% women. It has almost reached this objective, with a current figure of 15%. The department head ratio, on the other hand, exceeds the target at 19% (target of 15%).

The efforts made to promote young female professionals in particular will allow the Bank to fill vacant positions at the next higher level from the large group of female department heads in the future. To this end, the "Equal Opportunity Promotion Plan" was already expanded back in 2016 to include further measures such as workshops on female promotion and the embedding of this topic in the overall bank objectives.

STATISTICS ON EQUAL OPPORTUNITIES AS AT 31.12.2017

	Women	Men	Total	Women	Men
	Number			Ratio	
Managers reporting directly	3	17	20	15 %	85 %
Heads of department	11	48	59	19 %	81 %
Total	**14**	**65**	**79**	**18 %**	**82 %**

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

In August 2015, the Supervisory Board approved a target of 20 % for the proportion of women on HSH Nordbank AG's Management Board, which was to be achieved by 30 June 2017. To date, HSH Nordbank has been unable to meet this objective. In July 2017, however, the Supervisory Board renewed its objective of appointing a female member of the Management Board by 30 June 2022, which corresponds to a quota of 25 % based on the Bank's current size.

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

One of HSH Nordbank's top priorities is to ensure a composition of the Management Board and Supervisory Board that is appropriate for the Bank and meets the different requirements of the responsible boards and, as a result, to ensure the adequate exercise of management and control functions. This means that, in addition to the described targets for the proportion of women on the Management Board, there are additional requirements aimed at achieving the balanced composition of the Management Board and Supervisory Board. The rules of procedure for the Supervisory Board, for example, state, in Section 6 (3c) (aa), that, when filling a post on the Management Board, consideration should be given to ensuring balanced and varied knowledge, skills and experience for all Management Board members. In addition, with regard to the age of the members of the Management Board, a limit applies pursuant to Section 6 (3c) (bb) of the rules of procedure for the Supervisory Board, according to which the members of the Management Board should not have turned 65 at the time of their appointment.

With regard to diversity in the Supervisory Board, the Supervisory Board had already adopted the objective in 2011, based on what were, at that time, new requirements of the German Corporate Governance Code (DCGC), of ensuring that the prevailing proportion of women would 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 31.2 %, the Supervisory Board has already met the target set by itself. The proportion of women on the shareholder side is currently 25 %, and 37.5 % on the employee side. In addition, the Supervisory Board had already set objectives back in 2011 and 2012 that aim to ensure that the composition of the Supervisory Board is as diverse as possible. The objectives deal with the composition of the Supervisory Board in terms of including international members, avoiding any conflicts of interest, an age limit, the percentage of women already described above and the impartiality of the members. The status of the target achievement is calculated annually and shown in the Corporate Governance Report.

In addition, the Supervisory Board has created a competence profile that is reviewed on an annual basis and sets out the skills required for activities on the Supervisory Board of HSH Nordbank. This does not require that all members of the Supervisory Board cover all competencies. Rather, the competencies should be covered by the Supervisory Board as a whole. Each member of the Supervisory Board has submitted a self-assessment of his/her competencies, producing a general overview. When filling a Supervisory Board position, the competence profile is taken as a guide in order to ensure that the Supervisory Board remains diverse in its composition, also with regard to the competencies represented on the Board. Another aspect of good corporate governance with regard to the diversity of the Supervisory Board is the requirement that a sufficient number of independent members are represented on the Supervisory Board. As a result, the Supervisory Board specifies, in the Corporate Governance Report, which four members it considers to be independent.

REPORT ON EVENTS AFTER THE REPORTING DATE

In its decision of 2 May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings in favour of HSH Nordbank AG. One essential commitment related, among other things, to the sale of HSH Nordbank by 28 February 2018. Within this context, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing) at least until the end of 2021. The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

In addition, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of € 10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management GmbH and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million, which will put pressure on the statement of income in the first quarter of 2018.

At the same time, HSH Finanzfonds AöR will make a payment to HSH Nordbank to compensate for the losses that have not yet been settled based on a separate settlement procedure. The signed cancellation agreement is subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

FORECAST, OPPORTUNITIES AND RISKS REPORT

FORECAST REPORT INCLUDING OPPORTUNITIES AND RISKS

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

In its decision of 2 May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings involving HSH Nordbank AG. One of the key commitments entered into vis-à-vis the EU Commission was the privatisation of HSH Nordbank AG by 28 February 2018. Within this context, full compliance with the catalogue of conditions and commitments (in particular, the successful outcome of the viability review of the future Bank that is set out therein) must be ensured, and all regulatory requirements, in particular the minimum capital requirements, must be met. In order to implement the privatisation commitment, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several renowned investors on 28 February 2018 by concluding a corresponding share purchase agreement. The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, GoldenTree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG which are independent of each other. The sale is subject to various conditions which must be fulfilled before the closing of the transaction.

As a result, one of the key assumptions used in the Bank's corporate planning with regard to the ongoing sale process of HSH Nordbank AG is that the outstanding conditions for the closing of the transaction are fulfilled and that the privatisation process is completed successfully as a result. The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's membership of the guarantee scheme of the Savings Banks Finance Group (SFG) for a further three years after the closing of the share purchase agreement, at least until the end of 2021.

Simultaneously with the successful conclusion of the share purchase agreement, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio consisting largely of non-performing loans (in particular ship financing) to a special-purpose entity from the sphere of the investors (the portfolio transaction). The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of share purchase agreement. Its successful implementation would lead to a reduction in the NPE ratio at HSH Nordbank AG to below 2%.

The successful execution of this portfolio transaction and the associated reduction in the NPE ratio are key assumptions used in the Bank's corporate planning over and above successful privatisation.

A further significant assumption with regard to corporate planning is the termination of the Sunrise guarantee. In light of the privatisation, HSH Nordbank AG and HSH Beteiligungs Management GmbH reached an agreement with HSH Finanzfonds AöR on the premature termination of the agreement on the provision of a guarantee facility in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million (cancellation agreement). As a result, the corporate planning assumes that, taking into account the settlement procedures set out in the cancellation agreement, the entire guarantee facility of € 10 billion will be drawn down by HSH Nordbank AG and paid by the guarantor to HSH Nordbank. The implementation of the cancellation agreement is also subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

In this respect, the Bank's forecasts and assumptions assume that the privatisation process will be completed as planned overall, i.e. with the closing of the share purchase agreement and the two other agreements concluded within this context (namely the portfolio transaction and the cancellation agreement). Responsibility for the closing of the share purchase agreement – which, as already explained, is also a prerequisite for both the portfolio transaction and the cancellation agreement – lies with the owners and investors and depends on the approvals referred to above; the Management Board of HSH Nordbank AG will do everything in its power to support this closing. As it is not, however, possible to objectively predict the course and outcome of the privatisation process with absolute certainty, the privatisation process involving HSH Nordbank AG creates significant uncertainty regarding the implementation of the corporate planning, as well as accounting and measurement.

Other key planning assumptions include the smooth transition to the private-sector deposit guarantee fund of the Federal Association of German Banks (*Bundesverband deutscher Banken*), including the acquisition of fully fledged membership within 3 years, a gradual improvement in the rating position along with a normalisation of the funding spread, a reduction in total assets, surplus liquidity and a change in the funding structure taking into account retail deposits, volume expansion in the Core Bank and an improvement in gross margins, an increase in the cross-selling business with a lower impact on capital, a significant reduction in administrative expenses, the further recovery of the shipping markets and, in particular, the recovery of the container shipping industry.

Assessments that form the basis for corporate planning and, in particular, the planning of the development in loan loss provisions, take into account the information available at this time. 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. By way of example, material uncertainty factors with regard to the development of loan loss provisions include, for example, the development of the relevant market parameters such as freight and charter rates, ship values, the US dollar exchange rate, as well as the development of the macroeconomic environment.

Following the successful completion of privatisation, the assumptions taken as a basis for planning purposes may change considerably as a result of the new ownership structure and the potentially modified strategic objectives and plans of the new owners.

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

In light of the privatisation process, the following forecast refers exclusively to the operating company, HSH Nordbank AG, unless explicitly indicated otherwise below.

ANTICIPATED UNDERLYING CONDITIONS

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

Good prospects for a continued strong recovery – risk factor of increasing protectionism

The outlook for the economy is good in general. After accelerating considerably in 2017, the global economy could grow at a similar rate this year. The upswing is being driven by the industrialised nations, but also by emerging markets such as Russia and Brazil, which have pulled themselves out of recession and embarked on a gradual recovery phase. The US is expected to grow at a rate of 2.7% in 2018. In the short term, the tax reform implemented by the US government could provide growth impetus, as it provides companies with incentives to step up their investments. We also expect the high growth momentum to continue in the eurozone. GDP, for example, could expand by a good 2%, which is considerably higher than the growth potential of the EMU area. China's economic growth is expected to slow to 6.2% in 2018 as against the previous year as part of a continued trend towards a gradual growth slowdown. This positive outlook is, however, based primarily on the assumption that the increasingly protectionist tendencies that are currently emerging, triggered by the announcement of import tariffs imposed by the US government, will not result in an escalation of trade conflicts.

Global economy with continued high growth

Although the US is unlikely to reach the high growth rates of above the 3% mark seen in the second and third quarter of 2017, the upswing remains very solid and is only expected to slow slightly in the second half of 2018. The reduction in corporation tax implemented as part of the US tax reform, which should prompt companies to up their investments, will provide a boost. The positive situation on the labour market is likely to result in a gradual increase in wage growth, which should push the rate of inflation up. We expect inflation to come to 2.2% at the end of the year (core PCE rate).

We do not expect to see any abrupt economic slump in China, but rather a renewed slowdown in growth. Growth is expected to come to 6.2% in 2018, compared with 6.9% in 2017. The high level of debt in the private sector, in particular in the corporate sector, poses a mounting risk.

In the eurozone, growth looks set to continue in 2018, because the economic environment is looking very positive in light of interest rates that remain very low and political stabilisation, which is boosting confidence in the eurozone. Investments are on the rise and private consumption is fairly robust, meaning that the economy should grow by at least 2% over the year as a whole. Risks hanging over the upswing still include the arduous Brexit negotiations and the March parliamentary elections in Italy, which saw populist parties receive a considerable boost and will make the upcoming phase involved in forming a government difficult. The inflation rate in the eurozone should have increased slightly to 1.5% by the end of the year, which is still well below the ECB's price target of just below 2%. Inflation is not expected to reach a level that the ECB deems adequate until 2020/2021.

In Germany, too, sentiment indicators and the data released suggest that the upswing is continuing at a high speed. In 2018, a growth rate well above the 2% mark is expected, on a par with the level already seen in 2017. The labour market is in better shape than it has been for a long time – the unemployment rate recently dropped to a low of 5.3% – which is likely to make it increasingly difficult for the corporate sector to find skilled workers.

Fed with further interest rate moves, ECB to end asset purchases, rise in interest rates moderate by historical standards

In light of the strong economic momentum, the Fed is expected to continue with its strategy of interest rate hikes in 2018 and increase the target range for the Fed Funds Rate to between 2.00% and 2.25% by the end of the year. This means that US government bond yields are likely to head north – in particular, the yield on ten-year bonds should show more of a reaction to the economic upswing and the key rate hikes in 2018. In our opinion, the yield on ten-year T-Notes could come in at just over 3% at the end of 2018. The ECB bond purchase programme (QE) is expected to be terminated at the end of the year at the latest. Over the next few months, the central bank is likely to communicate how it plans to proceed with the programme. The ECB recently took its first "mini step" towards an exit from QE. As we approach the end of the asset purchases, the prospect of an initial rate hike is gradually starting to appear on the horizon. We do not, however, expect this step to be taken until the end of 2019. While German government bond yields are unlikely to be able to decouple completely from the rise in interest rates in the US, the increase is likely to be fairly moderate given that the ECB's monetary policy will remain expansive for the time being. At the end of 2018, the yield on ten-year German government bonds is expected to come in at just over 1%. The biggest risks both for the real economy and for the global financial markets could lie in increasingly protectionist measures on the part of the US – the US government already introduced import duties on steel and aluminium at the beginning of March – and subsequent reactions by third countries, or in a more pronounced slowdown in China.

The euro has made short-term gains against the US dollar, reaching a level of 1.25. The gains for the euro have recently decreased, because the interest rate differential between the two sides of the Atlantic is expanding with the prospect of rate hikes by the Fed. Looking ahead to the future, however, the euro could once again gain ground against the US dollar, because HSH Nordbank expects the ECB to break ties with its ultra-loose monetary policy as well. HSH's plans are based on a slightly stronger USD exchange rate.

Outlook for relevant markets

The moderate recovery on the **shipping markets** should continue – with the exception of the tanker segment. The increase in charter rates is also reflected in an increase in ship values. In the tanker segment, on the other hand, a recovery is yet to emerge, even though this market is also benefiting from the more favourable global economic conditions.

As far as **container vessels** are concerned, 2018 is expected to bring a continued moderate recovery trend. It is expected that both charter rates and ship values will increase. Demand growth will show similarly dynamic development to that witnessed in the previous year. On the supply side, however, fleet growth will start to pick up as scrapping activities are set to decrease slightly and more deliveries are expected. We expect to see a further revival in new order activities. The new ships would, however, only come on the market after some delay, meaning that the market recovery should continue in 2019. Geopolitical risks with the threat of trade restrictions could, however, start to put a damper on container handling.

Demand growth for **bulkers** is expected to stabilise in 2018 and become more solid beyond this year as well. The long-term outlook is, however, characterised by the heavy reliance on import demand for coal and iron ore from the Asian region, particularly from China, as well as the uncertainty regarding the development of environmental policy objectives, as well as steel production. Despite a slight drop in scrapping activity, fleet growth and, as a result, tonnage supply will remain at a relatively low level in 2018 due to the small number of deliveries and moderate level of new orders in the previous year. The positive development in 2017 as a whole, as well as the increase in transport volumes extending beyond 2018, will result in an increase in the utilisation of the existing fleet, which should lead to a moderate increase in charter rates and in ship values.

The **oil tanker market** will continue to stabilise in 2018. The demand growth for oil tanker tonnage will remain moderate. The OPEC production cuts will continue to hold things back until the end of the year at the very least, although this could be partially offset by the increasing crude oil exports from US. The supply side is also looking a bit brighter in 2018. The slowdown in fleet growth is the result of declining deliveries and increased scrapping activity. Utilisation is expected to remain at a relatively low level and is only expected to increase slightly in the following years. This means that both charter rates and second-hand prices are expected to fall slightly again. As far as 2019 is concerned, we expect to see a recovery emerge, albeit at a slow pace, in light of the dwindling tonnage growth.

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

The majority of Germany's **real estate markets** should continue to benefit from the favourable underlying economic conditions in 2018 and show positive development. On the **housing markets** in most large cities, however, demand is likely to grow at a slower pace than in the past due to the declining influx of inhabitants. It will still, however, cover the growing supply of housing resulting from brisk new construction activity, meaning that vacancy levels will remain low. The retail sector is benefiting from the positive consumer sentiment and increasing household income. Demand for space, however, is growing at an increasingly slower pace, not least because consumers are buying more online. On the **office real estate markets**, declining vacancy rates can be expected due to only a slight increase in completions and demand for space that is hardly flagging and remains buoyant. Office rents are therefore likely to continue to increase considerably, not least in central locations and also to a significant extent in secondary locations. In the **commercial real estate** segment, on the other hand, rents are likely to stagnate in most cases, with a slight increase only in selected top locations. Residential rents should increase more slowly as the number of completions increases. The statutory limits placed on rent increases on the re-letting of homes, however, are only likely to take effect in the event of supplementary measures. Given the price level reached after the strong increases in previous years and based on gradually rising interest rates, house prices and the market values of office properties will show only a moderate increase in 2018. The market values of retail properties are only likely to dip slightly from the current level in view of the ongoing structural change and depending on the location and the type of business.

Overall, incoming orders, the positive sentiment indicators and employment development in the **manufacturing sector** point towards a further upward trend in industrial activity. However, it is not only the economic slowdown in China that is putting pressure on heavily export-oriented sectors of the manufacturing industry, such as automotive, engineering, electronics and chemicals in the medium term. The long-term consequences of the Brexit vote cannot yet be predicted, but should gradually become clearer in 2018 as the exit negotiations progress. The ongoing discussion regarding combustion engines, in particular diesel vehicles, is likely to put pressure on the export prospects of the German automotive industry. In addition, it remains to be seen to what extent the US government – after the introduction of punitive tariffs on steel and aluminium imports in March 2018 – will, in fact, implement more protectionist measures, e.g. with regard to the survival of the North American Free Trade Agreement NAFTA. Overall, and in addition to geopolitical risks, this continues to pose a considerable downside risk to the global economy and, of course, in particular to the German export industry. The economic upswing in the US as a result of the expansionary fiscal measures that are currently being implemented (among others, tax cuts) and the continued more optimistic economic outlook in the eurozone are to be seen as positive factors. This means that the upward trend in growth rates will be sustainable for the time being. The food industry is also likely to continue with its growth trend due to consumer behaviour of private households that remains encouraging, but is expected to lose momentum.

The outlook for the international business of companies operating in the wholesale and foreign trade sector is positive due to the increasing growth momentum in **German industry**. In particular, cyclical intermediate industries are likely to continue to reap the benefits in this regard.

The positive underlying conditions caused by the good employment situation are also having a beneficial effect on the **retail** sector. However, momentum is likely to slow, as increases in real wages of private households will be lower as a result of increasing inflation. e-commerce is also likely to remain a retail growth driver in 2018.

The willingness among companies to make new (equipment) investments should increase considerably across the sector thanks to the brisk demand at home and abroad, as well as the further increase in capacity utilisation. The change in investment appetite is likely to have a continued positive effect on lending demand. Looking at all banks in Germany as a whole, the favourable financing conditions in conjunction with positive business expectations in the corporate sector were already reflected in an accelerated increase in the number of book loans to domestic (non-financial) companies in 2017: the annual growth rate at the end of the fourth quarter of 2017 showed significantly higher growth momentum than for loans to private households.

The revenues reported by companies in the **logistics industry** should be able to maintain the high rate of growth seen in 2017 for the time being. However, this cyclical sector is subject to the risks of a general macroeconomic downturn and a weakening in global trade, also possibly as a result of increasing protectionist measures. Brexit is not yet expected to have any real economic impact on the logistics industry to speak of in 2018. The economic climate in the German logistics industry is expected to remain above the long-term average at the beginning of the year 2018 as well, and to remain in expansive territory overall.

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

The prospects for the expansion of **renewable energies** remain mixed as far as 2018 is concerned: whilst the capacity added is likely to stagnate at a good level overall in Europe, there are definitely growth opportunities globally. A distinction, however, has to be made between wind and solar energy: the substantial increase in capacity added witnessed in the German wind energy segment over the last few years is expected to slow slightly. The move to bidding procedures implemented in connection with the amendment to the Renewable Energies Act (EEG) will still result in a temporary increase in demand for the transitional year of 2018. As of 2019, however, a marked downward correction in capacity added is likely to follow. The EEG amendment is not, however, likely to have an impact on existing facilities. New installations are likely to increase again in the rest of Europe. The absolute increase in generation capacity in the solar energy sector in Germany – and also in Europe as a whole – is likely to be moderate over the next few years due to the European climate protection targets and cost degression, although it will return to an upward trend. The outlook is, however, made bleaker by restrictions on state subsidies. The target set by the German federal government of constructing 2.5 gigawatts of additional capacity a year in Germany is also likely to be missed again in 2018.

Ongoing challenging environment for banks

In light of the ongoing geopolitical and economic uncertainties in connection with the economic policy course pursued by the new US government, the implementation of the vote by the British electorate to leave the EU (Brexit), which could put pressure on banks operating on a cross-border basis, as well as potentially high levels of volatility in the financial markets, the macroeconomic environment for banks is likely to remain challenging in 2018 – even though the prospects, particularly in Europe, and the global economic situation, are looking much brighter overall at the beginning of this year than at the start of last year. One of the consequences of Brexit could involve eligible counterparties in the United Kingdom within the meaning of the EMIR no longer being recognised, and the related privileges with respect to regulatory capital backing in accordance with the CRR being lost for trading risk positions.

In terms of monetary policy, signs are gradually emerging of the prospect of a turnaround in Europe as well. Although the ECB is likely to maintain its expansive monetary policy in the first instance, meaning that the pressure on net interest income resulting from the low interest rate environment will continue to increase for the time being, European banks should also be able benefit from a steeper yield curve in the medium term – with positive effects on the income side. Institutions must, however, continue to attempt to offset the negative effect on profitability resulting from the current low interest rate environment by expanding income sources that are not dependent on interest rates (for example, commission income) and by reducing costs further.

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

Regulators and market participants will continue to focus more on an increasingly 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 the new 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) defined by the national banking supervisory authorities and resolution authorities.

Other fundamental adjustments can already be identified alongside these capital requirements that are being increasingly defined. The changes summarised under Basel IV, which, amongst other things, will serve to improve the comparability of RWA profiles and the reduction of complexity concerning risk identification, are at the same time aimed at the harmonisation of supervisory practices in the EU and are designed to improve transparency vis-à-vis the markets. In particular, the changes include 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. This means that a gradual increase in capital requirements is likely from 2022 at the latest.

As part of the Supervisory and Evaluation Process (SREP), the EBA stress test that was launched at the beginning of 2018 is likely to become a focal point, in addition to the focus on the winding-down of non-performing loans and the review of internal models (TRIM). Back in December, the EBA, as in previous years, published extensive data on major European banks in order to increase market transparency and market discipline. As well as taking IFRS 9 elements into account, the stress test itself also models, in particular, the impact of the current low interest rate environment, as well as the implications of an interest rate shock. Results for the 59 participating major banks are scheduled to be published in mid-2018. HSH Nordbank will not be taking part in the stress test owing to the extensive realignment, which will result in a significantly different risk profile.

New accounting and reporting regulations

In addition to a wide range of new requirements with respect to future capital resources, one focal issue is the implementation of the new provisions governing accounting for financial instruments in accordance with IFRS 9, which apply as a mandatory requirement for the purposes of the Group financial statements as of 1 January 2018. These new regulations come hand-in-hand with changes in the classification of financial assets and the calculation of loan loss provisions.

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. Based on the assumption of what is still the largely analogous application (if permitted) of the requirements under IFRS 9 in the HGB single-entity financial statements, this could have a negative impact on loan loss provisions and the capital ratios at the level of the individual institution pursuant to HGB (CET1 capital ratio individual institution and overall capital ratio individual institution). Further details are provided in the section entitled "Opportunities and risks in the loan loss provisions forecast".

The new regulations set out in IFRS 9 will result, in the Group financial statements, in valuation effects to be recognised in equity in the opening balance sheet in retained earnings/the revaluation reserve at the time of initial application. HSH Nordbank estimates that, at the time of initial application on 1 January 2018, IFRS 9 will result in an increase in equity of approx. € 109 million before taxes, or € 79 million after taxes. The actual effect, based on the first interim financial statements including the time of initial application, is still subject to uncertainty, first of all because definitive verifications of certain parameters and models (e.g. PD and LGD) used in the calculation of loan loss provisions and fair value are still outstanding. Second, the process associated with the quality assurance of the opening balance sheet data that has been prepared has not yet been completed in full. HSH Nordbank estimates that, based on the remaining uncertainties, the above-mentioned value for the change in equity could still fluctuate by +/- € 10 million before taxes.

The main drivers of the estimated initial application effect include the increase in portfolio valuation allowances due to the new loan loss provision model (level 1 and 2 in the new loan loss provision model) and effects from the fair value measurement of certain loans and securities resulting from the new classification provisions.

The increase in portfolio valuation allowances is attributable to the increase in loan loss provisions on the lifetime expected loss (level 2)/the full 12-month expected loss (level 1). HSH Nordbank estimates that the increase in portfolio valuation allowances will reduce equity in an amount ranging from approx. € 136 million to € 153 million before taxes.

With regard to the impact of IFRS 9, HSH Nordbank expects to see an improvement in the core Tier 1 capital ratio (same-period CET1 ratio) of approximately 1.0-1.2 percentage points at the time of the initial application of IFRS 9 on 1 January 2018. This is due to the considerable difference between the nominal values and the market values to be recognised in the future under IFRS 9 for the largely non-performing loan portfolio sold as part of the portfolio transaction, meaning that the volume and the risk weight of the senior securitisation tranche for the Sunrise guarantee are significantly reduced. This leads to a significant decline in RWA for the Sunrise portfolio after the guarantee, and thus contributes significantly to the positive effect of IFRS 9. Within the context of the analysis of the pro forma CET1 ratio (for an explanation of the pro forma CET1 ratio, see the section entitled "Management System") HSH Nordbank expects this effect to lie within a range of +/- 0.1 percentage points. The quantitative effects of the changeover to IFRS 9 – insofar as they are known at the time of planning – have been included in HSH Nordbank's bank planning.

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 for granular lending data and credit risk data 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 still under discussion, would result in a significant reduction in income from the capital markets business. An agreement, however, is yet to be reached on the draft, which is currently being discussed. In view of the varied regulatory requirements accompanied, on the one hand, by noticeably higher costs and, on the other, by exacting regulatory requirements regarding capital adequacy, banks will be required to continuously review their business models and constantly improve efficiency to be able to ensure sufficient profitability and maintain the ability to build up capital from their own resources.

EXPECTED BUSINESS DEVELOPMENT OF HSH NORDBANK

2018 – privatisation process expected to be completed successfully

With regard to the share purchase agreement that was signed on 28 February 2018, the Bank expects the change of ownership to be implemented as planned in the second or third quarter of 2018 once the necessary approvals have been obtained and the further conditions have been met, meaning that the commitments made in the EU state aid proceedings on the replenishment of the second loss guarantee can be honoured. In addition, the Bank expects that the agreement on the portfolio transaction relating to the planned spin-off of a large part of the non-performing legacy burdens from the Non-Core Bank, and the cancellation agreement reached with regard to the second loss guarantee, can be completed and implemented.

Based on the restructuring progress achieved in the 2017 financial year, as well as the overall satisfactory operating performance, the Bank expects to be able to forge ahead with the transformation process that it has initiated in the 2018 financial year. In this respect, the Bank remains cautious in its forecast, in particular due to the considerable uncertainty that will naturally remain up until the closing date of the privatisation process.

In detail, the Bank expects, with regard to the key management indicators, that

- the new business of the Core Bank will be moderately higher in 2018 as a whole than in the previous year (2017: € 8.5 billion). The net income before taxes and the RoE of the Core Bank are likely to be clearly in positive territory, although they are likely to remain below the values reported in 2017, which benefited from one-off effects.
- the winding-down of high-risk portfolios will be completed within the context of the portfolio transaction planned in connection with the privatisation, meaning that the NPE ratio in the Group and the Core Bank will come to around 2%). At the same time, the total assets of the Non-Core Bank will fall considerably. The net income before taxes of the Non-Core Bank is likely to be clearly in the red again, but significantly less so than in 2017, when the portfolio transaction posed a considerable burden.
- the cost reduction programme, which has been running to plan so far, will be systematically continued, and further optimisation potential at cost and process level will be identified at Group level as part of the new Reset & Go transformation project.
- The Group net result before taxes will still be shaped by the implementation of the privatisation process and by restructuring costs, as well as by a compensation payment made for the termination of the federal state guarantee. This means that both net income before taxes and the RoE will once again be negative, but much less so than in 2017.
- the pro forma CET1 ratio, which is calculated excluding the regulatory RWA relief effect of the second loss guarantee (for details, see section entitled "Management system") will adhere to the ambition level of 15%.

In general, the plans assume that it will be possible to exploit further earnings and cost potential in the event of the successful closing of the share purchase agreement as part of the privatisation process. It is assumed that the closing of the share purchase agreement could have a positive impact both on the Bank's key management indicators and on the assessment of investors and rating agencies alike. Furthermore, the planned spin-off of a large part of the legacy burdens thanks to the portfolio transaction and the termination of the second loss guarantee will considerably reduce complexity in the Bank's processes and organisational structure, which is expected to result in significant efficiency gains.

In the strategic vision for 2022, the Bank expects, based on total assets of around € 55 billion, to have good asset quality with an NPE ratio of no more than 2%, a solid capital position with a CET1 ratio of around 15%, a good cost/income ratio of around 40% and an adequate RoE before tax of at least 8%.

The following statements assume that all of the requirements for the completion of the privatisation process will be met, establishing a business model that is sustainable in the long term and securing the Bank's survival as a result.

With regard to the consequences of unsuccessful completion of the sale process, reference is made to the information in the section entitled "Formal decision in the EU state aid proceedings".

Earnings forecast

For the 2018 financial year, the Bank expects to be able to achieve a moderate increase in its new business (key management indicator for the Core Bank). The positive development of the privatisation process to date should favour new business development accordingly, in particular after the closing date. With regard to the margins that can be achieved, HSH Nordbank is taking into account the continued challenging market environment and expects to see persistent margin pressure overall. Gross margins are expected to remain at the level seen in 2017, which is still adequate, on the whole, while net margins should increase moderately as a result of the gradual slight decline in funding costs. At the same time, the Bank aims to continue to drive forward sales of the range of services offered over and above loan financing to optimally exploit the business and earnings potential and generate additional commission business.

The earnings side will be strengthened further by the focused increase in new business and product sales. This will allow the Bank to counteract the loss, in particular, of interest income from non-strategic portfolios as a result of the progressive winding-down. Nevertheless, the portfolio transaction will not be able to compensate for the winding-down of portfolios of legacy burdens within the Non-Core Bank. As a result, HSH Nordbank expects to see a significant decline in total income at Group level in 2018 as a whole. A large part of this decline compared with the 2017 financial year is due to the loss of one-off effects (valuation effects from the reassessment of interest and principal cash flows relating to hybrid capital instruments, as well as special effects from the realisation of unrealised gains) incurred in the 2017 financial year.

Overall satisfactory operating earnings driven by all segments are expected for the Core Bank. With regard to the Non-Core Bank, HSH Nordbank expects that it will only play a minor role following the implementation of the portfolio transaction. The plan is to transfer the sold portfolios with retroactive effect from 1 January 2018 in the event of successful closing, meaning that total income in the Non-Core Bank will fall and reach an insignificant level compared with the Group's total income.

Also, at the HGB single entity level – influenced by a marked drop in net interest income and the fact that the special effects will no longer apply – a clear decrease in 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 successful and early completion of the privatisation process would offer numerous opportunities for stepping up moves to expand new business and broaden the client base, taking into account the business potential in the Core Bank which could be realised, in particular, after the abolition of the restrictions and obligations contained in the catalogue of conditions and commitments. This could allow additional earnings potential to be exploited. The business opportunities in the corporate sector included in the list of conditions and commitments, for example, 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.

Once the significant uncertainty associated with the privatisation process has been cleared up, the Bank could once again play a more active role, in particular with regard to its existing portfolio, as a stable banking partner, further expanding its objective of establishing itself as a bank for entrepreneurs. The Bank's refinancing costs could also fall more significantly than expected in the event of the successful completion of the privatisation process, which would strengthen its competitive standing.

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 the planned expansion of structured and commission-based products 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. In addition, a more pronounced increase in interest rates than planned could have a positive effect on income.

Risks

Delayed closing or any deterioration in the macroeconomic environment – not least due to trade policy or geopolitical effects – and conditions in relevant markets would probably result in a lower than assumed demand trend for loan financing. The competitive situation could also put more pressure on margins than expected.

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 could have a negative impact on the planned refinancing costs.

Measurement losses on debt instruments and derivatives in the existing portfolio arising as a consequence of market developments or tensions in the financial markets also cannot be ruled out. IFRS measurement effects resulting from movements in the US dollar or interest rates as well as basis swaps could have a more adverse impact than expected, although US dollar sensitivity has decreased markedly since 2016 and will continue to 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) associated with the realisation of unrealised gains by selling securities or promissory note loans that is planned for 2018.

US dollar and interest rate trends could also lead to stronger negative effects in the HGB single entity than expected. For example, there could be an impact on the valuation of the banking book pursuant to IDW RS BFA 3, the provisions in connection with valuation units, the participation of hybrid financial instruments in gains/losses and the measurement of deferred taxes.

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.

In addition, potential adjustments to the business model, as well as the planned expansion of structured and commission-based products, which is expected to be driven considerably from the financial year 2019 onwards, might not have the expected impact on earnings. The delayed closing of the share purchase agreement could also put pressure on new business and the Bank’s future earnings situation due to uncertainty.

Forecast for administrative expenses

The strategic realignment of HSH Nordbank plans to reduce administrative expenses further in the period leading up to 2022 within the context of the Bank's realignment so that the Bank can achieve an appropriate cost-income ratio of around 40 % and an RoE before taxes of around 8 % in the long term.

As far as 2018 as a whole is concerned, HSH Nordbank once again expects to see a marked reduction in the administrative expenses that can be controlled operationally. The cost-income ratio (key management indicator for the Group and the Core Bank), which benefited from one-off effects in 2017, is likely to increase in spite of the lower cost base at both Group and Core Bank level. The reduction is to be achieved in the first instance by the systematic implementation of the cost reduction programme (2018PLUS)) that has been pursued to date. The main measures associated with this programme include an accelerated reduction in staff numbers, as well as reductions in operating expenses, in particular in connection with the further streamlining of the organisational structure, the ongoing simplification of key processes, the optimisation of the product portfolio and the ongoing realignment of IT.

With the future-oriented further development of IT and the system landscape, the Bank is aiming to leverage considerable efficiency potential in the medium to long term. These efforts aim primarily to establish a one-system strategy in the securities business and to concentrate on the core systems/core processes of a Bank focusing on the medium-sized company segment. IT is driving the digitalisation strategy in this respect. This first of all allows the Bank to tap into client groups and market potential, e.g. using what is known as a “digital corporate platform”. Second, this approach is associated with the optimisation of recurring processes, which is often summarised under the key term “robotics”. In addition, the Bank is aiming to optimise application development and support. The Bank hopes that this will allow it to exploit efficiency potential, highlighting its own objectives as far as the ambitious cost planning is concerned.

The cost reduction programme, which has been running since 2014 overall and was last adjusted to reflect the latest requirements in May 2016, generally aims to achieve a sustainable and efficient structure for the Bank in this period of transformation. The Bank is planning to develop another cost reduction programme in the 2018 financial year to support the Bank's realignment, which has now been initiated. The plan is to implement this new programme before the year is out. To this end, efficiency levers and measures relating to operating expenses are currently being identified as part of the Reset & Go transformation project and will be implemented after the closing date at the earliest following consultation with the Bank’s social partners. Significant potential arises with regard to the expected reduction in complexity that is to be achieved by the closing of the portfolio transaction and the resulting substantial reduction in the Non-Core Bank portfolio, as well as by the termination of the guarantee. The Bank also expects to be able to exploit further efficiency potential relating to controllable operational administrative expenses, even though additional restructuring costs will be incurred in 2018.

In light of the future streamlined and mid-sized enterprise structure of an agile bank whose risks have been reduced considerably, the Bank expects the number of employees to be gradually reduced further in the planning period leading up to 2022. Another significant reduction was already achieved in 2017 as a whole without having to make significant cuts relating to the client and product range. 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 for administrative expenses

Opportunities

If the privatisation process is completed successfully, there will be an opportunity to continue to adapt the current cost structures and realise additional cost potential. This potential could arise from possible synergies and, where appropriate, from new strategic options.

HSH Nordbank is confident that it will achieve its stated objectives after also taking account of the successes 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 and HR area, will be continuously reviewed as part of the measures controlling process to ensure the successful implementation of the cost plan.

Also, with regard to the expected reduction in the number of employees as part of the current cost reduction programme, the Bank is assuming that the measures initiated will continue to be implemented successfully. 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 further reductions in total assets, and therefore refinancing requirements, savings may be achieved in terms of the Bank's planned expenses for the bank levy and deposit guarantee fund, assuming that other calculation parameters (for example the institution risk factor) remain the same.

Risks

If the cost-saving measures are not implemented as planned, in particular due to risks affecting business operations that cannot be predicted, it cannot be ruled out that some costs will not be able to 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 dimensions are difficult to predict. Unavoidable consequences for administrative expenses are possible. In connection with the restructuring and cost programmes, there is also the risk that, in order to achieve the desired cost targets, additional restructuring and transformation outlay will be required over and above the outlay that is already planned.

Similarly, it is impossible to rule out a scenario in which 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 the reduced effectiveness of internal control functions, or in implementation risks, 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 associated with privatisation to achieve efficiency gains 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.

In addition, there is a risk of additional expenses for legal and litigation costs resulting from legal risks in connection with certain refinancing operations due to additional claims risks and unfavourable court decisions.

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

Within the context of the privatisation, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio, consisting largely of non-performing loans, to a special-purpose entity from the sphere of the buyers of the shares in HSH Nordbank on 28 February 2018. In detail, this portfolio transaction relates, in particular, to non-performing exposures (NPE) - consisting mainly of ship financing. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of share purchase agreement.

Within this context, the Bank's plan is for the NPE ratio at HSH Nordbank AG to amount to around 2 % at Group level following the implementation of the portfolio transaction.

In this respect, the Bank expects its loan loss provisions in 2018 to be down considerably on the level seen in the 2017 financial year. The Bank expects its additions to specific loan loss provisions, as one component of loan loss provisions, to fall in the high double-digit million range. Loan loss provisions are likely to continue to focus on shipping loan exposures. In this respect, it is assumed that the moderate recovery on the shipping markets will continue at a slow pace in 2018. The NPE ratio, which will be reduced to a level that is sustainable in the long run as a result of the portfolio transaction, will then come in at the low level of around 2 % that will be achieved during the planning period. Based on the Bank's plans, the coverage ratio in 2018 will remain at the good level seen in 2017.

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

The loan loss provision plan is based on valuation models that also take into account the regulatory environment, the expected development of risk parameters over time as well as the Bank's empirical values in critical situations in addition to portfolio developments and key macroeconomic data (including the EUR/USD exchange rate, charter rates and ship values).

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

A key driver of the amount of loan loss provisions is also the breakdown of impaired loan commitments into "capable of recovery" (and therefore recognition of a specific loan loss provision based on the assumption of the continuation of the borrower's business) or "not capable of recovery" (and therefore recognition of specific loan loss provision based on the assumption of a workout). The plans for loan loss provisions are based on the assumption of a recovery on the shipping markets/recovery in the container shipping industry, as well as the continuation of the current commitment strategies and, as a result, the assumption that HSH Nordbank is prepared to provide further financing. Developments over the past years have, however, shown that the ability to make forecasts in a volatile environment is limited.

With regard to the UK's Brexit vote and exit from the EU, HSH Nordbank expects real estate prices to drop. With regard to the Bank's real estate financing portfolio in the UK, which has a volume of around € 1.3 billion EaD, the Bank does not expect to see any additional need for loan loss provisions in connection with Brexit.

Also, at the level of the individual institution, the Bank expects loan loss provisions to be down significantly on the level seen in the 2017 financial year in accordance with the HGB provisions as well.

No separate forecasts for the NPE ratio and the coverage ratio are made at 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.

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. After its successful privatisation and the portfolio transaction, the Bank will have a much more balanced portfolio with improved asset quality, meaning that the earnings burdens resulting from loan loss provisions could also be much lower than assumed in the plans.

Risks

The risks relating to loan loss provisions that are higher than planned can be broken down into the following aspects: Firstly, less favourable macroeconomic and sector-specific/market-specific developments than assumed in the plans. Secondly, regulatory risks resulting from adjustments to the statutory and regulatory framework. Thirdly, single commitment-specific risks (e.g. changes in the recovery and resolution strategy). And fourth, bank-specific risks, including from the settlement of the second loss guarantee, which is to be redeemed.

As far as original loan loss provisions are concerned, there is uncertainty with regard to the need for impairment losses, in particular in the ship financing business, but also with regard to real estate financing, due to volatility and the cyclical nature of the market environment for key sub-portfolios. Material uncertainty factors relate, in particular, to the development of the US dollar exchange rate, political risks, for example in the form of tariffs/barriers to trade, the interest rate environment, as well as significant segment-specific market parameters, such as freight and charter rates and ship values in the shipping market, or real estate prices and rents in the real estate business, which are used as key input parameters for modelling within the context of planning loan loss provisions. If these parameters show less favourable development than expected, then it is impossible to rule out an increased volume of new defaults, or a scenario in which the recoverability of individual commitments cannot be achieved in the planning period as assumed in the loan loss provisions plans. This could lead to unplanned burdens caused by additional loan loss provisions. In particular, in view of the ongoing overcapacity in the shipping markets, it is impossible to rule out a scenario in which the extent and timing of the market recovery do not materialise as planned, which could increase the need for loan loss provisions considerably in this case, or in the event of constant or falling charter rates and ship values.

In addition, it is impossible to rule out a scenario in which real estate prices fall significantly following the UK's Brexit vote and exit from the EU. Additional loan loss provision expense could arise with regard to the Bank's real estate financing portfolio in the UK as a result.

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.

Single commitment-specific risks could result in additional loan loss provisions due to changes in the commitment strategy, in particular if assessments of the recoverability of borrowers change, resulting in changes in the willingness on the part of the Bank to provide further funding for problem loans. Changed assessments of the recoverability of a borrower could, for example, result in loan loss provisions having to be set up based on the assumption of a workout and, as a result, the realisation of collateral.

With regard to regulatory risks, the impact of new accounting standards (in particular IFRS 9) could have a negative impact on loan loss provisions in the Group financial statements extending beyond the changeover effects that are currently included in the Bank's plans. The actual changeover effect at the time of initial application is still associated with uncertainty, since, first of all, the final validation of certain parameters and models on which the calculation of loan loss provisions and fair value is based (e.g. PD and LGD) is still pending. Second, the quality assurance of the opening balance sheets is not yet complete. For example, higher than planned required portfolio valuation allowances as a result of a deterioration in the risk parameters may adversely impact loan loss provisions in the lending business or capital on the adoption date.

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

Concerning bank-specific risks, there is the risk that, with regard to the guarantee cancellation agreement that has been concluded, the losses calculated by the Bank based on the defined guarantee settlement mechanism will not be recognised in full by the guarantor. This sort of scenario would result – compared with the assumptions made by the Bank on the full utilisation of the second loss guarantee – in a reduction in the hedging effect and would therefore result in additional expenses within loan loss provisions corresponding to the amount of the reduction in the hedging effect. In this scenario, an agreement has been reached in the share purchase agreement that the purchase price for the shares in HSH Nordbank will be reduced by a corresponding amount. At the same time, it has been agreed that a corresponding amount of capital will be injected at HSH Nordbank by the new owners.

Capital and RWA forecast

For this year and as at the end of2018, HSH Nordbank assumes that the capital ratio will continue to be significantly above the SREP requirements. Since 1 January 2018, an SREP minimum requirement of around 10.2% (Pillar 2 Requirement "P2R" incl. the combined capital buffer requirements) has applied to HSH Nordbank for the CET1 ratio.

With regard to the CET1 ratio, HSH Nordbank does not expect to see any net burden resulting from the changeover to IFRS 9 at the beginning of 2018. The IFRS 9 transitional arrangements in accordance with the CRR will not be applied. HSH Nordbank therefore expects a positive change in the core Tier 1 capital ratio (same-period CET1 ratio) at the time of the initial application of IFRS 9 on 1 January 2018. For details regarding the expected impact of the introduction of IFRS 9, reference is made to Note 1 of the notes to the Group financial statements.

In light of the share purchase agreement signed on 28 February 2018, the agreement on the portfolio transaction and the cancellation agreement for the second loss guarantee, which was also signed on 28 February, the regulatory CET1 capital ratio is expected to no longer be recognised as a securitisation arrangement taking into account the regulatory relief effect as of March 2018, but rather will correspond to the pro forma CET1 ratio excluding the regulatory RWA relief effect of the second loss guarantee calculated based on hypothetical assumptions (for details, see the section entitled "Management system").

In the further course of the year, the planned closing of the portfolio transaction (following the closing of the share purchase agreement in 2018) is to result in a significant reduction in RWA.

At the end of 2018, HSH Nordbank expects a slight increase in RWA overall as against 31 December 2017 based on a stronger US dollar, expected new business and the elimination of the regulatory RWA relief effect of the federal state guarantee.

In this respect, the Bank nevertheless expects to be able to report a same-period CET1 ratio that is significantly higher than the SREP requirements and is consistent with its current ambition level of 15% at the level of the IFRS Group at the end of 2018.

Separate forecasts are not prepared for the CET1 capital 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 in 2016 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 (4.5% CET1) as well as additional capital buffer requirements (around 1.9% CET1), are to be complied with. According to the plan, the Pillar 1 minimum capital requirements pursuant to CRR (4.5% CET1) 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 closed (share purchase agreement). After the sale of HSH Nordbank has been closed (share purchase agreement), HSH Nordbank will no longer form part of the financial holding group. This means that the capital requirements at the level of the financial holding group would no longer apply to HSH Nordbank.

The transposition of the Bank Recovery and Resolution Directive – BRRD) into national law (Recovery and Resolution Act – *Sanierungs- und Abwicklungsgesetz* – SAG) will result in a new capital requirement 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 HSH Nordbank (Minimum Requirements on Eligible Liabilities – MREL). For this year and as at the end of 2018, HSH Nordbank assumes that the MREL ratios will be significantly above the SREP requirements.

Within the context of the further development of the regulatory requirements, a large number of potential changes will be made with regard to market, operational and counterparty risks. The capital ratios may be impacted in future by the intended changes to the regulatory requirements (sometimes referred to as "Basel IV"). HSH Nordbank expects that this will not have any significant impact prior to 2022. This means that a gradual increase in capital requirements is likely from 2022 onwards at the latest. The Bank will adjust its business and capital management to reflect the expected Basel IV burdens in order to keep any impact on the capital ratios at a minimum. As a result, the Bank does not anticipate any significant burden in the period leading up to 2022.

Opportunities and risks in the capital and RWA forecast

The aspects referred to in the "Loan loss provision forecast" section could generally also result in the capital position developing in a manner that deviates from the plan due to higher earnings burdens or increases in RWA. The opportunities and risks can also be broken down into aspects relating to the macroeconomic, sector and market-specific developments, the overall regulatory framework and single commitment-specific and Bank-specific factors.

Opportunities

Opportunities for the capital ratios and RWA result from more favourable trends in the relevant market and risk parameters and the optimisation of the capital structure. The closing of the sale of HSH Nordbank (share purchase agreement) to the new owners and, as a result, the implementation of a sustainable business model may lead to an increase in income and the optimisation of the cost structure with positive effects on the Bank's capital position.

If the EUR/USD exchange rate remains at the high level reached on 31 December 2017, or the EUR/USD exchange rate strengthens even further, then the capital ratio could be significantly higher than expected.

Earnings development that outstrips expectations in 2018 would also have a positive impact on the capital ratio.

Risks

Significant macroeconomic risks regarding the capital ratios and RWA result from a potential deterioration in the market and risk parameters in the Bank's core markets, including a stronger US dollar. In addition, there is the risk, in particular, 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 RWA and loan loss provisions and put considerable and direct pressure on the capital ratios as a result.

In addition, risks to the capital ratios could emerge from the regulatory environment, for example due to regulatory interpretation decisions or audits.

It is possible, for example, that additional individual and increased capital requirements could arise from the regular SREP process carried out in the Banking Union. Additional discretionary decisions made by the supervisory authorities and industry-wide capital requirements (capital buffer for systemic and anti-cyclical risks) could therefore result in RWA burdens or higher capital requirements. Discretionary decisions by the supervisory authorities with regard to model risks/validations could, for example, be made in the context of the Targeted Review of Internal Models/TRIM or in relation to HSH's application regarding a waiver of the inclusion of the effects of the portfolio transaction in the future LGD/PD estimates in the internal models.

If the market recovery in the shipping market, which is one of the aspects assumed in the Bank's planning, fails to materialise, or in the event of a deterioration of the real estate market (in particular in real estate values), or if the macroeconomic environment is considerably weaker or the USD exchange rate is much stronger (downside scenario), this would lead to a significant deterioration in the risk parameters and measures would have to be taken to strengthen the capital ratios (for example, reduction of new business and securitisation of portfolios) in order to comply with the regulatory requirements (Pillar 2 Requirement) at the level of the HSH Nordbank subgroup. If capital buffer requirements (Pillar 2 Requirement) are not met in this sort of scenario despite measures being taken, then a capital conservation plan would have to be prepared in accordance with Section 10i (3) of the German Banking Act (KWG). For details, refer to the following section "Special risks resulting from the financial holding group".

Risks relating to adherence to the MREL ratio for HSH Nordbank lie in the national transposition of the adopted Directive Amending the EU Bank Recovery and Resolution Directive (BRRD) with regard to the ranking of unsecured debt instruments in the event of insolvency in accordance with Article 108 BRRD, which could have repercussions for the eligibility of liabilities as eligible liabilities within the meaning of the MREL.

The further development of the regulatory requirements could result in further burdens for the capital ratios resulting from the proposed changes to the regulatory requirements – partly referred to as "Basel IV" – probably on a gradual basis from the year 2022 until 2027.

For HSH Nordbank, stricter rules concerning counterparty risk resulting from Basel IV will be of particular relevance. HSH Nordbank extensively uses models approved by the supervisory authorities to map counterparty risk (Internal Ratings Based Approach – IRBA). Under Basel IV, the plan is 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).

The bank-specific risks are currently still determined by the privatisation process. If the portfolio transaction, which was signed on 28 February 2018, is not executed, or is not executed as planned, after the closing of the share purchase agreement, or if material deselections are made, significantly reducing the portfolio that is sold, then the RWA reduction that is planned within this context will not occur and this will put pressure on the capital ratios. In addition, the non-recognition of losses in connection with the settlement mode agreed in the cancellation agreement on the second loss guarantee could put a temporary strain on the capital ratios. This temporary strain would be offset by a capital injection in a corresponding amount made by the buyers of the shares in HSH Nordbank set out in the share purchase agreement.

As far as the risks relating to capital associated with the privatisation process are concerned, reference is made to the section entitled "Opportunities and risks of the formal decision in the EU state aid proceedings". If several of the risks for the capital ratios described above or the risks relating to capital set out in the section entitled "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" occur in combination with each other, then additional measures to strengthen capital may need to be taken by the owners and/or third parties at all regulatory levels.

Special risks resulting from the financial holding group

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

With regard to the financial holding group subject to banking supervision, there is a risk that, in the event of a downside scenario (weaker macroeconomic environment, deterioration in the market parameters in the real estate market as well as on the shipping markets, significantly stronger USD exchange rate, burdens associated with further loan loss provisions), it will not be possible to meet all capital buffer requirements extending beyond the Pillar 1 minimum requirements pursuant to the CRR (4.5 % CET1) at the level of the financial holding group due to the high premiums 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.

In this sort of scenario, measures would have to be taken by the shareholders or third parties to strengthen the capital ratios in order to adhere to the capital buffer requirements at the level of the financial holding group before the conclusion of the privatisation process.

If the closing of the share purchase agreement is delayed and it cannot be executed as planned in 2018, the regulatory requirements would still have to be adhered to at the level of the financial holding group.

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 abovementioned risks regarding non-compliance with capital requirements.

The capital forecast for the financial holding group is based on the assumption of the full settlement of the guarantee in 2018 in connection with the privatisation. 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 level of the financial holding group.

With the formation of HSH Beteiligungs Management GmbH, HSH Nordbank as the "parent institution" is also required, under Article 11 (2) CRR, to comply with the large exposure regulations (Part 4 of the CRR) at the financial holding group level. The additional large exposure limit to be observed is based on the regulatory capital at the Group level of the financial holding group. However, as this is significantly lower than in the subgroup of the HSH Nordbank Group due to premium obligations assumed under the guarantee of the federal states of Hamburg and Schleswig-Holstein, the limit represents a powerful limiting factor in the Bank's large exposure monitoring. HSH Nordbank has also applied the lower regulatory capital at the Group level of HSH Beteiligungs Management GmbH as a parameter for the purpose of its major risk management, meaning that it has set limits for its trading and credit lines as a precautionary measure to reduce the risk of exceeding the large exposure limit.

A reduction in the large exposure limit may result in restrictions on the choice of restructuring instruments that can be used for loan recoveries, or the large exposure limit may be exceeded by individual existing large exposure cases. This risk will also cease to apply at the time of the closing of the share purchase agreement and the associated dissolution of the financial holding group.

Funding forecast

The funding forecast is still influenced to a considerable degree by the upcoming privatisation of the Bank. The Bank plans to gradually reduce the liquidity resources built up prior to privatisation in order to hedge against uncertainties in the course of the 2018 financial year. In particular, the intention is to use the reduction in the deposit level and the long-term raising of funding to transform and optimise the liabilities side of the balance sheet, taking into account the conservative liquidity management that is still required.

The Bank expects to continue to successfully implement its diversified funding strategy in 2018. The Bank's asset business will continue to be refinanced primarily by placing secured and unsecured bonds with institutional investors and by the deposit business transacted with the Bank's corporate clients and with private clients.

The investment of fixed-term deposits by private clients will also be expanded further. In addition to the online Deposit Solutions platform, there are also plans to increase the distribution of the investments via other providers as well. This will allow the Bank to compensate for the lower sales of retail bonds in a market that has become significantly smaller overall. It will therefore establish a new sales channel outside of the savings bank sector and create a broader base for the Bank's refinancing following the planned change in ownership.

The funding plan is based on access to the relevant markets, in particular to institutional depositors in Germany. 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. The asset-based funding platform will be further expanded by the Bank. Based on lower USD requirements, the Bank also uses these funding opportunities for the cost-effective refinancing of the lending business in euros and other currencies.

With regard to the liquidity coverage ratio (LCR) and the net stable funding ratio (NSFR) (key management indicators in the IFRS Group), HSH Nordbank expects the ratios to remain more or less constant compared with the end of 2017 due to the planned transformation of the liabilities side. Nevertheless, it still expects to adhere to the corridor of 80% to 120% set out in the catalogue of conditions and commitments. HSH Nordbank also expects that all other supervisory requirements such as the survival period in the liquidity development report for the combined stress scenario will continue to be complied with at a comfortable level.

No separate forecasts for the LCR and NSFR are made at 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 market portfolio sales concluded at the beginning of 2017 and inflows from the settlement of losses have contributed to the improvement in the Bank's liquidity situation. Further liquidity inflows are expected for the 2018 financial year. Significant payments are expected from the portfolio transaction, as well as from the full settlement of the second loss guarantee. Within this context, the Bank has assumed, in its liquidity planning, that the purchase price for the portfolio transaction will be paid immediately after the closing of the share purchase agreement, i.e. upon the completion of the privatisation process. With regard to loss settlement, the Bank expects this to be achieved at this point in time as well.

Even under unfavourable market conditions, stable access to refinancing sources that are largely independent of capital market developments, such as fixed term deposits made by private clients in direct sales, for example via online platforms, and deposits from clients of savings banks and other financial networks, as well as access to secured refinancing sources such as Pfandbriefe and asset-based funding, are of paramount importance.

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

The implementation of the Bank's privatisation will involve a change in the deposit guarantee fund. The funding plan is based on the assumption of a smooth transition in the deposit guarantee fund. The plan is that HSH Nordbank can keep its full membership of the institutional protection scheme of the Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of the year 2021, by which point it will have obtained senior membership of the deposit guarantee fund of the Federal Association of German Banks.

The two rating agencies, Moody's and Fitch, regarded the conclusion of the EU proceedings as an important milestone and assessed measures leading to an improvement in the financial and risk profile as positive in principle. This applies, in particular, to the portfolio transaction that was concluded on 28 February 2018, which will relieve the Bank of non-performing loans and ultimately strengthen the capital position as a result. Nevertheless, the agencies consider the uncertainty during the change of ownership phase and the planned smooth transition with regard to the deposit guarantee fund to be particular challenges. This applies to Fitch, in particular, which believes that the rating position could deteriorate, in particular due to the planned change in the deposit guarantee fund (exit from the German Savings Banks Finance Group (DSGV)), the associated impact on refinancing and the future shareholder structure (no controlling majority owner) if the improvement in the individual rating is not sufficient to compensate for these aspects. The Bank's future rating position will therefore be determined by the scheduled implementation of the change of ownership, as well as the Bank's realignment against the backdrop of a challenging market environment. With regard to the planned refinancing costs, the Bank expects that the successful privatisation will reduce the Bank's refinancing costs, assuming an improvement of the rating position.

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 would support the implementation of the issuing strategy in the course of 2018. A sustained expansive monetary policy on the part of the ECB and the associated generous liquidity resources are 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. The gradual reduction in liquidity resources via the reduction in the deposit level and the raising of funding may lead to an improvement in the earnings situation.

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 over the past few years. 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 segment, which could have a significant adverse impact on the Bank's funding.

Should the purchase price payment for the portfolio transaction and the loss settlement agreed in the cancellation agreement for the second loss guarantee be delayed, this could have a negative impact on the Bank's planned liquidity position.

Should the expected improvement in the rating position fail to materialise, the planned reduction in the deposit level, the long-term raising of funding and the transformation and optimisation of the liabilities side of the balance sheet may not be implemented, and funding costs could rise with a corresponding negative impact on earnings.

Potential rating downgrades, which, despite the recently confirmed investment grade rating, cannot be excluded during the further privatisation process leading up to the closing date, 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 Moody's or Fitch would result in a rating outside investment grade. Adverse developments, particularly during the further privatisation period leading up to the closing of the share purchase agreement (for example a decrease in capitalisation, non-compliance with the minimum capital requirements, liquidity burdens, an unplanned deterioration in earnings or setbacks in the privatisation process, for example with regard to the fulfilment of the closing conditions) could 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 42: Residual maturity breakdown of financial instruments in the Group financial statements as at 31 December 2017) and the high existing depositor concentration on institutional investors. In the event of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

Should a smooth transition and inclusion in senior membership of the guarantee scheme of the Federal Association of German Banks not succeed as planned, this could lead to a significant outflow of deposits and a significant increase in funding costs. Also, as a result of the different manner in which the deposit guarantee funds work, i.e. institutional protection under the protection system of the German Savings Banks Finance Group versus protection of deposits, there is a risk of liquidity outflows associated with the change in the deposit guarantee fund.

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. In particular 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 the existing sources of refinancing deteriorate, this would also severely limit the funding options and would adversely impact the Bank's rating.

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

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

It is also possible that additional requirements in various prudential regulatory areas such as liquidity may arise from the regular SREP process carried out 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.

As far as the risks also relating to liquidity and funding associated with the privatisation process, reference is made to the section entitled "Opportunities and risks of the formal decision in the EU state aid proceedings".

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. 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 was to be restructured in such a way that would enable the successful sale of this company by 28 February 2018. The transfer in rem of the shares to a buyer (closing) may be made at a later date. The participating bidders must have the necessary financial resources and proven sector expertise to manage the operating company as a profitable and active competitor. Furthermore, the intention was set out to sell HSH Nordbank by 28 February 2018. Both the measures to relieve the Bank of legacy burdens and the sale of HSH Nordbank AG were agreed in a timely manner by concluding corresponding agreements and have laid the foundation for a permanent structural improvement in the Bank's financial and risk situation.

Within this context, the Bank expects, based on the information available and with regard to the ongoing sale process of HSH Nordbank AG, that the conditions that still have to be met, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review of the future Bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust and competition authorities and the confirmation of the extension of the Bank's full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of the year 2021, will be fulfilled and that the privatisation process will be completed successfully.

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.

In connection with the imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, HSH Nordbank AG expects, from today's perspective, that it will not be possible, contrary to past plans, to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2020 financial year for the 2019 financial year as originally anticipated, but rather that this will only be possible at the earliest from the 2024 financial year for the 2023 financial year.

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

Opportunities

The successful completion of the privatisation process would create a significantly improved basis for establishing a business model that is sustainable in the long run and for enabling the sustainable and successful realignment of the Bank.

Similarly, the closing of the privatisation process would improve the Bank's business activities and funding situation and put an end to uncertainty for clients and employees, as well as capital market participants.

The execution of the share purchase agreement and, as a result, the assumption of the ownership position by the investors would expand the Bank's business and refinancing opportunities and thus to further contribute to the strengthening of the business model.

Risks

Should the individual outstanding conditions for the closing of the share purchase agreement not be met in full or in part or within the time frame that is currently planned, this would significantly jeopardise the further implementation of the business model and, as a result, the Bank's future prospects.

If the portfolio transaction relating to the sale of a portfolio of largely non-performing loans agreed within the context of privatisation can only be implemented in part, this could hamper the viability review carried out by the EU Commission and potentially pose an obstacle to the closing of the share purchase agreement.

In the event that the privatisation process is not implemented, that the necessary viability review on the new corporate structure is not performed, or that the approval of the acquisition by the EU Commission is not obtained, either in full or in part, or if this is not achieved within the currently envisaged time frame, then HSH Nordbank would have to suspend its new business and manage its assets to the extent legally permitted with the objective of achieving a privately managed orderly wind-down. The long-term survival of HSH Nordbank in its present form would not be ensured in this case. Also, in view of the fact that cessation of new business would also include the deposit business – this sort of 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. The same would apply if the Bank were to become involved in an orderly wind-down for this or other reasons.

In this regard, the Bank analyses different scenarios as a precaution in coordination with the ECB and the federal states in order to ensure sufficient process certainty in a theoretically possible adverse privatisation process.

Furthermore, it cannot be excluded that in the event that the privatisation process does not progress in line with the plan, in the event of a 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.

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.

Under the list of conditions and commitments, the Bank is required to limit annual new shipping business to € 1.2 billion. In addition, the catalogue 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, and an extension of the ban on proprietary trading and the restriction of external growth by prohibiting the acquisition of control in other companies.

In the event that the trend in the shipping markets is significantly better than planned or good business opportunities arise in other business sectors, these restrictions could have a negative effect on potential transactions.

In light of the agreement in principle reached with the EU Commission, HSH Nordbank AG remains a member of the Savings Banks Finance Group during the sale process. All issues of HSH Nordbank AG (excluding equity/instruments with equity characteristics, notably under paragraphs 41, 44 of the EU Commission Communication 2013/C 216/01 of 30 July 2013 ("Banking Communication")) therefore fall under the voluntary institutional protection of the guarantee fund of the Savings Banks Finance Group (Section 39 (1) of the Framework Statute). Under the voluntary institutional protection there is no legally binding entitlement to support measures vis-à-vis the protection scheme in the event of the occurrence of a guarantee case. Should HSH Nordbank AG's membership in the Savings Banks Finance Group end as scheduled with the completion of the change of ownership (closing), its membership in the guarantee fund of the German 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 long term, HSH Nordbank AG is aiming to achieve membership of the guarantee scheme of the Federal Association of German Banks, where possible following on seamlessly from its membership of the guarantee scheme of the German Savings Banks Finance Group.

If a smooth transition and admission to the guarantee scheme of the Federal Association of German Banks cannot be achieved as planned, or if the Bank cannot keep its full membership of the institutional protection scheme of the Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing), at least until the end of the year 2021, this could lead to a fundamental outflow of deposits, triggering a significant increase in funding costs.

The going concern assumption for accounting and measurement purposes, as well as the continued survival of HSH Nordbank AG and major group companies is based, in particular, on the share purchase agreement concluded on 28 February 2018, in which with the HSH Beteiligungs Management GmbH sold 94.9% of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG (hereinafter referred to as the "bidders") being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF) Luxembourg) grants the necessary approvals,
- the European Commission approves the proposed new corporate structure after performing a viability review,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank 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, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation;

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

Overall appraisal and net income forecast

2018 will be a crucial year of transformation for the Bank, even if it will not signal the end of the realignment process. On the one hand, the coming months will be shaped to a considerable degree by the implementation of the closing conditions to ensure the conclusion of the privatisation process in a manner that can be deemed successful from today's point of view. On the other hand, the operational measures aimed at the realignment of a corporate structure that will be risk-optimised and agile in the future will be defined and implemented as soon as possible. Overall, the Bank is confident, based on its plans, that the efforts made to date and the privatisation process, which the Bank currently believes to have developed in a positive manner, will result in a business model that is sustainable in the long term, provided that the process is completed successfully.

In the reporting period, the Bank set the course for a successful privatisation process. The marked acceleration in the winding-down of legacy burdens, operational development that was largely in line with the planned development, and the cost optimisation achieved have created a solid basis. At the same time, the agreements reached within the context of the privatisation process, in particular the Bank's fundamental relief from non-performing legacy loans thanks to the portfolio transaction and the cancellation agreement on the second loss guarantee will result in considerable structural optimisation.

The Bank, which will have been privatised when the share purchase agreement is executed, will develop additional business opportunities in Germany and abroad together with its new international owners, which boast expertise in the financial services sector, under a new brand and free from the existing EU restrictions. The focus will remain on medium-sized corporate clients, as well as clients in the real estate, energy, infrastructure and shipping sectors, to which the Bank aims to provide support in all relevant issues relating to financing with a comprehensive product and consultancy approach. In order to improve its profitability, the Bank has identified a large number of measures on both the earnings and the cost side that will be addressed and implemented in 2018. The strategic vision for 2022, with total assets of around € 55 billion, an NPE ratio of no more than 2 %, a CET1 ratio of around 15 %, a cost-income ratio of 40 % and an RoE before tax of at least 8 %, will be pursued in a rigorous and focused manner. (Management indicators based on internal control for the IFRS Group (in this regard, and for details on reconciliation, refer to the section entitled “Management System”).

Results are to reap considerable benefits from the implementation of the strategic measures over the next few years. The 2018 financial year will still be shaped to a considerable degree by the implementation of the privatisation process, as well as by the planned additional restructuring costs. As a result, taking into account the compensation payment of € 100 million for the premature termination of the second loss guarantee, a loss before tax of around € 100 million is forecast for the 2018 financial year. The net income forecast is subject to potential effects resulting from closing and the related change of ownership. At the same time, the pro forma CET1 ratio is expected to come in at around 15 % and the NPE ratio at around 2 %.

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 substantial loss incurred in 2017, HSH Nordbank AG also expects to report a negative result in 2018 based on the HGB accounting standards. The loss will be significantly lower than in 2017 and will be attributable, in particular, to restructuring expenses, the proposed compensation payment made for the termination of the federal state guarantee and deferred tax effects in connection with the implementation of the portfolio transaction.

In principle, the Bank remains cautious in its earnings forecast for the whole of 2018 given the continuing challenging environment for banks in general and HSH Nordbank in particular.

There are, however, also challenges associated with the earnings forecast and the future development of HSH Nordbank. In summary, these relate primarily to risks resulting from adverse developments during the closing process associated with privatisation and, as a result, the fulfilment of the closing conditions agreed as part of the share purchase agreement. In this extremely complex privatisation process, the Bank will continue to do its utmost to support its owners, who are responsible for the sales process. The Bank’s aim is to bring a change in ownership that makes sense from a financial perspective to a successful conclusion.

In addition to the specific risks in connection with the privatisation process, the Bank will also face other general challenges. These include, first of all, possible setbacks in the recovery for container vessels and bulkers and a further deterioration in the tanker segment, a possible slowdown in the real estate markets, a significantly stronger USD exchange rate, the low level of interest rates, as well as a competitive environment and volatile financial and currency markets (in particular US dollars); secondly, changing assessments of the rating agencies and the steadily increasing requirements imposed by the European banking regulators, and thirdly, it is of key importance that, despite a multitude of influencing factors (e.g. discretionary decisions on the part of the banking supervisory authorities, assumed long-term recovery of the shipping markets), the minimum capital ratios are complied with at both the HSH Nordbank sub-group level and the financial holding group level (HSH Beteiligungs Management GmbH) and that liquidity requirements are complied with at all times despite possible adverse developments in the privatisation process or, for instance, in the event of reactions of the rating agencies with a negative impact.

In connection with imminent multi-year transformation phase, which will be characterised by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, the Bank expects to be able to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2024 financial year for the 2023 financial year.

In order to fulfil the net income forecast for the financial year 2018, HSH Nordbank’s planning needs to be implemented as intended and the risks described in this forecast report must 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 met.

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

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

In addition to insolvency risk (financial risk) as a second type of liquidity risk other, material risk types of HSH Nordbank include business strategy risk and reputation risk (NFR). Default risk is the most significant risk type due to HSH Nordbank's business model.

Determination of risk appetite and risk guidelines

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

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

KEY RISK INDICATORS OF THE GROUP

	31.12.2017	Limit	Guideline
Utilisation of gone concern RBC	18.6 %	< 90 %	–
Economic capital required	€ 1,394 m	≤ € 4,900 m	–
of which: for default risks[1]	€ 753 m	≤ € 2,700 m	–
for market risks	€ 399 m	< € 1,450 m	–
for liquidity risks	€ 46 m	–	< € 500 m
CET1 ratio (phase-in, same period calculation, including Pillar 2 requirement)	18.5 %	> 9.00 %	–
Liquidity coverage ratio (LCR) - actual	169 %	> 85 %	–
Net stable funding ratio (NSFR)	114 %	–	85 % – 115 %
USD share of overall bank exposure	15 %	–	< 30 %
USD refinancing ratio	94 %	–	> 60 %
NPE ratio	10.4 %	–	< 13 %
NLP2 in stress case (1st – 3rd months)	Month 1: € 7.4 bn Month 2: € 7.0 bn Month 3: € 7.1 bn	> € 500 m over the 1 month maturity band, i.e. minimum (NLP SC) 1 – 30 days	–

[1] After deducting the first loss piece under the second loss guarantee of the federal states of Hamburg and Schleswig-Holstein in the amount of € 3.2 billion.

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

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

Organisation of risk management

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

The Risk Committee of the Supervisory Board is in particular responsible for reviewing 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 risk position and risk management by the Management Board in meetings.

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

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

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

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

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

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

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

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 Core Bank and the outsourcing arrangements and equity holdings as well as projects and changes in operational processes and structures.

The CRO makes decisions independently of the Management Board member responsible for the Market divisions and Trading and periodically informs the Overall Management Board and Risk Committee of the risk situation of the 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.

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

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

HSH Nordbank uses an economic scope of consolidation as the basis for the Group-wide risk management. It includes those entities that are to be specifically monitored at the Group level due to material risks. The risks of other entities 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 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 Overall Bank Management committee (OBM committee), which is chaired by the Chief Financial Officer (CFO) and the Chief Risk Officer (CRO), is the committee responsible for managing and allocating financial resources within the risk limits, risk guidelines and plan targets. Its duties include, inter alia, the monitoring and management of risks associated with bottleneck resources (including risk concentration, credit, liquidity as well as FX and interest rate risks), taking account of management control mechanisms for all aspects (income and costs, risks, liquidity and capital). This ensures an integrated view of the key financial and risk indicators. The OBM 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 the Bank's risk-bearing capacity is at all times based on its risk tolerance level, the OBM 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 OBM drafts decisions on strategic guidelines, the type of management, objectives restrictions and other targets for the corporate investment portfolio. The relevant decisions are made by the Overall Management Board. The risk limits adopted by the Management Board are monitored by the units with operational responsibility. Risk limit overdrafts are escalated to the Management Board together with recommended courses of action and the implementation of measures to reduce such overdrafts is monitored. The OBM committee is also the committee responsible for drafting the decision memorandum regarding transition from or continuation of the phases defined in the recovery plan, for the appointment and specific staffing of the teams that prepare for the implementation of the options identified and – if the Management Board has approved their implementation – implement them.

The Scenario Steering Committee (SSC), in which the trend of market indicators is monitored and decisions made regarding simulation assumptions and scenarios (macroeconomic and segment-specific), provides significant support to the OBM committee. The simulation scenarios together with their key assumptions and an analysis of the results are also presented to the Overall Management Board in addition to the OBM committee.

The Credit Committee (CC) is an independent, decision-making body at the level of individual lending transactions, which is chaired by the head of the Credit Risk Management (CRM) division with the participation of the CRO on a case-by-case basis. The CC is responsible, among other things, for the operational management of limited resources of liquidity, economic and regulatory capital, in particular where overall bank management requires the active control of the capital and liquidity requirements of the lending business. The CC is guided by the requirements for Group resource management defined in the OBM committee. 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 Review Meeting (BRM), chaired by the CFO and with the involvement of the Management Board member responsible for the Market divisions and selected division heads, regularly monitors the achievement of targets by the divisions with regard to new business, income and costs and discusses other general topics of strategic importance. The analysis is used as a basis for identifying any plan variances at an early stage and initiating any possible measures, such as the allocation of new income or cost targets.

Risk reporting and measurement systems

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

The following key reports are prepared for the overall risk:

- The HSH management report, which as an integrated financial and risk report provides information on HSH Nordbank's overall situation with regard to the key value drivers, particularly income, costs, liquidity, capital and risk as well as on the trend of the recovery plan indicators, is submitted to the OBM committee, Management Board and also the Risk Committee (relevant extracts thereof). Adherence to the risk limits and risk guidelines relevant for managing economic capital is monitored by means of this report. The HSH management report is generally prepared on a monthly basis. In addition, it is updated on a weekly basis for selected key figures and ratios.
- The Risk Committee also receives for its quarterly meetings the trend of aggregated risk parameters of HSH Nordbank in the form of the "current risk trend" report.

The management reporting policy sets out the management requirements regarding the structure, contents, frequency, deadlines and form of the internal reporting combined in the HSH management report for the purposes of complying with BCBS 239 and ensuring the sustainability of the internal reporting.

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

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 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 (repeating the tests).

The top priority of this ICS assessment is the structured and systematic examination of potential or known process risks together with the definition of and decision on measures to be taken to mitigate them. Furthermore, the ICS makes a significant contribution to the effectiveness of the processes by specifying uniform rules for the Bank as a whole. The ICS cycle also ensures that the ICS is continuously enhanced with respect to its correctness and functionality as well as its appropriateness and effectiveness. Central responsibility for the management and monitoring of the ICS as well as for methodology guidelines and their enhancement lies with the ICS Office in the Corporate Compliance organisational unit.

Clear 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. The ICS Office also ensures proper reporting to the Management Board and Supervisory Board.

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

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

Furthermore, subsidiaries of 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 the 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 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 member of staff responsible for 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 is performed by another organisational unit with regard to the accounting functions for lending transactions and capital market transactions in Germany and the transactions in subsidiaries and foreign branches. This organisational unit is also responsible for consolidating the accounting information and preparing the annual and consolidated financial statements. In addition, this unit centrally monitors amendments to legislation concerning financial statements, in order to ensure uniform application of the standards.

Regulatory requirements

HSH Nordbank determines the amount of regulatory capital backing for default, market and operational risks as well as for risks resulting from credit valuation adjustments (CVA) of OTC derivatives on the basis of the CRR requirements. In this context, the so-called IRB Advanced Approach is applied for default risk, for which the supervisory authority has issued the relevant authorisation to the Bank. The Credit Risk Standardised Approach (CRSA) is used for a small part of the portfolio. This means that the Bank applies consistent parameters for regulatory reporting (COREP) and the internal default risk management of the IRBA portfolio. HSH Nordbank determines the amounts allocated to market risk positions in accordance with the prescribed 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 "Net assets and financial position" section. 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 is disclosed in this Annual Report which is based on the accounting principles applied, as it provides a comprehensive insight into the regulatory framework and the Bank's current risk situation based on regulatory figures. The Disclosure Report as at 31 December 2017 is available on our website, www.hsh-nordbank.de, four weeks after the publication of this Annual Report. The Disclosure Report does not form part of the Management 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. The description of the approach required in accordance with Article 438 (a) CRR, under which the institution assesses the adequacy of its internal capital to support current and future activities (capital adequacy process), is also included in this risk report. The same applies to the description of the approaches and methods adopted for determining specific and general credit risk adjustments under Article 442 (b) CRR.

Risk-bearing capacity

HSH Nordbank has integrated a capital adequacy process (ICAAP) into its risk management system 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 this to the Bank's supervisory authorities. 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 associated hedging transactions (line items) as well as the liabilities.

The risk coverage potential amounted to € 7.5 billion as at 31 December 2017 (31 December 2016: € 8.5 billion). The main reason for the decrease is the recognition of loan loss provisions as at 31 December 2017.

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

Overall economic risk decreased by € 1.5 billion compared to the 2016 year end and amounted to € 1.4 billion as at the reporting date (31 December 2016: € 2.9 billion). On the one hand, this reduction compared to the previous year was due in particular to the decrease of € 1.1 billion in the default risk potential (details on the trend of the default risk potential are set out under "Default risk management") and, on the other, to lower market and liquidity risks compared to the previous year.

Utilisation of risk coverage potential amounted to 19% as at the reporting date (31 December 2016: 34%). The risk-bearing capacity was ensured at all times during the period under review.

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

RISK-BEARING CAPACITY OF THE GROUP

(€ bn)	**31.12.2017**	31.12.2016
Economic risk coverage potential[1]	**7.5**	**8.5**
Economic capital required	**1.4**	**2.9**
of which for default risks[2]	0.8	1.9
for market risks	0.4	0.6
for liquidity risks	–	0.1
for operational risks	0.2	0.2
Risk coverage potential buffer	**6.1**	**5.6**
Utilisation of risk coverage potential (in %)	**19**	**34**

[1] After deducting the first loss piece under the second loss guarantee of the federal states of Hamburg and Schleswig-Holstein in the amount of € 3.2 billion.
[2] Taking the second loss guarantee into account.

Stress tests

In addition to stress tests specific to risk types, 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. Based on observed market developments, the Scenario Management Committee approves macroeconomic and segment-specific forecasts for the carrying out of forecast-based, dynamic stress tests. These expected and stress forecasts are incorporated in different simulation scenarios and presented quarterly to the OBM committee and Overall Management Board. The impact of macroeconomic scenarios, such as a severe economic downturn or non-materialisation of the expected recovery in the shipping markets and a historical scenario, on the Pillar I and II capital ratios and leverage ratio is calculated. The results are incorporated in HSH Nordbank's internal reporting system every quarter and analysed on a regular basis by the Management Board in terms of an action-oriented management dialogue. Besides the review of the appropriateness of the buffer for risk coverage potential, regulatory capital and liquidity maintained to offset stress effects, this analysis is used to discuss the need for options to strengthen the financial stability of HSH Nordbank.

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

The particular purpose of both processes is to ensure that the Bank is able to comply with the regulatory minimum requirements even under stress conditions. In addition, HSH Nordbank carries out inverse stress tests at least once a year. Scenarios that could endanger HSH Nordbank's ability to survive are identified for these. This information is also used by HSH Nordbank's Management Board as guidance for explaining and deciding upon any action required in the event of developments that threaten the Bank's existence.

In addition to stress tests across all risk types, HSH Nordbank has 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.

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

Settlement risk consists of clearing risk and advance performance risk. Clearing risk arises in the case of possible loss of value if delivery or acceptance claims pertaining to a transaction that is already due have not been met by both parties. Advance performance risk arises where 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 government-imposed restrictions on cross-border payments (transfer risk). The risk is not related to the debtor's credit rating.

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

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

Organisation of default risk management

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

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

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

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 monitored by the Group Risk Management division. As part of the monitoring of trading lines, the potential future exposure on currency interest rate derivatives is recalculated daily for each client on the basis of a 95% quantile and compared to the respective trading limit. Group Risk Management is also responsible for the independent analysis and monitoring of risks at the portfolio level, independent reporting and management of country risk. This also includes ensuring portfolio transparency and independent business area analysis (including scenario simulations) and the operation of an early warning system at individual transaction level for identifying commitments on a timely basis that are beginning to show signs of increased risk.

The principles and regulations contained in HSH Nordbank's Credit Manual, in particular on lending competencies (definition of decision-making powers for credit decisions made by the Bank and definition of decision-making powers for entering into, changing and terminating equity holdings), on limiting and reporting the concentration of counterparty default risks, the determination of the rating, treatment of collateral, commitment monitoring and the definition of a default, form the basis for the operating activities within the lending business. Credit risks, which are recognised based on the definition of a loan under Article 389 of the Capital Requirements Regulation (CRR), are thereby considered and treated differently based on collateral, loan type, rating category and type of credit risk. The basis is HSH Nordbank Group's total 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 & Tax divisions.

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

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 risk accounts for the largest proportion of the Bank's overall risk potential. In order to measure and manage this risk, Group Risk Management uses procedures and methods that are continually reviewed and enhanced to ensure they are appropriate.

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

Economic capital required for default risk amounted to € 0.8 billion as at the reporting date after taking account of the second loss guarantee provided by the federal states of Hamburg and Schleswig-Holstein (31 December 2016: € 1.9 billion). This decrease in economic capital required for default risk is mainly attributable to the progress made in winding down the loan portfolio (portfolio transfer).

Non-performing exposure (NPE), which is the total of all risk positions of borrowers in default, serves as an important management indicator, and has also been defined as a risk guideline in the SRF. Information on the non-performing portfolio is disclosed in the "Default risk structure by rating category" table. In addition, the coverage ratio (ratio of total loan loss provisions recognised on the non-performing exposure to the total non-performing exposure) is monitored at the overall bank level as a MaSan indicator. After the portfolio transaction is executed in 2018, HSH Nordbank AG's NPE ratio would decrease significantly to the Group level. Following this substantial improvement in the risk profile of the Bank's loan portfolios the trend of loan loss provisions and the NPE ratio would have an equivalent weight relative to the Bank's other relevant management indicators. This also applies in particular in view of the fact that the shipping portfolio, which has hitherto been characterised by a high level of defaults, would be significantly reduced.

The syndication of lending transactions also helps to actively shape the composition of the portfolio and align individual financing risks (so-called final takes) to the balance sheet ratios. The Bank subjects all potential new business from a certain volume limit to a market conformity review and syndication assessment performed by the credit syndication unit within the Credit Solutions department as part of the Credit Committee Pre-Check (CCPC). The CCPC and/or Credit Risk Management then make a joint decision with the credit syndication unit and the sales staff in the deal team as to whether syndication should be arranged as part of the new business or underwriting process. The Bank's existing portfolio is also reviewed for saleability on a quarterly basis as part of the MaSan procedure (and on an ad hoc basis where appropriate).

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, savings banks standard rating and leasing as well as for special financing for ships, real estate, projects and aircraft. Various qualitative in addition to quantitative characteristics are also used in each rating module. The result is a probability at default (PD) for each borrower and hence the allocation to a specific rating category. The Bank uses an identical rating master scale for all modules which not only allows comparison of differing portfolio segments but also mapping with external ratings.

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

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

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

Risk concentrations

As part 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. HSH Nordbank's material concentrations of credit risk were in the real estate portfolio, which accounted for 20% of the overall portfolio (previous year: 20%) and in the shipping portfolio, which accounted for 14% of the overall portfolio (previous year: 20%). Other concentration risks relate to the US dollar business, which accounted for 15% of the overall portfolio (previous year: 25%). The shipping loan portfolios denominated in US dollars are included in both key ratios. Despite a decrease in the concentration in shipping financing and financing denominated in USD, the key capital and liquidity figures remain highly sensitive to developments on the shipping market and movements in the EUR/USD exchange rate.

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

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

For regulatory purposes, equity holdings must be consolidated, deducted from equity or backed with equity capital in the equity holdings receivable class. In this context, equity holding risk is treated as a sub-category of default risk under regulatory law. 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. New equity holdings are only acquired if they meet HSH Nordbank's strategic objectives. The opportunities and risks associated with a potential equity holding are analysed extensively prior to the conclusion of the transaction.

A regular company valuation represents an important instrument for monitoring and managing equity holding risk. Impairment tests are performed at least once a year on all equity holdings of HSH Nordbank. Significant 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, inter alia, on the identification of risks in the individual companies. 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.

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

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 pricing by means of standard risk costs. In the same way, an actual costing (profit centre accounting) is made for all transactions on a monthly basis, taking the above-mentioned cost elements into account. Standard risk costs and the resulting contribution margins are determined based on the current risk parameters of the individual transactions. Furthermore, utilisation of the capital commitment set as part of the Bank's annual plan is determined regularly at the division level for the purposes of managing default risk. When bottleneck resources are overdrawn, new transactions and prolongations are subject to stricter approval requirements. The objective of this dual management of plan utilisation 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). Risk-mitigating effects (such as recognition of collateral) are not included in the EaD. Total EaD amounted to € 72,220 million as at 31 December 2017.

EaD broken down by internal rating categories is presented in the following table. EaD with an investment grade rating (rating category 1 to 5) accounts for 68% of the total exposure at the Group level (31 December 2016: 59%). The Core Bank accounted for 74% of the investment grade exposures (31 December 2016: 69%) and the Non-Core Bank for 10% (31 December 2016: 16%). 20% of the overall bank portfolio is covered by the hedging effect of the second loss guarantee (31 December 2016: 34%). 13% of the Core Bank exposures is covered by the guarantee (31 December 2016: 20%) and 79% of those of the Non-Core Bank (31 December 2016: 85%). The proportion of the guaranteed portfolio in the default categories 16 to 18 is particularly high at 78% (31 December 2016: 87%).

DEFAULT RISK STRUCTURE BY RATING CATEGORY[1)]

(€ m)	2017				
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**	of which guaranteed (in %)
1(AAAA) to 1 (AA+)	16,255	79	5,615	21,949	6
1(AA) to 1 (A–)	7,160	239	2,284	9,683	11
2 to 5	16,158	680	444	17,282	11
6 to 9	10,732	1,009	1	11,742	21
10 to 12	1,425	228	–	1,653	54
13 to 15	1,151	845	3	1,999	59
16 to 18 (default categories)	840	6,649	–	7,489	78
Other[2)]	4	88	331	423	–
Total	**53,725**	**9,818**	**8,678**	**72,220**	**20**

[1)] Mean default probabilities (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 reported in the "Other" line item, such as receivables from third parties of our consolidated equity holdings.

DEFAULT RISK STRUCTURE BY RATING CATEGORY[1)]

(€ m)	2016				
	Core Bank	Non-Core Bank	Other and Consolidation	Total	of which guaranteed (in %)
1(AAAA) to 1 (AA+)	13,684	700	6,726	21,110	17
1(AA) to 1 (A–)	6,889	755	2,006	9,650	18
2 to 5	14,948	1,920	1,464	18,332	19
6 to 9	11,270	1,373	66	12,709	27
10 to 12	1,609	569	–	2,178	52
13 to 15	2,296	2,394	69	4,759	60
16 to 18 (default categories)	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 reported in the "Other" line item, such as receivables from third parties of our consolidated equity holdings.

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

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Industry	7,692	977	–	8,669
Shipping	5,056	4,170	–	9,226
Trade and transportation	3,123	322	–	3,445
Credit institutions	6,340	209	4,340	10,889
Other financial institutions	1,904	825	24	2,753
Land and buildings	9,595	2,262	–	11,857
Other services	4,686	392	542	5,620
Public sector	15,042	373	3,757	19,172
Private households	289	286	14	589
Other	–	–	–	–
Total	**53,725**	**9,818**	**8,678**	**72,220**

DEFAULT RISK STRUCTURE BY SECTOR

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

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

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Up to 3 months	12,813	2,054	525	15,393
> 3 months to 6 months	1,528	403	354	2,285
> 6 months to 1 year	3,322	955	516	4,793
> 1 year to 5 years	20,440	3,096	4,776	28,312
> 5 years to 10 years	10,399	1,773	2,132	14,304
> 10 years	5,223	1,535	374	7,132
Other	–	–	–	–
Total	**53,725**	**9,818**	**8,678**	**72,220**

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

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

The following table provides an overview of the foreign exposure by region, which reached € 23.286 million as at 31 December 2017 (previous year: € 33,617 million):

FOREIGN EXPOSURE BY REGION

(€ m)	2017			
	Core Bank	Non-Core Bank	Other and Consolidation	**Total**
Eurozone	7,515	2,648	1,226	11,389
Western Europe	3,232	1,557	1,190	5,979
Eastern Europe	296	446	–	742
Africa	543	263	–	806
North America	413	385	–	798
Latin America	262	191	–	453
Middle East	38	334	–	372
Asia-Pacific region	1,210	804	–	2,014
International organisations	129	–	604	733
Total	**13,638**	**6,628**	**3,020**	**23,286**

FOREIGN EXPOSURE BY REGION

(€ m)	2016			
	Core Bank	Non-Core Bank	Other and Consolidation	Total
Eurozone	8,331	5,443	1,214	14,988
Western Europe	2,528	3,466	1,932	7,926
Eastern Europe	499	580	–	1,079
Africa	568	253	–	821
North America	1,302	1,770	52	3,124
Latin America	298	288	–	586
Middle East	44	650	–	694
Asia-Pacific region	1,307	2,399	1	3,707
International organisations	94	–	598	692
Total	**14,971**	**14,849**	**3,797**	**33,617**

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

A number of European countries are subject to increased monitoring due to their unfavourable fiscal and economic data. These include in particular Croatia, Cyprus, Greece, Italy, Portugal and Spain. As a result of economic developments and the EU sanctions, the exposure to Russia is also being monitored more closely as is the exposure to Turkey due to internal and geopolitical developments.

The following table shows the EaD of the exposures to the European countries shown. HSH Nordbank's total exposure to these countries has decreased by 39% compared to the previous year and amounted to € 3,605 million in total as at 31 December 2017 (previous year: € 5,925 million).

EXPOSURE AT DEFAULT IN SELECTED EUROPEAN COUNTRIES

(€ m)	Country		Banks		Corporates/Other		Total	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016
Greece	–	–	–	–	940	1,478	940	1,478
Italy	19	425	–	–	574	602	593	1,027
Croatia	–	–	–	–	94	101	94	101
Portugal	180	219	–	–	52	26	232	245
Russia	–	–	1	3	47	74	48	77
Spain	79	151	36	46	918	1,215	1,033	1,412
Turkey	–	–	59	31	173	379	232	410
Cyprus	–	–	–	–	434	1,175	434	1,175
Total	**278**	**795**	**96**	**80**	**3,231**	**5,050**	**3,605**	**5,925**

The previously low direct country exposure to the countries shown above was further reduced in 2017. Exposures shown under Corporates/Other sector for Greece and Cyprus relate primarily to ship financings, which do not entail transfer risk due to the existing collateral.

Further information on the selected European countries is set out in Note 73 .

Loan loss provisions

HSH Nordbank pays the most attention to default risk within the risk management framework. 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 recognises general loan loss provisions for loans and advances for which no individual valuation allowances have been recognised but which entail latent risks. Country-specific general loan loss provisions are recognised for borrowers with an increased country risk depending on the relevant internal country rating and the collateral.

All restructuring and workout commitments, as well as intensified loan management commitments with a rating greater or equal to 13, are subject every quarter to a comprehensive two-step review process. In a first step, a review is carried out on the basis of objective criteria (so-called trigger events) to determine whether the receivable could be impaired (impairment identification). If this is the case, the loans identified are reviewed in a second step to determine whether a loan loss provision is actually required and the amount thereof (impairment measurement). 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 proceeds from the liquidation of collateral.

In the case of problem loans, the basis for the amount of the loan loss provision is generally the impairment as determined in accordance with IFRS. In the past financial year, loan loss provisions were characterised on the one hand by additions for legacy commitments in line with the plan. Additional loan loss provisions were recognised as a result of the impact of the loan portfolio transaction signed on 28 February 2018. In determining the loan loss provisions for the loans affected by the portfolio transaction, the purchase price for the entire portfolio was allocated to the individual loans and assets sold based on a valuation report, and this allocated portion of the purchase price representing the expected cash flow as at the intended closing date was discounted to the balance sheet date using the original effective interest rate. A closing date by the end of the third quarter was assumed for this purpose. Additional loan provisions were recognised primarily for legacy positions held in the shipping portfolio. In contrast, the risk trend in the other segments remained insignificant.

The loan loss provisions recognised were no longer fully compensated for due to the full balance sheet utilisation of the second loss guarantee in the first quarter of 2017.

After taking account of the payments of € 3,797 million in total (of which € 1,852 million were received in the previous year) received to date from HSH Finanzfonds AöR the second loss guarantee of € 10 billion is fully utilised in balance sheet terms as at the reporting date. An amount of € 88 million (previous year: € 1,811 million) was recognised as a relieving effect in the loan loss provisions line item in the income statement.

In view of the termination agreement reached between HSH Nordbank AG and HSH Finanzfonds AöR the guarantee will be terminated prematurely on the closing date of the loan portfolio transaction and settled in full (for details, see the "Sale of

HSH Nordbank on 28 February 2018) section in this Management Report).

Detailed information on the change in loan loss provisions in the individual divisions is set out in the “Segment” section.

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

TOTAL LOAN LOSS PROVISIONS

(€ m)	**2017**	2016
Loans and advances to customers	40,349	52,937
Loans and advances to banks	2,770	2,240
Volume of impaired loans	7,341	11,028
Total loan loss provisions (individual valuation allowances) for loans and advances to customers	– 4.588	– 6.608
Total loan loss provisions (general loan loss provisions) for loans and advances to customers	– 177	– 484
Total loan loss provisions (individual valuation allowances) for loans and advances to banks	–	–
Total loan loss provisions (general loan loss provisions) for loans and advances to banks	–	–
Total loan loss provisions for balance sheet items	**– 4.765**	**– 7.092**
Provisions for individual risks in the lending business	– 59	– 67
Provisions for contingent liabilities (general loan loss provisions) in the lending business	– 8	– 44
Total loan loss provisions for off-balance sheet items	**– 67**	**– 111**
Total loan loss provisions (before compensation item)	**– 4.832**	**– 7.203**
Compensation item	6,203	8,060
Total loan loss provisions (including compensation item)	**1,371**	**857**

HSH Nordbank AG's loss ratio was 4.08 % in the reporting year (previous year: 3.37 %). The loss ratio is calculated based on actual defaults (utilisation of individual valuation allowances 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 defaults in 2017 was € 3,160 million (previous year: € 3,046 million), the credit risk exposure € 77,483 million (previous year: € 90,464 million). The credit risk exposure includes all balance sheet and off-balance sheet assets, taking into account both specific and general loan loss provisions recognised on loans and advances to customers and banks subject to default risk.

Loan loss provisions recognised by the Bank in the form of individual valuation allowances and provisions for default risks amounted to € –4,647 million in total as at 31 December 2017 (previous year: € –6,675 million), which is equivalent to a ratio of 6.00 % in relation to the credit volume (previous year: 7.38 %). Loan loss provisions comprise individual valuation allowances for loans and advances to customers of € –4,588 million (previous year: € –6,608 million) and provisions of € –59 million for individual risks in the lending business (previous year: € –67 million). General loan loss provisions (including country-specific general loan loss provisions) amounted to € –185 million (previous year: € –483 million). In addition, total loan loss provisions for off-balance sheet items amounted to € –67 million (previous year: € –111 million). Total loan loss provisions including the compensation item arising from the balance sheet hedging effect of the second loss guarantee amounted to € 1,371 million as at 31 December 2017 (previous year: € –857 million). The reason why the compensation item exceeds the loan loss provisions is that the compensation item also includes the hedging effect for other transactions covered by the guarantee (e.g. securities). In such cases, any related impairments are not disclosed under loan loss provisions. The compensation item also includes compensation claims against HSH Finanzfonds AöR arising from settled losses for transactions, for which loan loss provisions have already been derecognised.

This also results in the overcompensation of loan loss provisions.

Planning for loan loss provisions

Loan loss provisions are planned as part of the annual Bank plan under the plan assumptions specified therein and include the annual changes in the amounts of the specific and general loan loss provisions.

In planning additions to as well as utilisations and reversals of loan loss provisions, 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 are also taken into account. Furthermore, the loan portfolio transaction signed on 28 February 2018 was also reflected in the planning for loan loss provisions.

Due to its full balance sheet utilisation, planned termination in 2018 and the planning assumption of the full payment of the hedging effect by the guarantor, the second loss guarantee has no impact on the planned loan loss provision results.

An important driver of the amount recognised for loan loss provisions is the breakdown of non-performing loan commitments 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 individual valuation allowances based on the assumption of a workout). The estimates made for loan loss provisions are based on the assumption of the continuation of the stabilisation process started in 2017 and the recovery of the shipping markets, in particular in container shipping, as well as the continuation of the current recovery strategy.

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 trend in individual asset classes and sub-portfolios and risk concentrations as well as recommended measures by means of regular reports.

The HSH Management Report also includes reports on problem loans and new business in addition to information on the trend of the relevant key default risk figures, structural analyses on business areas and conspicuous individual commitments. It also includes the profit centre accounting, rating validation results and rating migration development as well as information on the monitoring and management of country risk.

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) as well as share prices, indices and fund prices (equity risk) including their volatilities.

Organisation of market risk management

The Management Board determines the methods and processes for measuring, limiting and 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 reporting year. The Bank Management division performs the central management function for interest rate and currency risks in the banking book. The Overall Management Board is responsible for selected strategic positions exposed to market risk.

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

Market risk management

Market risk measurement and limitation

Our system for measuring and managing market risk is based, on the 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. In the context of the value-at-risk approach, the interest VaR in the banking book is also determined and limits are explicitly set for interest rate risk in the banking book. The present value basis used in the measurement of market risk was expanded by an earnings-oriented perspective, in which the change in average interest income is simulated in different scenarios over a 5 year time horizon.

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 risk for both the trading book and 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 overdrafts.

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 effects of the hedging transactions entered into are included in the VaR disclosed. Further information on this and the type and categories of the hedging instruments and hedging relationships entered into by HSH Nordbank as well as the type of risks hedged is presented in the Notes. In particular, we refer to Note 14 "Hedge accounting via valuation units" and Note 71 "Derivatives business".

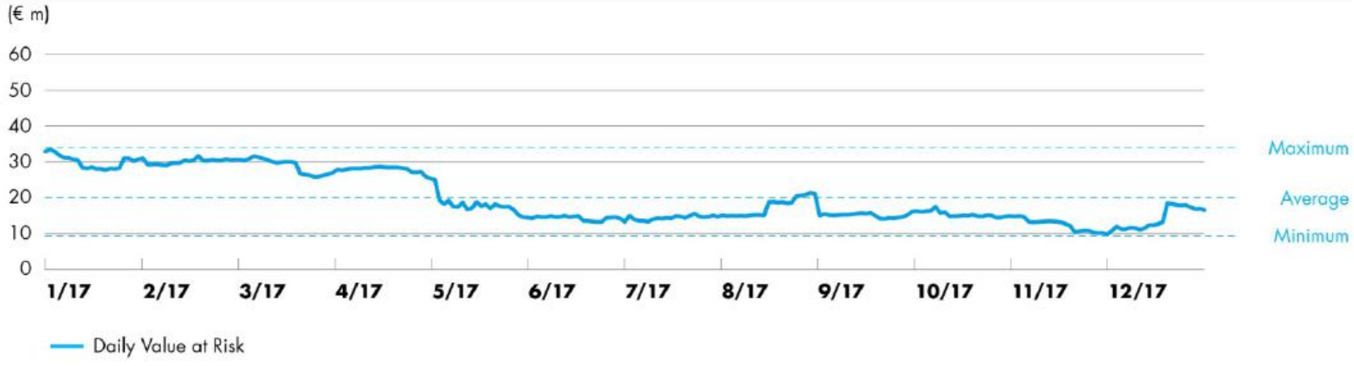
Market risks arising from HSH Nordbank's lending business and liabilities are transferred to the trading divisions and taken into account in the corresponding risk positions. There they are managed as part of a proactive portfolio management process and hedged through external transactions.

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 shows the movement in the daily VaR for the total trading and banking book positions of HSH Nordbank over the course of 2017.

DAILY VALUE-AT-RISK IN THE COURSE OF 2017



Market risk fluctuated between € 9.9 million and € 33.7 million. It decreased significantly from € 34.5 million to € 16.7 million on a year-end comparison. The main drivers of this reduction in the overall VaR were the winding down of the divestment portfolio and lower market volatility compared to the previous year.

The VaR of the trading book positions amounted to € 0.3 million as at 31 December 2017, while that of the banking book transactions amounted to € 16.6 million. The overall VaR, which cannot be derived from adding the VaR of the trading and banking book positions due to risk-mitigating correlation effects, amounted to € 16.7 million as at the reporting date. This resulted in a limit utilisation of 24 % 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 over the course of the year under review.

DAILY VALUE-AT-RISK OF THE GROUP

(€ m)	Interest rate risk[1]		Credit spread risk[1]		Foreign exchange risk		Equity risk		Commodity risk		**Total**[2]	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016
Average	5.2	9.7	15.6	25.1	11.1	18.1	1.2	2.0	–	–	**20.0**	41.8
Maximum	9.7	19.9	26.7	27.1	20.8	25.8	1.6	4.1	–	–	**33.7**	49.9
Minimum	2.9	4.6	8.1	21.6	0.8	9.1	0.8	0.9	–	–	**9.9**	30.2
Period end amount	5.3	12.3	9.1	22.9	14.5	18.3	1.5	1.4	–	–	**16.7**	34.5

[1] Credit spread risk is a sub-type of interest rate risk. It is not disclosed as part of interest rate risk but as a separate item due to its significance for HSH Nordbank.
[2] Due to correlations the VaR does not result from adding up individual values.

With regard to the risk types there was a significant decrease in both interest rate and FX risk as well as in credit spread risk. Due to the accelerated winding down of the divestment portfolio the sharpest decrease was in credit spread risk.

Commodity risk is no longer disclosed as the commodity business has been discontinued and the last positions were wound down by the end of 2016.

As the market risk of the Core Bank (as at the 2017 year end: € 15.6 million) 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 as well as bond trading. Market risk also includes credit spread risk on securities held in the liquidity buffer and cover pool portfolios that have good credit quality.

The market risk of the Non-Core Bank (as at the 2017 year end: € 3 million) results primarily from the residual balances of the credit substitute business in the banking book. Accordingly, credit spread risk is the dominant factor here.

Backtesting

HSH Nordbank performs regular backtests to review 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. This threshold was always maintained at the HSH Nordbank Group level in 2017.

Stress tests

In addition to the limit-based management of the daily VaR, at least weekly stress tests are performed that analyse the effects of unusual market fluctuations on the 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, a distinction is also made between economic scenarios that simulate a downturn in the macroeconomic environment and portfolio-specific scenarios that can represent a potential threat for the value of individual sub-portfolios of HSH Nordbank. The hypothetical scenarios are periodically reviewed and adjusted where necessary depending on changes in the market environment.

Instruments used to manage market risk as part of accounting for hedging transactions

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

When hedging assets not held for trading, transactions which can be clearly assigned to a documented hedge relationship may be accounted for as a valuation unit as defined in Section 254 of the 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 of the trend in market risk and results as well as limit utilisations. In addition, weekly and monthly reports are submitted to the Overall Bank Management Committee.

LIQUIDITY RISK

HSH Nordbank breaks down its liquidity risk into insolvency risk and liquidity maturity transformation risk.

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

Organisation of liquidity risk management

Strategic liquidity management is the responsibility of the Bank Management division. The objective of liquidity management is to ensure the solvency of 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. Bank Management uses the risk measurement results to support it in managing liquidity for all maturity bands and enable it to counter possible risks at an early stage.

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

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

Liquidity risk management

Measurement and limitation of liquidity risk

The transactions in the Group impacting liquidity are presented as cash flows and the resultant inflows and outflows allocated to maturity bands (liquidity development report) for the purposes of measuring insolvency risk or funding requirements. The difference between inflows and outflows represents a liquidity surplus or deficit (gap) in the relevant maturity bands. The gaps are are shown on a cumulative basis from day one to twelve months in order to map future liquidity requirements. They are compared to the respective liquidity potential which is applied to close the cumulative gaps of the individual maturity bands and consequently represents the respective limit for insolvency risk. Utilisation of this limit is monitored daily. 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. The measures used in the normal market phases to generate liquidity are already included in the net liquidity position.

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

The liquidity potential available to close gaps is composed of a securities portfolio held as a precaution in the event of a crisis (liquidity buffer), other 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 reviews the funding potential on a daily basis based on the expected prolongation ratios for short-term deposits. The Bank Management division 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 theoretically necessary to immediately close the current maturity transformation position. It is assumed for this purpose that these hypothetical close-out transactions could actually be executed 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 regulatory liquidity ratios are operationally managed by the Bank Management division based on general parameters specified by the Treasury & Markets division. In addition to the regulatory requirements the liquidity development report is relevant amongst other things for determining these general parameters. The definition of or change to individual parameters or the framework is decided by the OBM committee or the Management Board. This places HSH Nordbank in the position to react flexibly to market developments.

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

The maturity mismatch liquidity development report was introduced in 2017 to obtain a long-term view of insolvency risk. It shows the pure maturity mismatches in the base case. The base case scenario maps the normal, expected business operations taking account of fluctuations in cash flows usual in normal market phases and defined by regulation. The benefit lies in the setting of a limit on the liquidity maturity transformation in order to limit future insolvency risks.

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

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 case liquidity development report. 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, an analysis is carried out to determine how the LVaR changes 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 or liquidity gap 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.

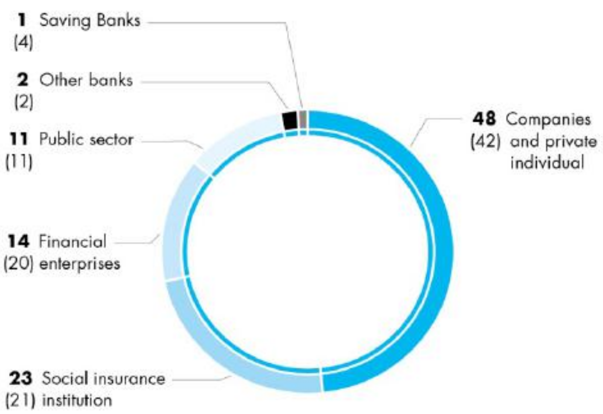
Risk concentrations

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). The deposit structure is characterised by a high level of concentration relating to a small number of large institutional investors that place deposits based on interest rates and ratings. The ten largest depositors account for around 29% of total deposits. Furthermore, a high proportion (more than 44%) of total deposits comprises overnight deposits.

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

DEPOSITOR STRUCTURE AS AT 31 DECEMBER 2017[1)]

(in %, previous year figures in brackets[2)])



[1)] In addition to call an term deposits this illustration also includes demand deposits for the first time.
[2)] The figures reported for the prior year have been adjusted to the new 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.

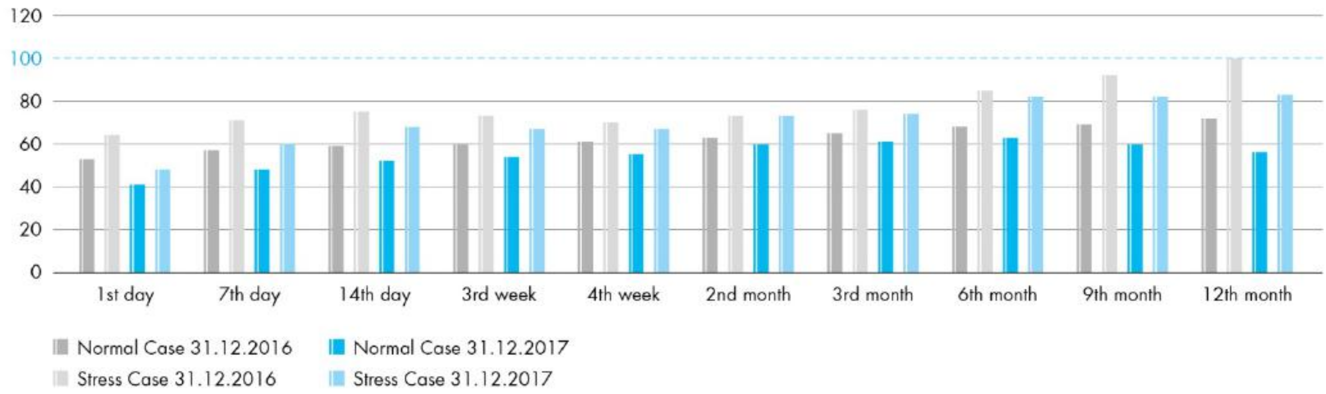
In addition to the analysis of the depositor structure with regard to existing depositor concentrations, risk concentrations are examined with regard to the US dollar asset/liability position. This shows the dependency of the liquidity situation on the movement in the US dollar exchange rate, which, although it has decreased in 2017 due to the overall reduction in US dollar assets, is still relevant. This is, inter alia, due to the large amount of US dollar assets that are refinanced through EUR/USD basis swaps. 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 and a US dollar stress test of the liquidity development report are performed.

Quantification of liquidity risk

The following chart shows the relative utilisation levels of the liquidity potential for individual cumulative liquidity gaps in the normal case and stress case as at 31 December 2017 as well as at the end of 2016. Utilisation represents the ratio of the cumulative gap to the total liquidity potential, which also includes the liquidity buffer required under supervisory law. HSH Nordbank's risk tolerance with regard to liquidity risk is reflected, amongst other things, in the definition of a minimum survival period, which describes how long utilisation of a liquidity potential lower than 100% is to be maintained under the normal and stress cases for insolvency risk.

LIMIT ON CUMULATIVE LIQUIDITY GAPS

(Utilisation of liquidity potential in %)



The liquidity potential had a peak utilisation of 63% in the sixth month as at the reporting date in the normal case assessment, which is based on the assumption of business development in an ordinary market environment. All limits within the minimum survival period of twelve months defined by the Bank were thereby adhered to. The stress case liquidity development report (combined scenario – economic downturn and rating downgrade – 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 2017 are even adhered to for a period of twelve months. Compared to the 2016 year end, utilisation levels have decreased in the normal case and stress case in virtually all maturity bands. This improvement is primarily attributable to the planned sale and already implemented winding down of loan and securities portfolios. Critical limit utilisation levels were not reported in the normal case nor in the stress case liquidity development report in the course of the period under review.

The results of the market-specific and Bank-specific stress scenarios determined in addition to the stress case liquidity development report show that, as at December 2017, HSH Nordbank's liquidity requirement was covered by the liquidity potential over twelve months in all scenarios despite the worst-case assumptions. A minimum survival period of one month is thereby maintained in all scenarios. The results show that HSH Nordbank is prepared accordingly for the crisis scenarios assessed.

In the year under review, the LVaR as an expression of the liquidity maturity transformation risk decreased to € 46 million (31 December 2016: € 83 million). This decrease is attributable to a new relevant scenario, in which deposit volatilities have declined.

Regulatory liquidity ratios

The regulatory management parameter for liquidity risks is the liquidity ratio defined by the German Liquidity Regulation (LiqV). With values between 1.69 and 1.95, HSH Nordbank's liquidity ratio remained above the regulatory minimum value at all times throughout the reporting year. The average value for 2017 was 1.83 (previous year: 1.78), and the ratio was 1.79 as at the reporting date (31 December 2016: 1.92).

Under Basel III and the 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 from the entry into force of the Delegated Regulation (EU) 2015/61 on 1 October 2015, whereby the compliance rate increases from an initial 60% to 100% in 2018. Under the SREP requirements for 2018 a LCR ratio of 110% is to be maintained at the sub-consolidated level. As at the reporting date, the LCR was 169% (determined on an internal sub-consolidation basis) in the survey carried out under the Delegated Regulation (EU) 2015/61 (previous year: 179%) and was therefore above the future minimum threshold.

The net stable funding ratio (NSFR), which must be adhered to from 2020 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 2017 the NSFR amounted to 114% under the QIS (Basel framework) (previous year: 111%).

Refinancing situation

The implementation of the funding strategy was successfully driven forward during the course of the financial year thereby improving the Bank's liquidity profile. The measures stepped up during the year to reduce risk positions, thereby releasing liquidity, had a positive impact. The liquidity position was also improved by the accelerated settlement of losses under the second loss guarantee. 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 in the context of its privatisation. 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. 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 OBM committee and 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 2017 (31 December 2016: € 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.

As a bank-wide steering committee for operational and other risks in the Group, the OpRisk Steering Committee convenes every quarter and provides support to the Overall Management Board in the implementation of the OpRisk strategy under the chair 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 of loss events and measures taken. The Management Board is immediately informed of any 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 53% (previous year: 38%) 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 15% (previous year: 26%). 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 28% (previous year: 35%). The proportion of loss events reported under the Internal infrastructure category (e.g. system failures, functionality or security) amounted to 4% (previous year: 1%).

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 takes the risk inventory based on defined scenarios, which take into account both actual and 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 staff or poor motivation of employees. This risk could materialise particularly in light of the current reduction in staff. The Human Resources division is therefore focusing increasingly on measures to reduce personnel risk. A large number of personnel management tools for employee retention are used to prevent the unscheduled departure of key personnel. In addition, succession planning is performed and regularly reviewed for relevant positions.

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

IT-specific risk tools are used by means of which risks 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 HSH Nordbank's internal control system (ICS). A major objective of the ICS is to optimise the internal bank processes in order to avoid losses that may arise as a result of, for example, processing errors. Detailed information on the ICS is set out in the Risk management system section.

Management of legal risk
Legal risks also fall under operational risk. Legal risk 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 materialises, this may lead to a higher financial burden than planned.

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

HSH Nordbank recognised provisions of € 112 million for litigation risks as at the reporting date (previous year: € 31 million). In addition, there are contingent liabilities of € 31 million arising from legal disputes (previous year: € 28 million). HSH Nordbank takes a number of factors into consideration to determine for which claim a loss is likely to be incurred and to estimate the possible payment obligation. This includes the type of claim and underlying facts, the status of the individual proceedings, (preliminary) decisions of courts and arbitration boards, experience of HSH Nordbank and third parties in similar cases (insofar as they are known to the Bank), previous settlement discussions as well as expert reports and assessments of internal and external legal advisers and other experts.

A major portion of the provisions for litigation risks relates to the legal proceedings mentioned below. The provision amounts are not disclosed individually in order not to influence the outcome of the respective proceedings. The current status of the proceedings and expected outcome of the proceedings are taken into in recognising these amounts. Utilisation can differ from the amounts provided depending on the actual outcomes of the proceedings:

Since 2005 HSH Nordbank AG has been involved in legal proceedings with a Turkish shipping group and previously had to pay a total amount of US$ 54 million in 2013 due to decisions made by Turkish courts. The plaintiffs have asserted further claims under which damages are asserted based on loss of profit and third party liabilities in connection with measures taken to realise the Bank's collateral for a loan.

Furthermore, HSH Nordbank is being sued by a former borrower for payment of a total amount of € 197 million plus interest. The plaintiff is asserting various claims, particularly claims for payment of damages and claims for unjust enrichment in connection with measures taken by the Bank regarding a problem loan. Material aspects of the underlying facts of this legal action have already been the subject of several lawsuits in the past, in which the Bank has always succeeded before different courts apart from relatively small amounts.

Furthermore, claims in connection with different legal opinions on the interpretation of the contract regarding certain financial instruments on the liability side are also being asserted against the Bank in legal actions.

As a component of legal risk, tax risks mainly result from the fact that the binding interpretation of rules that can be interpreted in specific cases may only be known after several years due to the long period between tax audits. The tax audits have been finalised for the years 2003–2007 and appropriate provisions have been recognised on the balance sheet. The tax audits have not yet been finalised for the years starting from 2008.

HSH Nordbank recognised provisions and liabilities (including interest) totalling € 63 million (previous year: € 116 million) for tax risks as at the reporting date. A major portion of this relates to tax audit risks (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).

Management of compliance risk

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

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

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

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

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 strategic risk and reputation risk.

Business strategy risk

Business strategy risk refers to the risk of financial damage being incurred due to long-term strategic decisions based on incorrect assumptions. Should 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 & Management Board Office division 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 & Management Board Office division is responsible for the process. An action-oriented management dialogue, including on the strategic business objectives, is conducted during the year in the business review meeting held on a monthly basis.

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 2017 financial year was characterised by the continuing winding down of high-risk, non-strategic lending and capital markets transactions held in the Non-Core Bank's portfolios as well as by the progress made in implementing the business model as the key strategic steps on the path to a successful change in owners. In addition to various transactions and activities entered into during the course of the 2017 financial year to wind down the portfolio, HSH Nordbank AG at the same time entered into, upon the successful conclusion of the share purchase agreement, an agreement regarding the sale of a predominantly impaired loan portfolio (consisting mainly of large ship financing amounts) to an acquisition vehicle of the investor group. This transaction serves, inter alia, to sustainably strengthen the regulatory capital ratios, improve the Bank's external ratings by increasing the asset quality and reduce the stress sensitivity.

HSH Nordbank's risk-bearing capacity was maintained at all times during the year under review with a maximum utilisation of the risk coverage potential of 36%. The guarantee facility and ongoing winding down of risk positions made a positive contribution in this regard.

Based on the restructuring progress made in the past financial year together with the overall satisfactory operating performance, the Bank expects to be able to drive forward the implemented transformation process in line with the plan in the 2018 financial year. The privatisation process can be brought to a successful conclusion by fulfilling the closing conditions. Operating measures aimed at realigning a future risk-optimised and agile corporate structure are to be defined for this and implemented as quickly as possible. The Bank's realignment activities are combined in a bank-wide transformation project. The key focuses of the project include the development of profitable and risk-oriented growth strategies and associated implementation projects. The Bank's operating business model will be realigned in this connection.

The accompanying aim is to reduce the complexity in processes and products, enabling an organisational structure freed of legacy assets and the guarantee structure.

Within this transformation process a highly effective and efficient CRO division aligned to the future strategy and targets must be developed based on the risk organisation and the Bank must be further stabilised. This is accomplished in particular by being able to ensure the risk-bearing capacity and an adequate capital and liquidity base at all times.

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

The implementation of the new supervisory requirements will be a further focus of our activities in 2018. For example, extensive requirements of the EBA/ECB resulting from the “Supervisory Review and Evaluation Process” (SREP) and expected update of the “SSM Guides on ICAAP and ILAAP”, which are still in the consultation phase, have to be met.

The risk and bank management systems described in this report are aligned to take account of risk on a systematic basis. This also applies to our expectations regarding future market and business developments. We believe that we have appropriately presented the overall risk profile of the 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 2017.

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 Finanzfonds AöR – Gemeinsame Anstalt der Freie und Hansestadt Hamburg und des Landes Schleswig-Holstein (HSH Finanzfonds AöR) - incorporated with effect from 21 April 2009 as well as HSH Beteiligungs Management GmbH - incorporated with effect from 20 May 2016.

Hamburg/Kiel, 17 April 2018

Stefan Ermisch Oliver Gatzke

Ulrik Lackschewitz Torsten Temp

ANNUAL ACCOUNTS OF HSH NORDBANK AG

BALANCE SHEET OF HSH NORDBANK AG AS AT 31 DECEMBER 2017

ASSETS

(€ k)	(Note)			**31.12.2017**	31.12.2016
1. Cash reserve					
a) Cash on hand			4,132		5,424
b) Balances with central banks			6,507,343		3,353,173
thereof:				**6,511,475**	**3,358,597**
with Deutsche Bundesbank	6,499,476				
	(previous year: 3,341,635)				
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			105,940		118,499
thereof: eligible for refinancing at the Deutsche Bundesbank	–				
	(previous year: –)			**105,940**	**118,499**
3. Loans and advances to banks	(6, 7, 24–28)				
a) Payable on demand			363,425		395,306
b) Other loans and advances			2,406,826		1,845,034
				2,770,251	**2,240,340**
4. Loans and advances to customers	(6, 7, 25–28)			**40,348,844**	**52,937,483**
thereof: secured by mortgages	10,091,955				
	(previous year: 8,592,678)				
public-sector loans	4,054,771				
	(previous year: 5,484,419)				
secured by ship mortgages	5,692,150				
	(previous year: 9,784,292)				
5. Debentures and other fixed-interest securities	(9, 25–30, 33)				
a) Money market instruments					
aa) from other issuers		5,004			11,017
			5,004		
b) Bonds and debentures					
ba) from public-sector issuers		6,887,370			7,722,153
thereof: eligible as collateral at the Deutsche Bundesbank	6,816,402				
	(previous year: 7,474,045)				
bb) from other issuers		6,644,597			7,653,036
thereof:			13,531,967		
eligible as collateral at the Deutsche Bundesbank	6,118,453				
	(previous year: 5,765,118)				
c) Own debentures			1,446,671		1,263,955
Nominal value	1,432,617			**14,983,642**	**16,650,161**
	(previous year: 1,249,037)				
To be carried forward				**64,720,152**	**75,305,080**

ASSETS

(€ k)	(Note)			**31.12.2017**	31.12.2016
	Carried forward			**64,720,152**	**75,305,080**
6. Shares and other non-fixed-interest securities	(9, 29, 30, 33)			**50,796**	**171,057**
6a. Trading portfolio	(10, 31)			**2,696,443**	**3,227,601**
7. Equity holdings in non-affiliated companies	(16, 29, 33, 68)			**10,007**	**89,448**
thereof: in banks	4,907				
	(previous year: 42,107)				
8. Interests in affiliated companies	(16, 29, 33, 68)			**621,417**	**694,925**
thereof: in banks	82,590				
	(previous year: 49,700)				
in financial services institutions	–				
	(previous year: –)				
9. Trust assets	(32)			**3,934**	**5,147**
thereof: trust loans	3,934				
	(previous year: 5,147)				
10. Intangible fixed assets	(17, 33)				
a) Industrial property rights acquired in-house and similar rights and assets			1,100		1,918
b) Licences, industrial property rights and assets as well as licenses to use such rights and assets purchased			6,988		8,204
				8,088	**10,122**
11. Tangible fixed assets	(18, 33)			**86,175**	**88,377**
12. Other assets	(34)			**1,525,184**	**2,392,506**
13. Prepaid expenses	(6, 20, 35)			**76,964**	**131,888**
14. Deferred tax assets	(19, 36)			**531,336**	**609,119**
Total assets				**70,330,496**	**82,725,270**

LIABILITIES

(€ k)	(Note)			**31.12.2017**	31.12.2016
1. Liabilities to banks	(20, 39–42)				
a) Payable on demand			488,662		1,450,524
b) With agreed maturities or notice periods			8,402,614		8,824,450
				8,891,276	**10,274,974**
2. Liabilities to customers	(20, 40–42)				
a) Savings deposits					
aa) with agreed notice period of three months		14,344			18,188
ab) with agreed notice period of more than three months		–			–
			14,344		18,188
b) Other liabilities					
ba) Payable on demand		10,997,724			12,256,733
bb) With agreed maturities or notice periods		25,809,905			29,220,531
			36,807,629		41,477,264
				36,821,973	**41,495,452**
3. Securitised liabilities	(20, 42, 72)				
a) Debentures issued			14,082,878		17,485,098
b) Other securitised liabilities			3,002		69,078
				14,085,880	**17,554,176**
thereof: money market instruments	3,002 (previous year: 69,078)				
3a. Trading portfolio	(10, 43)			**1,414,071**	**1,770,739**
4. Trust liabilities	(44)			**3,934**	**5,147**
thereof: trust loans	3,934 (previous year: 5,147)				
5. Other liabilities	(45)			**971,622**	**1,221,822**
6. Prepaid expenses	(6, 20, 46)			**76,488**	**126,625**
6a. Deferred tax liabilities	(19, 47)			**69,144**	**174,356**
7. Provisions	(21)				
a) Provisions for pensions and similar obligations			814,812		780,088
b) Tax provisions			109,771		77,464
c) Other provisions	(48)		411,458		452,982
				1,336,041	**1,310,534**
8. Subordinated debt	(49)			**1,048,002**	**2,092,557**
9. Profit participation capital	(50)				**13,616**
thereof: maturing in less than two years	– (previous year: 13,616)				
10. Fund for general banking risks	(51)			**2,362,444**	**2,348,495**
of which special items under Section 340e (4) HGB	52,642 (previous year: 38,694)				
To be carried forward				**67,080,875**	**78,388,493**

LIABILITIES

(€ k)	(Note)			31.12.2017	31.12.2016
	Carried forward			**67,080,875**	**78,388,493**
11. Equity capital	(52)				
a) Subscribed capital					
aa) Share capital		3,018,225			3,018,225
ab) Silent participations		908,773			1,242,017
			3,926,998		4,260,242
b) Capital reserves			76,535		76,535
c) Accumulated loss			– 753,912		–
				3,249,621	**4,336,777**
Total liabilities				**70,330,496**	**82,725,270**
1. Contingent liabilities	(64)				
a) Liabilities from guarantee and indemnity agreements				**2,022,220**	**2,398,625**
2. Other commitments	(64)				
a) Irrevocable loan commitments				**6,724,077**	**6,737,564**

INCOME STATEMENT OF HSH NORDBANK AG

FOR THE PERIOD 1 JANUARY TO 31 DECEMBER 2017

(€ k)	(Note)			**2017**	2016
1. Interest income	(53, 54)				
a) lending and money market transactions		2,990,942			3,351,037
negative interest resulting from loan and money market transactions		–184,678	2,806,264		–114,964
b) from fixed-interest securities and book-entry securities		305,610			357,270
negative interest resulting from securities and book-entry securities		–	305,610		–
			3,111,874		3,593,343
2. Interest expenses	(54)				
from the banking business		2,505,967			2,846,251
positive interest resulting from the banking business		–107,529			–62,039
			2,398,438		2,784,212
				713,436	**809,131**
3. Current income from	(53)				
a) shares and other non-fixed-interest securities			2,241		3,909
b) equity holdings in non-affiliated companies			12,569		21,815
c) interests in affiliated companies			42,674		33,012
				57,484	**58,736**
4. Income from profit pooling, profit and loss transfer or partial profit and loss transfer agreements	(53)			–	**6,452**
5. Commission income	(53, 55)		111,335		116,621
6. Commission expenses	(55)		199,363		258,213
				– 88,028	**-141,592**
7. Net income/Net expenses from the trading portfolio	(53)			**125,535**	**82,537**
8. Other operating income	(53, 56)			**179,331**	**158,678**
9. General administrative expenses					
a) Personnel expenses					
aa) Wages and salaries		166,621			194,320
ab) Compulsory social security contributions, expenses for retirement pensions and other employee benefits		35,075			12,435
			201,696		206,755
thereof: for retirement pensions	9,836 (previous year: –15,677)				
b) Other administrative expenses	(61)		310,549		358,143
				512,245	**564,898**
10. Depreciation, amortisation and impairments on intangible fixed assets and tangible fixed assets	(38)			**8,234**	**8,357**
11. Other operating expenses	(57)			**266,475**	**164,234**
12. Depreciation and impairments on loans and advances and certain securities and additions to provisions in the lending business				**1,294,525**	**-**
To be carried forward				**-1,093,721**	**236,453**

(€ k)	(Note)			**2017**	2016
	Carried forward			**-1,093,721**	**236,453**
13. Income from additions to loans and advances and certain securities as well as from the reversal of provisions in the lending business				**-**	**64,702**
14. Additions to the fund for general banking risks				**-**	**257,467**
15. Income from additions to equity holdings in non-affiliated and interests in affiliated companies and securities treated as fixed assets				**141,645**	**167,283**
16. Expenses from the transfer of losses				**13,371**	**1,817**
17. Profit on ordinary activities				**-965,447**	**209,154**
18. Extraordinary income	(58)		**8,680**		**6,730**
19. Extraordinary expenses	(58)		**77,487**		**112,236**
20. Extraordinary result	(58)			**-68,807**	**-105,506**
21. Income tax expenses	(59)		**1,912**		**100,778**
22. Other taxes not shown under item 11			**2,870**		**2,870**
				4,782	**103,648**
23. Income from loss-sharing	(60)			**285,124**	**-**
24. Annual net loss				**-753,912**	**-**
25. Loss carried over from the previous year				**-**	**-100,035**
26. Withdrawals from the capital reserve				**-**	**100,035**
27. Accumulated loss				**-753,912**	**-**

NOTES FOR THE 2017 FINANCIAL YEAR

GENERAL INFORMATION AND NOTES

1. HSH NORDBANK AG AND ITS SHAREHOLDERS

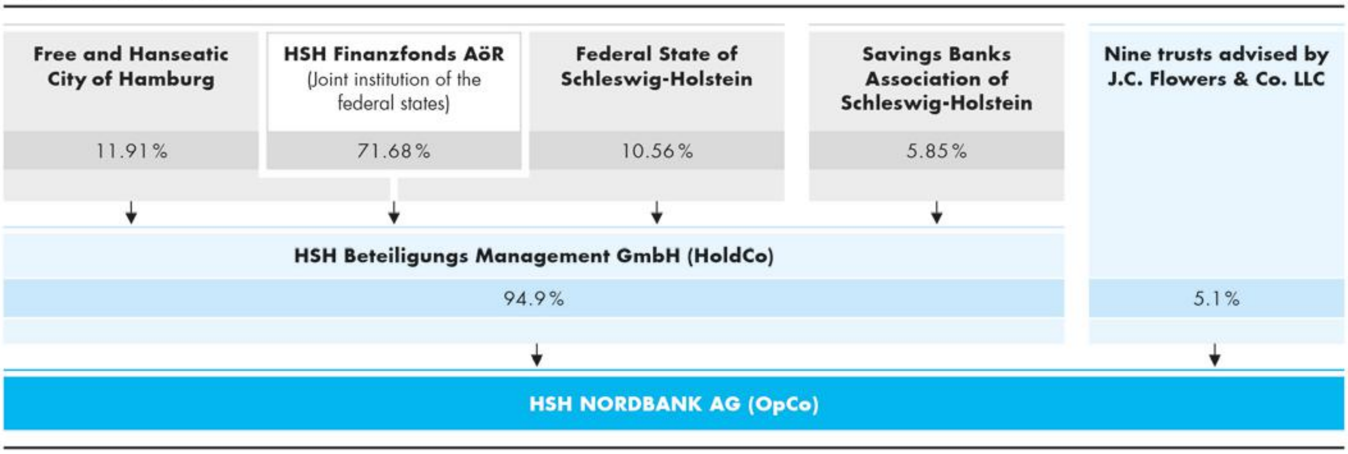
HSH Nordbank AG, with its registered offices in Hamburg and Kiel, was established by the merger of the Hamburgische Landesbank Girozentrale, Hamburg, and the Landesbank Schleswig-Holstein Girozentrale, Kiel, on 2 June 2003. For accounting and tax purposes, the merger took effect retroactively as of 1 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 as at 31 December 2017.

OWNERSHIP STRUCTURE



2. EVENTS AFTER THE REPORTING DATE

In its decision of 2 May 2016, the EU Commission approved the replenishment of the second loss guarantee based on a catalogue of commitments and conditions in the state aid proceedings in favour of HSH Nordbank AG. One essential commitment related, among other things, to the sale of HSH Nordbank by 28 February 2018. Within this context, the federal state owners Hamburg and Schleswig-Holstein, as well as the minority owner Sparkassen- und Giroverband für Schleswig-Holstein, sold their stake of 94.9% in HSH Nordbank AG, which was held indirectly via HSH Beteiligungs Management GmbH, in full to several investors on 28 February 2018 (signing). The buyers are funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG, which are independent of each other. The closing of the share purchase agreement is subject to various conditions, in particular parliamentary approval in Hamburg and Schleswig-Holstein, the viability review on the future bank conducted by the European Commission, the approval of the banking supervisory authorities (ECB, BaFin and CSSF in Luxembourg), the approval of the competent antitrust/competition authorities and confirmation of the successful extension of HSH Nordbank AG's full membership of the guarantee scheme of the German Savings Banks Finance Group (SFG) for three further years after the conclusion of the share purchase agreement (closing) at least until the end of 2021. The closing of the privatisation process (share purchase agreement) is scheduled for the end of the second or for the third quarter of the current financial year.

In addition, the Bank sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017. The closing of the portfolio transaction is subject, first of all, to the approval of the competent antitrust and competition authorities and also depends on the closing of the share purchase agreement. This means that the sold portfolio cannot be transferred to the sphere of the investors until immediately after the closing of the privatisation process, which is why the Bank's balance sheet cannot be relieved until this time.

In addition, an agreement has been reached as part of the privatisation negotiations between the parties that the second loss guarantee in an amount of € 10 billion granted by the federal state owners to the Bank will be terminated prematurely immediately after the closing of the share purchase agreement. In this respect, a corresponding cancellation agreement has been signed between the guarantor, HSH Beteiligungs Management and the Bank. Under this agreement, the second loss guarantee will be terminated prematurely in return for a compensation payment made by HSH Nordbank AG to HSH Finanzfonds AöR in an amount of € 100 million, which will put pressure on the statement of income in the first quarter of 2018.

At the same time, HSH Finanzfonds AöR will make a payment to HSH Nordbank AG to compensate for the losses that have not yet been settled based on a separate settlement procedure. The signed cancellation agreement is subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

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 are 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 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.

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.

As long as and insofar as the cash drawdown of the guarantee was 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 could not 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 individual valuation allowances 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 individual valuation allowances and general loan loss provisions recognised are not changed by the accounting applied to the hedging effect.

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 formal 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. Against this background, HSH Nordbank AG was relieved of material guarantee premiums by a newly established holding company (HSH Beteiligungs Management GmbH).

In exchange for the guarantee, HSH Nordbank AG since 1 January 2016 has therefore 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 HSH Beteiligungs Management GmbH.

Accounting impact of the second loss guarantee in the 2017 financial year

The hedging effect of the financial guarantee granted by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein via HSH Finanzfonds AöR, which was reported on the face of the balance sheet for the first time as at 31 December 2010, , amounted to € 6,203 million as at 31 December 2017 (previous year: € 8,060 million).

As at 31 December 2017 the hedging effect of the second loss guarantee resulted in a compensation item on the balance sheet in the amount of € 6,203 million (previous year: € 8,060 million) which is offset in the item loan loss provisions. An amount of € 88 million (previous year: € 1,811 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 amount of € 319 million. This means that HSH Nordbank has a contractual entitlement to loss compensation with regard to the main claims in default and the interest accrued.

The payments already made by the guarantor amount to € 3.8 billion as at 31 December 2017.

HEDGING EFFECT OF THE SECOND LOSS GUARANTEE ON LOAN LOSS PROVISIONS

(€ m)	**2017**	2016	**2017**	2016
	Balance sheet	Balance sheet	Income statement	Income statement
	Loan loss provisions	Loan loss provisions	**Loan loss provisions**	Loan loss provisions
Hedging effect before guarantee costs	6,203	8,060	– 1,857	– 41
Payments of HSH Finanzfonds AöR	–	–	1,945	1,852
Compensation under the second loss guarantee	**6,203**	**8,060**	**88**	**1,811**

Taking into account the payments of HSH Finanzfonds AöR already received for credit losses in the hedged portfolio totalling € 3,797 million (€ 1,852 million in the prior year), the utilisation of the guarantee as at 31 December 2017 comes to € 10,000 million (previous year: € 9,912 million). Since the 2009 reporting year the Bank has recorded premium expense totalling € 3,860 million for the provision of the second loss guarantee. € 3,825 million has been paid to date, of which € 2,790 million is attributable to the current base premium and € 1,035 million to one-off payments (thereof € 260 million to HSH Beteiligungs Management GmbH).

Privatisation of the Bank

As part of the privatisation of the Bank, an agreement was reached between HSH Nordbank AG, the guarantor and HSH Beteiligungs Management GmbH on 28 February 2018 on the premature termination of the agreement on the provision of a guarantee facility. This means that, on the date on which the cancellation takes effect, HSH Nordbank AG will no longer be under any obligation to pay guarantee fees, and the guarantor will make a compensation payment to HSH Nordbank AG to compensate for the loss facility that has not yet been settled/disbursed. In addition, HSH Nordbank AG is to make a one-off payment of € 100 million to the guarantor to compensate for the monetary benefits associated with the early termination of the guarantee, as well as the premature liquidity effect, in particular state aid law advantages resulting from the fact that premium payments are no longer to be made. This will put pressure on the statement of income in 2018. Losses from guarantee cases that have not yet been definitively confirmed at the time of the signing of this agreement will be assessed based on a separate settlement procedure and compensated for within the context of the compensatory payment.

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

II. Synthetic securitisation transaction

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

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

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

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

HSH Nordbank AG pays an annual premium on the respective outstanding mezzanine tranche. The premium to be paid in each case is determined primarily by the extent to which the guarantee has actually been utilised. The premium is recognised through profit or loss in commission expense. In 2017, the premium expense amounted to approximately € 25.9 million. In 2018, the Bank expects to incur premium expense totalling a maximum of around € 25.9 million. The contractual term of the guarantee is nine years (starting from the time at which the guarantee agreement was concluded in the fourth quarter of 2016).

As long as and insofar as the cash drawdown of the guarantee is not yet made through the invoicing of losses that in total exceed the first loss piece to be borne by HSH Nordbank AG (on the securitised portfolio) in an initial and current 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 individual valuation allowances 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 allowance 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 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 (Gewährträger-haftung) 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 2017 in accordance with the provisions of the German Commercial Code (HGB), the German Stock Corporation Act (AktG), the German Bank Accounting Regulation (RechKredV) and the German Mortgage Bond Act (PfandBG). In addition, we complied with the applicable pronouncements of the Institute of Public Auditors in Germany, Incorporated Association - IDW.

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, the basis for corporate planning and in particular the planning of the movement in loan loss provisions, 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. By way of example, material uncertainty factors with regard to the development of loan loss provisions include the development of the relevant market parameters such as freight and charter rates, ship values, the US dollar exchange rate and changes regarding macroeconomic trends. One key assumptions used in corporate planning in view of the ongoing sale process of HSH Nordbank AG is that the outstanding conditions for the closing of the privatisation transaction are fulfilled and that the privatisation process is completed successfully as a result.

Simultaneously with the successful conclusion of the share purchase agreement, HSH Nordbank AG concluded an agreement on the sale of an extensive portfolio consisting largely of non-performing loans (in particular ship financing) to a special-purpose entity from the sphere of the investors (the portfolio transaction). The closing of the portfolio transaction is subject, first of all, to the approval of the

German Federal Cartel Office (Bundeskartellamt) and also depends on the closing of the share purchase agreement.

The successful execution of this portfolio transaction and the associated reduction in the NPE ratio are key assumptions used in the Bank's corporate planning over and above successful privatisation.

A further significant assumption with regard to corporate planning is the termination of the Sunrise guarantee. In light of the privatisation, HSH Nordbank AG and HSH Beteiligungs Management GmbH reached an agreement with HSH Finanzfonds AöR on the premature termination of the agreement on the provision of a guarantee facility in return for a compensation payment made by HSH Nordbank to HSH Finanzfonds AöR in an amount of € 100 million (cancellation agreement). As a result, the corporate planning assumes that, taking into account the settlement procedures set out in the cancellation agreement, the entire guarantee facility of €10 billion will be drawn down by HSH Nordbank AG and paid by the guarantor to HSH Nordbank AG. The implementation of the cancellation agreement is also subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

As it is not, however, possible to objectively predict the course and outcome of the privatisation process, the privatisation process involving HSH Nordbank AG creates significant uncertainty regarding the implementation of the corporate planning, as well as accounting and measurement, based on the assumption that the business activities are continued. Additional assumptions, uncertainties, opportunities and risks of corporate planning 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, as well as the continued survival of HSH Nordbank AG is based, in particular, on the share purchase agreement concluded on 28 February 2018, in which HSH Beteiligungs Management GmbH sold 94.9% of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C.Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K.AG (hereinafter referred to as the "bidders"), being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) grants the necessary approvals,
- the European Commission grants its approval for the acquisition following a viability assesment of the new corporate structure,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank 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, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank AG'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.

It is further required that acceptance by market participants and other relevant stakeholders necessary for the successful implementation of HSH Nordbank AG's future business model 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.

Proceeds from the closing of the underlying transactions which contributed to reconciliation items are reported as part of the Net interest income.

Receivables are derecognised when all material risks and opportunities associated with a receivable have been transferred, i.e. when contractual claims on cash flows from this asset have been extinguished. Receivables are also derecognised if the contractual rights to cash flows have expired.

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.

HSH Nordbank AG sold largely non-performing portfolios consisting mainly of ship financing in an amount of € 6.3 billion (EaD) to a special-purpose entity (SPE) from the sphere of the investors (the portfolio transaction) on 28 February 2018, giving rise to one-off negative valuation effects as at 31 December 2017.

When calculating the loan loss provisions for the affected loans, the purchase price for the entire portfolio was allocated, among other things, based on a valuation report on the individual loans and assets sold, and the purchase price share that was attributed in each case was discounted to the balance sheet date as an expected cash flow on the expected closing date based on the original effective interest rate. A closing date of 30 September 2018 was assumed.

The composition of the loan portfolio sold can also still change for various reasons (among other things, due to certain exclusion rights of the contracting parties). As a result, the required loan loss provisions can also change.

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 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, collateralised debt obligation model) if a valuation cannot be derived either of adequate quality or at all. Trading assets and liabilities are measured using mid-market rates.

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

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

For the balance sheet treatment and the presentation of hedging relationships, please refer to our remarks under Note 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 15 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, € 14 million (previous year: € 9 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 2017, accounting for internal derivatives resulted in interest income in the amount of € 1,122 million (previous year: € 1,490 million), interest expense in the amount of € 986 million (previous year: € 1,253 million), Other operating income of € 19 million (previous year: € 16 million) and Other operating expense of € 9 million (previous year: € 7 million). Reverse effects are reported in the Net income from the Trading portfolio.

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

To the extent a margin system is used in the case of financial instruments, the initial margin payments are recognised as assets or liabilities. Variation margin payments in the Trading portfolio are recognised for income purposes directly in Trading portfolio net income or loss. Variation margins outside of the Trading portfolio are recognised as assets or liabilities. We disclose both initial margins and variation margins arising from OTC derivatives under Other assets (cf. Note 34) 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 components 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 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 is 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)	31.12.2017		31.12.2016	
	Micro valuation units	**Portfolio valuation units**	Micro valuation units	Portfolio valuation units
Assets				
Loans and advances to customers	861,330	–	861,469	–
Debentures and other fixed-interest securities	438,574	9,076,705	1,054,294	9,775,322
Liabilities				
Liabilities to banks	32,158	–	42,115	–
Liabilities to customers	983,299	–	1,458,950	–
Securitised liabilities	95,995	–	101,689	–
Positive market values of derivatives	40,629	–	68,610	–
Negative market values of derivatives	148,026	–	196,114	–

HEDGING INSTRUMENTS

(€ k)	31.12.2017		31.12.2016	
	Micro valuation units	**Portfolio valuation units**	Micro valuation units	Portfolio valuation units
Positive market values of derivatives	425,412	5,434	542,768	35
Negative market values of derivatives	635,283	357,887	1,125,636	603,877

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)	**31.12.2017**				31.12.2016			
	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	359,549	–	–	–	424,290	–	–	–
Debentures and other fixed-interest securities	176,273	–	200,986	–	532,789	363	415,773	–
Liabilities								
Liabilities to banks	–	2,674	–	–	–	3,137	–	–
Liabilities to customers	1,182	156,367	–	–	1,065	200,793	–	–
Securitised liabilities	–	3,797	–	–	–	5,415	–	–
Derivatives	24,796	29,916	–	–	43,693	50,137	–	–

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 2017.

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 impairments 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 € 1 million (previous year: € 2 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 31.97 %. Deferred taxes are not discounted in accordance with the regulations. Deferred tax assets and deferred tax liabilities are stated in the balance sheet on a gross basis (asset item 14 and liability item 6a).

At each reporting date 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.

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:

	2017	2016
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 10 years in accordance with Section 253 (2) sentence 1 HGB. In this respect, the Bank makes use of the simplification rule pursuant to Section 253 (2) sentence 2 HGB. The discount rate applied as at the balance sheet date was 3.67% p.a. (previous year: 4.01% p. a.). Up to 1 January 2016, the average market interest rate of the previous seven years was applied. The difference, which according to Section 253 (6) HGB is non-distributable, amounts to € 105 million as of 31 December 2017 (previous year: € 86 million) (cf. Note 62).

Assets, whose sole purpose is the fulfilment of pension obligations and to which no other creditors have access (fund assets) are recognised at their fair value of € 7 million (previous year: € 7 million), which is also equivalent to the amortised cost of the assets. 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 2017 (previous year: € 10 million).

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 established restructuring programmes in 2014 and 2016 in order to bring about a further reduction in the costs of banking operations.

The resultant income and expense is disclosed under the Extraordinary income and expenses and are 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)	31.12.2017	31.12.2016
Loans and advances to associated savings banks	32,144	35,379

25. AFFILIATED COMPANIES

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

(€ k)	31.12.2017	31.12.2016
Loans and advances to banks	488,447	634,397
Loans and advances to customers	423,396	781,506
Debentures and other fixed-interest securities		
Bonds and debentures	270,184	739,508

26. NON-AFFILIATED COMPANIES

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

(€ k)	31.12.2017	31.12.2016
Loans and advances to banks	5,058	55
Loans and advances to customers	74,003	287,376

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)	**31.12.2017**	31.12.2016
Loans and advances to banks		
Other receivables	102,838	112,438
Loans and advances to customers	54,017	153,520
Debentures and other fixed-interest securities		
Bonds and debentures	12,074	22,750
Shares and other non-fixed interest securities	102	–

28. RESIDUAL MATURITIES

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

(€ k)	**31.12.2017**	31.12.2016
Loans and advances to banks		
Other receivables		
Up to 3 months	1,006,635	391,233
Between 3 months and 1 year	810,322	790,714
Between 1 year and 5 years	177,010	197,394
More than 5 years	412,859	465,693
Loans and advances to customers		
Up to 3 months	6,654,878	12,162,199
Between 3 months and 1 year	5,472,302	7,399,492
Between 1 year and 5 years	17,518,200	21,367,782
More than 5 years	10,703,464	12,008,010
Debentures and other fixed-interest securities		
Due in the following year	3,148,438	1,482,730

29. NEGOTIABLE SECURITIES

(€ k)	Listed		Unlisted		Total	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Debentures and other fixed-interest securities	13,898,696	14,777,468	1,084,946	1,872,693	14,983,642	16,650,161
Shares and other non-fixed-interest securities	5,164	6,180	10,047	39,400	15,211	45,580
Equity holdings in non-affiliated companies	1,128	42,593	4,580	3,576	5,708	46,169
Interests in affiliated companies	–	–	46,890	25,400	46,890	25,400

30. NEGOTIABLE SECURITIES NOT VALUED USING THE LOWER-OF-COST-OR-MARKET PRINCIPLE

(€ k)	**31.12.2017**	31.12.2016
Debentures and other fixed-interest securities		
Carrying amount of securities valued using the moderate lower-of-cost-or-market principle	1,334,450	3,400,882
Carrying amount of securities reported above their fair value	161,980	1,528,544
Market value of securities reported above their fair value	159,777	1,451,446
Unrealised losses	2,203	77,098
of which unrealised losses on securities which are not part of a valuation unit	2,126	75,835
Shares and other non-fixed-interest securities		
Carrying amount of negotiable securities valued using the moderate lower-of-cost-or-market principle	855	27,966
Carrying amount of non-negotiable securities valued using the moderate lower-of-cost-or-market principle	–	125,207
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 € 15 million as at 31 December 2017 (previous year: € 124 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	31.12.2017	31.12.2016
No trigger events have occurred		**1,343**	**27,052**
	Rating investment grade or better	226	17,440
	Rating lower than investment grade	1,117	9,612
Trigger events have occurred		**860**	**50,047**
	Rating investment grade or better	–	37,987
	Rating lower than investment grade	860	12,060
Total		**2,203**	**77,099**

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

31. TRADING PORTFOLIO (ASSETS)

The trading portfolio is comprised of the following:

(€ k)	31.12.2017	31.12.2016
Derivative financial instruments	1,536,676	2,113,982
Loans and advances	–	10,212
Debentures and other fixed-interest securities	1,151,304	1,097,928
Shares and other non-fixed-interest securities	357	194
Other assets	12,623	13,601
Risk discount	– 4,517	– 8,316
Total	**2,696,443**	**3,227,601**

32. TRUST ASSETS

Trust assets are comprised of the following balance sheet items:

(€ k)	31.12.2017	31.12.2016
Loans and advances to customers	3,934	5,147
Total	**3,934**	**5,147**

33. STATEMENT OF CHANGES IN FIXED ASSETS

DEVELOPMENT IN FIXED ASSETS

(€ k)	1.1.2017	2017				31.12.2017		31.12.2017	31.12.2016
	Historical cost of acquisition	Additions	Disposals	Trans-fers	Exchange rate differences	Historical cost of acquisition	Accumulated depreciation	Carrying amount	Carrying amount
Securities	3,585,349	109,032	2,170,853	–	– 89,282	1,434,246	63,565	1,370,681	3,527,044
Equity holdings in non-affiliated companies	225,867	213	113,371	–	–	112,709	102,702	10,007	89,448
Interests in affiliated companies	1,384,781	–	32,360	–	– 74,088	1,278,333	656,916	621,417	694,925
Land and buildings	83,232	–	149	–	–	83,083	9,695	73,388	75,124
Plant and equipment	58,881	1,143	1,165	180	–	59,039	47,679	11,360	12,774
Assets under construction	479	1,128	–	– 180	–	1,427	–	1,427	479
Leasing assets	–	–	–	–	–	–	–	–	–
Intangible fixed assets	172,375	2,007	873	–	–	173,509	165,420	8,089	10,122
Total	**5,510,964**	**113,523**	**2,318,771**	**–**	**– 163,370**	**3,142,346**	**1,045,977**	**2,096,369**	**4,409,916**

DEVELOPMENT IN DEPRECIATION/AMORTISATION

(€ k)	1.1.2017	2017						31.12.2017
	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	58,305	59,672	–	–	54,412	–	–	63,565
Equity holdings in non-affiliated companies	136,419	1,253	449	–	34,521	–	–	102,702
Interests in affiliated companies	689,856	–	32,890	–	50	–	–	656,916
Land and buildings	8,108	1,616	–	–	29	–	–	9,695
Plant and equipment	46,107	2,615	–	–	1,043	–	–	47,679
Assets under construction	–	–	–	–	–	–	–	–
Leasing assets	–	–	–	–	–	–	–	–
Intangible fixed assets	162,253	4,003	–	–	836	–	–	165,420
Total	**1,101,048**	**69,159**	**33,339**	**–**	**90,891**	**–**	**–**	**1,045,977**

Real estate includes land and buildings used for the Bank's own business activities at a carrying amount of € 73 million (previous year: € 75 million).

34. OTHER ASSETS

The major components of other assets are:

(€ k)	31.12.2017	31.12.2016
Initial and variation margins from OTC derivatives (cf. Note 12)	1,399,614	2,236,015
Tenant loans	36,863	33,019
Receivables on fiscal authorities	20,120	34,541
Receivables from profit and loss transfer agreements and from dividends	16,919	15,056
Swap deferrals under forward exchange transactions	10,471	154
Adjustment item for currency translation	9,399	14,545
Premiums paid from options trading and from interest limitation agreements	6,837	17,291

35. PREPAID EXPENSES

The major items disclosed here are:

(€ k)	31.12.2017	31.12.2016
Discount accruals from issuing business	36,816	61,735
Premium accruals from claims	8,538	21,571
Prepaid expenses from derivatives	11,855	26,338
Discount accruals from liabilities	3,149	4,170

36. DEFERRED TAX ASSETS

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

(€ k)	31.12.2017	31.12.2016
Assets		
Loans and advances to customers	356,114	305,681
Debentures and other fixed-interest securities	18,710	18,759
Equity holdings in non-affiliated companies	4,683	6,658
Interests in affiliated companies	1,860	287
Intangible fixed assets	36	53
Tangible fixed assets	6,406	9,643
Other assets	1,379	2,149
Prepaid expenses	661	1,110
Liabilities		
Other liabilities	126	48
Prepaid expenses	829	6,423
Provisions	93,536	163,303
Losses carried forward	46,996	95,005
Total	**531,336**	**609,119**

The deferred tax assets fell by € 78 million in the financial year.

Deferred tax assets on losses carried forward in the amount of approximately € 17 million are attributable to losses carried forward for the Singapore branch. Deferred taxes of € 30 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 € 330 million (previous year: € 64 million).

37. GENUINE REPURCHASE AGREEMENTS

As a borrower under genuine repurchase agreements, we have sold assets with a carrying amount of € 1,807 million (previous year: € 2,140 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.

38. ASSETS TRANSFERRED AS COLLATERAL

In addition to assets sold under repurchase agreements (cf. Note 37) 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)	**31.12.2017**	31.12.2016
Assets transferred as collateral	7,432,399	7,806,566
thereof for		
Liabilities to banks	5,944,126	5,245,517
Liabilities to customers	88,659	325,034
Trading portfolio (liabilities)	1,399,614	2,236,015

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)	**31.12.2017**	31.12.2016
Liabilities to associated savings banks	122,791	153,272

40. AFFILIATED COMPANIES

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

(€ k)	**31.12.2017**	31.12.2016
Liabilities to banks	686,471	816,280
Liabilities to customers	884,106	1,615,100

41. NON-AFFILIATED COMPANIES

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

(€ k)	**31.12.2017**	31.12.2016
Liabilities to banks	19	6
Liabilities to customers	68,952	180,920

42. RESIDUAL MATURITIES

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

(€ k)	**31.12.2017**	31.12.2016
Liabilities to banks		
With an agreed maturity or notice period		
Up to 3 months	2,911,775	2,045,917
Between 3 months and 1 year	1,302,512	1,492,367
Between 1 year and 5 years	2,392,046	3,457,564
More than 5 years	1,796,281	1,828,602
Liabilities to customers		
Other liabilities with an agreed maturity or notice period		
Up to 3 months	10,901,013	10,444,673
Between 3 months and 1 year	4,483,022	6,480,864
Between 1 year and 5 years	6,248,114	6,195,329
More than 5 years	4,177,756	6,099,665
Securitised liabilities		
Debentures issued		
Due in the following year	4,525,739	3,553,244
Other securitised liabilities		
Up to 3 months	2	57,742
Between 3 months and 1 year	3,000	11,336

43. TRADING PORTFOLIO (LIABILITIES)

The trading portfolio is comprised of the following:

(€ k)	**31.12.2017**	31.12.2016
Derivative financial instruments	1,412,670	1,738,483
Liabilities	1,401	32,256
Total	**1,414,071**	**1,770,739**

44. TRUST LIABILITIES

Trust liabilities are reported under the following balance sheet items:

(€ k)	**31.12.2017**	31.12.2016
Liabilities to banks	48	48
Liabilities to customers	3,886	5,099
Total	**3,934**	**5,147**

45. OTHER LIABILITIES

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

(€ k)	**31.12.2017**	31.12.2016
Security deposits for assumption of debt	519,528	656,841
Variation margin from OTC derivatives	234,014	165,732
Pro rata interest on subordinated debt, profit participation rights and silent participations	80,453	93,906
Outstanding payments for the second loss guarantee	34,706	46,565
Adjustment item for currency valuation	33,175	108,493
Tax liabilities	6,320	6,839
Liabilities from profit and loss transfer agreements/loss compensation obligations and from dividends	3,426	3,303

46. DEFERRED INCOME

The major components of deferred income are the following:

(€ k)	**31.12.2017**	31.12.2016
Deferrals from advance loan fees	52,665	59,078
Prepaid expenses from derivatives	8,571	39,160
Discount deferrals from receivables	2,442	4,169
Premium deferrals from issuing business	9,444	13,282

47. DEFERRED TAX LIABILITIES

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

(€ k)	31.12.2017	31.12.2016
Assets		
Loans and advances to customers	25,832	43,953
Interests in affiliated companies	93	1,365
Intangible fixed assets	352	607
Tangible fixed assets	10,456	44,979
Liabilities		
Provisions	32,411	83,452
Total	**69,144**	**174,356**

The deferred tax liabilities fell by € 105 million in the financial year.

48. OTHER PROVISIONS

Other provisions primarily relate to the following items:

(€ k)	31.12.2017	31.12.2016
Litigation risks and costs	111,787	31,416
Lending business	66,961	110,861
Securities transactions and financial derivatives	49,662	69,644
Restructuring measures	43,190	79,356
Outstanding invoices	36,286	38,903
Personnel expenses	28,990	43,617
Interest on corporate tax and trade tax	23,730	27,659
Expected back payment from tax audit	13,615	13,615
Expenses related to privatisation	8,721	–
Archiving costs	4,338	5,500
Assumption of costs of associated companies and discretionary benefits in the customer business	1,800	12,262
Processing fees for commercial loans	1,600	–
Reimbursement of loan processing fees	–	1,550

€ 23 million (previous year: € 49 million) of the provisions for restructuring measures relate to personnel expenses and € 20 million (previous year: € 30 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 and USD. The original maturities range from under ten years to 40 years and the interest rates payable are between 0% p.a. and 6.51% p.a.

Individual items exceeding 10% of total subordinated debt:

(€ m)	Currency	Interest rate	Maturity	Termination rights
119	USD	2.05%	21.03.2031	none

In principle subordinated debt meets the requirements of Article 63 of the Capital Requirements Regulation (CRR) for recognition as Tier 2 capital. Subordinated debt in the amount of € 0 million (previous year: € 1,020 million) will mature in less than two years.

For the 2017 financial year, interest expense on subordinated debt amounted to € 17 million (previous year: € 26 million).

50. PROFIT PARTICIPATION CAPITAL

There was no profit participation capital at the end of 2017 as it had fallen due. The terms and conditions of the profit participation capital also fulfilled 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. In the previous year, there was profit participation capital in the amount of € 14 million maturing in less than two years.

51. FUND FOR GENERAL BANKING RISKS

Amounts from net income from the trading portfolio totalling € 14 million (previous year: € 9 million) and no other amounts were allocated in the reporting period to the fund for general banking risks in accordance with Section 340g HGB (previous year: € 258 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. HSH Finanzfonds AöR – Gemeinsame Anstalt der Freien und Hansestadt Hamburg und des Landes Schleswig-Holstein – holds an interest of 68.03%, the Free and Hanseatic City of Hamburg, incl. the interest held indirectly via HGV Hamburger Gesellschaft für Vermögens- und Beteiligungs Management mbH holds an interest of 11.30%, the Federal State of Schleswig-Holstein holds an interest of 10.02% and Sparkassen- und Giroverband für Schleswig-Holstein holds an interest of 5.55% in HSH Nordbank AG, with all of these interests being held indirectly via HSH Beteiligungs Management GmbH. As at 31 December 2017, the nine groups of investors advised by J.C. Flowers & Co LLC held 5.10% of the voting rights. The ownership structure has not changed compared to the previous year.

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 holds 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. Silent participations shared in the Bank's losses in the 2017 fiscal year in the amount of € 285 million (previous year: € 0 million). Silent participations are placed in the international capital markets (€ 661 million) and with institutional investors (€ 248 million).

NOTES ON THE INCOME STATEMENT

53. BREAKDOWN OF INCOME ITEMS BY GEOGRAPHICAL MARKETS

(€ k)	2017			2016		
	Germany	**Rest of Europe**	**Asia**	Germany	Rest of Europe	Asia
Interest income	2,990,991	84,769	36,114	3,432,236	113,053	48,054
Current income from shares and other non-fixed-interest securities, equity holdings in non-affiliated companies and interests in affiliated companies	43,629	13,855	–	53,000	5,736	–
Income from profit pooling, profit and loss transfer or partial profit and loss transfer agreements	–	–	–	6,452	–	–
Commission income	106,511	4,294	530	111,701	4,020	900
Net income from the trading portfolio	122,898	–	2,637	79,883	–	2,654
Other operating income	166,402	11,895	1,034	132,244	25,990	444

54. NET INTEREST INCOME

Net interest income includes non-recurring income from the disposal of receivables in the amount of € 298 million (previous year: € 136 million).

55. NET COMMISSION INCOME

Net commission income is comprised of the following:

(€ k)	**2017**	2016
Lending business	53,943	49,368
Payment transactions and foreign business, documentary business	18,778	19,707
Securities business	1,263	1,356
Guarantee business	– 170,753	– 216,586
Other	8,741	4,563
Total	**– 88,028**	**– 141,592**

Net commission income for the year ended 31 December 2017 includes expenses for the guarantee from HSH Finanzfonds AöR in the amount of € 154 million (previous year: € 227 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 previous year.

The premium expense of € 25.9 million resulting from the synthetic securitisation transaction (cf. Note 3 II) is also shown under Net commission income.

56. OTHER OPERATING INCOME

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

(€ k)	2017	2016
Income from the reversal of other provisions	44,456	21,934
Cost allocations and reimbursement of expenses	40,882	36,570
Income from option premiums received as well as compensation payments received for options held in the non-trading portfolio	36,333	19,381
Income from the reversal of provisions for contingent losses from valuation units (cf. Note 14)	19,420	7,686
Income from legal disputes	4,558	35,021
Income from the reversal of provisions for processing fees in the lending business	1,550	2,235
Interest income from claims against tax authorities	608	1,268
Income on exchange from transactions not specifically hedged	–	10,680
Net income from the change in the interest rate for pension provisions	–	7,501

The Other operating income in the previous year included income from a change in the interest rate for pension provisions. This comprises a change in the interest rate to a ten-year mean interest rate (income: € 86 million) and a change in the seven-year mean interest rate from 2015 to 2016 (expense: € 78 million).

57. OTHER OPERATING EXPENSES

Other operating expenses primarily include the following items:

(€ k)	2017	2016
Expenses for the compounding of provisions outside the lending business	66,297	33,465
Expenses relating to option premiums paid as well as compensation payments for options held in the investment portfolio	65,907	64,833
Expenses from the creation of provisions for litigation risks	61,475	3,562
Expenses from additions to other provisions	26,431	11,826
Loss on the sale of receivables	25,023	–
Interest expenses pursuant to Section 233 AO	7,215	4,120
Expenses from additions to provisions for contingent losses for valuation units (cf. Note 14)	2,846	– 7,438

The expenses for the compounding of provisions also include the expense resulting from the change in the ten-year mean interest rate in the amount of € 36 million.

58. EXTRAORDINARY RESULT

The Extraordinary result includes restructuring expenses connected to the strategic realignment of the Bank in the amount of € 77 million (previous year: € 112 million). € 52 million (previous year: € 3 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)	2017	2016
Deferred income taxes	–27,428	64,527
on temporary differences	–75,437	68,166
on loss carryforwards	48,009	– 3,639
Current income taxes	29,340	36,251
Total	**1,912**	**100,778**

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 as well as the reduction in deferred tax assets in New York.

The current income tax expense of € 29 million comprises tax expense attributable to the current financial year in the amount of € 42 million, and tax income attributable to previous years in the amount of € 13 million.

60. INCOME FROM LOSS-SHARING

The income from loss-sharing results from the loss participation of the silent participation in the amount of € 285 million (previous year: € 0 million).

61. FEES FOR WORK BY THE STATUTORY AUDITORS

Auditor's activities

KPMG AG Wirtschaftsprüfungsgesellschaft audited the annual financial statements and Group financial statements of HSH Nordbank as at 31 December 2017 and conducted various audits of annual financial statements at subsidiaries. In addition, reviews of the half-year financial report as at 30 June 2017 and certain services in accordance with the requirements of the guarantee scheme of the Landesbanken and Girozentralen were performed as part of the audit. Quality assurance controls were also performed, in particular with regard to accounting-specific issues, including the quality assurance of selected technical concepts for the implementation of IFRS 9 and of certain regulatory issues, directly as a result of the audit of the annual financial statements and Group financial statements as at 31 December 2017 or within the context of this audit. Furthermore, audits were conducted in accordance with Section 36 of the German Securities Trading Act (WpHG) and services were provided in connection with enforcement proceedings.

In addition, two comfort letters were issued, investigations were performed in connection with the requirements of the guarantee scheme of the Landesbanken and Girozentralen and the charging of the European banking levy, and other contractually agreed services (including audits of certain parts of the internal control system pursuant to IDW PS 951 (new version) were performed. Other activities related to various project-related quality assurance measures in connection with the implementation of regulatory and banking industry requirements, and in connection with the privatisation process, technical assistance with a project to implement future banking supervisory requirements and the preparation of expert opinion. Support services were also provided in connection with the preparation of tax returns.

Auditors' fees within the meaning of IDW AcPS HFA 36 (new version)

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 € 568 million (previous year: € 522 million) of the reserves available for distribution are barred from being distributed. Of this amount, € 1 million (previous year: € 1 million) relate to the recognition of internally generated Intangible fixed assets less the Deferred tax liabilities created in relation thereto. € 462 million (previous year: € 435 million) represent the amount by which the Deferred tax assets recognised on the balance sheet exceed the other Deferred tax liabilities. € 105 million (previous year: € 86 million) are attributable to the difference pursuant to Section 253 (6) HGB in connection with the interest rate generally used for the discounting of provisions.

OTHER DISCLOSURES

63. LEASING BUSINESS

Assets related to the leasing business include € 76 million (previous year: € 98 million) shown under Loans and advances to customers. Liabilities from the leasing business amount to € 18 million (previous year: € 30 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 € 5,134 million (previous year: € 4,674 million) and to foreign clients in the amount of € 1,590 million (previous year: € 2,063 million).

As was the case in the previous year, there were no placement or underwriting commitments as at 31 December 2017.

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.

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 (€ 6 million, previous year: € 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 € 42 million (previous year: € 47 million) result from long-term leases for land and buildings used for business purposes. Additional obligations amounting to € 105 million (previous year: € 89 million) result from leasing agreements for IT services.

Long-term rental agreements for office space result in annual obligations of approximately € 1 million (previous year: € 5 million).

Under a sale of an equity holding the Bank has undertaken to purchase fund units at the market price up to a nominal amount of € 8 million (previous year: € 8 million).

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. As in the previous year, 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 (previous year: € 2 million).

There is a payment obligation amounting to a maximum of € 7 million vis-à-vis two affiliated companies under cost assumption agreements.

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). As at 31 December 2017, the guarantee is fully utilised for risks.

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	201,004,327.84	2,381,598.00

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	261,810.02	– 7,931.13
3	Bu Wi Beteiligungsholding GmbH, Hamburg	100.00	100.00	EUR	18,980.04	1,092.08
4	CAPCELLENCE Dritte Fondsbeteiligung GmbH, Hamburg[1]	100.00	100.00	EUR	6,447,604.90	1,078,745.96
5	CAPCELLENCE Erste Fondsbeteiligung GmbH, Hamburg[1]	100.00	100.00	EUR	875,245.13	173,515.05
6	CAPCELLENCE Holding GmbH & Co. KG, Hamburg[1]	100.00	100.00	EUR	111,969,111.75	5,328,794.48
7	Capcellence Vintage Year 06/07 Beteiligungen GmbH & Co. KG, Hamburg[1]	83.33	99.91	EUR	119,931.09	1,750.16
8	Capcellence Vintage Year 07/08 Beteiligungen GmbH & Co. KG, Hamburg[1]	90.91	99.99	EUR	906,332.53	918,304.58
9	CAPCELLENCE Vintage Year 11 Beteiligungen GmbH & Co. KG, Hamburg[1]	83.33	99.99	EUR	4,864,568.60	117,781.76
10	CAPCELLENCE Vintage Year 13 Beteiligungen GmbH & Co. KG, Hamburg[1]	90.91	99.47	EUR	1,050,920.78	108,152.65
11	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH & Co. KG, Hamburg[1]	83.33	99.99	EUR	15,276,780.00	– 347,031.65
12	CAPCELLENCE Vintage Year 16 Beteiligungen GmbH, Hamburg[1]	100.00	100.00	EUR	257,608.93	– 4,148.18
13	CAPCELLENCE Zweite Fondsbeteiligung GmbH, Hamburg[1]	100.00	100.00	EUR	4,969,406.32	1,715,603.48
14	GmbH Altstadt Grundstücksgesellschaft, Mainz[1] [14]	50.00	50.00	EUR	– 519,005.46	– 453,805.30
15	GODAN GmbH, Hamburg	100.00	100.00	EUR	– 1,193,578.03	– 68,738.53
16	HGA New Office Campus-Kronberg GmbH & Co. KG, Hamburg	56.44	56.44	EUR	11,122,855.95	793,635.61
17	HSH Auffang- und Holdinggesellschaft mbH & Co. KG, Hamburg	100.00	100.00	EUR	1,958,365.58	– 39,597,753.52
18	HSH Care+Clean GmbH, Hamburg[1] [3]	51.00	51.00	EUR	25,000.00	– 4,512.33
19	HSH Facility Management GmbH, Hamburg[2]	100.00	100.00	EUR	205,600.00	6,451,827.30
20	HSH Gastro+Event GmbH, Hamburg[1] [3]	100.00	100.00	EUR	25,000.00	791,895.28
21	HSH Move+More GmbH, Kiel[1] [3]	51.00	51.00	EUR	25,000.00	323,453.36
22	HSH Private Equity GmbH, Hamburg[2]	100.00	100.00	EUR	550,000.00	– 1,817,346.83
23	Ilex Integra GmbH, Hamburg[1]	100.00	100.00	EUR	– 23,241,426.21	– 2,265,426.20
24	Lyceum Capital Fund 2000 (Number Five) GmbH & Co. KG, Stuttgart[1]	80.00	0.00	EUR	– 240,902.29	–
25	PERIMEDES GmbH, Hamburg	100.00	100.00	EUR	28,483.61	2,230.08

AFFILIATED COMPANIES – OTHER FOREIGN COMPANIES

Serial no.	Name/place	Share	Voting rights	Currency code	Equity capital in respective currency	Income/loss in respective currency
26	2200 Victory LLC, Dover (Kent County), USA	100.00	100.00	USD	50,208,605.00	– 521,121.00
27	Asian Capital Investment Opportunities Limited, Hong Kong, Hong Kong[1)]	51.00	51.00	USD	115.00	–
28	Avia Management S.à r.l., Luxembourg, Luxembourg	100.00	100.00	EUR	– 16,591.15	10,241.88
29	Aviation Leasing OpCo France III, Paris, France[1)]	100.00	100.00	EUR	– 338,764.00	– 198,445.00
30	Aviation Leasing OpCo France IV, Paris, France[1)]	100.00	100.00	EUR	– 61,818.00	– 22,672.00
31	European Capital Investment Opportunities Limited, St. Helier, Jersey[1)]	51.00	51.00	EUR	328.00	218.00
32	FSL Asset Management Pte. Ltd., Singapore, Singapore[1)]	100.00	100.00	USD	792,573.00	982,222.00
33	FSL Holdings Pte. Ltd., Singapore, Singapore[1)]	100.00	100.00	USD	– 13,119,359.00	– 10,454,757.00
34	FSL Trust Management Pte. Ltd., Singapore, Singapore[1)]	100.00	100.00	USD	994,737.00	290,623.00
35	HSH N Finance (Guernsey) Limited, St. Peter Port, Guernsey	100.00	100.00	EUR	486,467.00	52,396.00
36	HSH N Funding II, George Town, Cayman Islands	56.33	100.00	USD	654,305,988.00	36,276,800.00
37	HSH N Residual Value Ltd., Hamilton, Bermuda	100.00	100.00	USD	3,915,732.00	339,668.00
38	HSH N Structured Situations Limited, St. Helier, Jersey[6)]	100.00	100.00	USD	351,241.00	10,805.00
39	ISM Agency, LLC, New York, USA[1)]	100.00	100.00	USD	[5)]	[5)]
40	Neptune Finance Partner II S.à.r.l., Luxembourg, Luxembourg[11)]	100.00	100.00	USD	62,763.63	–
41	Neptune Finance Partner S.à.r.l., Luxembourg, Luxembourg	100.00	100.00	USD	73,894.70	–
42	Next Generation Aircraft Finance 2 S.à.r.l., Findel, Luxembourg[1) 14)]	49.00	49.00	EUR	– 9,434,111.00	– 239,838.00
43	Next Generation Aircraft Finance 3 S.à.r.l., Findel, Luxembourg[1) 14)]	49.00	49.00	EUR	– 10,672,196.00	– 241.00
44	NORDIC BLUE CONTAINER V LIMITED, Majuro, Marshall Islands	100.00	100.00		[5)]	[5)]
45	RESPARCS Funding Limited Partnership I, Hong Kong, Hong Kong[1)]	0.01	100.00	USD	– 8,534,938.00	– 1,294,326.00
46	RESPARCS Funding II Limited Partnership, St. Helier, Jersey[1)]	0.01	100.00	EUR	– 346,251,935.00	217,422.00

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
47	4Wheels Management GmbH, Düsseldorf[1) 10)]	68.75	40.00	EUR	6,203,896.79	320,426.03
48	AGV Irish Equipment Leasing No. 4 Limited, Dublin, Ireland[9) 13)]	100.00	100.00	USD	500.00	– 17,382.00
49	AGV Irish Equipment Leasing No. 7 Limited, Dublin, Ireland[1)]	49.00	49.00	USD	41,796.00	– 35,008.00
50	AKA Ausfuhrkredit-Gesellschaft mbH, Frankfurt am Main	1.33	1.33	EUR	231,752,103.15	22,885,000.00
51	Amentum Aircraft Leasing No. Five Limited, Dublin, Ireland[1)]	49.00	49.00	USD	4,910,713.00	22,008,813.00
52	Amentum Aircraft Leasing No. Seven Limited, Dublin, Ireland[1)]	49.00	49.00	USD	377,198.00	– 3,484,891.00
53	Amentum Aircraft Leasing No. Six Limited, Dublin, Ireland[1)]	49.00	49.00	USD	16,538.00	10,158,437.00
54	Amentum Aircraft Leasing No. Ten Limited, Dublin, Ireland[1) 7)]	49.00	49.00	USD	– 6,521,915.00	– 2,858,784.00
55	Amentum Aircraft Leasing No. Three Limited, Dublin, Ireland[1) 9)]	49.00	49.00	USD	– 15,046,554.00	– 1,175,030.00
56	Aprel Shipping (MI) Inc., Majuro, Marshall Islands	15.00	15.00	USD	8,364,000.00	4,291,000.00
57	Arzel Shipping (MI) Inc., Majuro, Marshall Islands	15.00	15.00	USD	3,523,000.00	3,972,000.00
58	BRINKHOF Holding Deutschland GmbH, Erfurt[1)]	100.00	0.00	EUR	[12)]	[12)]
59	CapVis Equity III L.P., St. Helier, Jersey[1)]	2.50	0.00	EUR	330,702,444.00	121,046,857.00
60	CVC European Equity Partners V (A) L.P., St. Helier, Jersey[1)]	0.45	0.00	EUR	2,957,430,366.00	72,152,377.00
61	Deutsche WertpapierService Bank AG, Frankfurt am Main	2.51	2.51	EUR	180,187,783.45	8,724,744.89
62	EDD AG (formerly Börse Düsseldorf AG), Düsseldorf	0.89	0.89	EUR	32,244,559.01	– 542,351.26
63	EURO Kartensysteme GmbH, Frankfurt am Main	2.82	2.82	EUR	11,635,404.22	172,979.08
64	First Ship Lease Trust, Singapore, Singapore[1)]	24.82	24.82	USD	247,454,000.00	– 30,995,000.00
65	FSP CAPCELLENCE Beteiligungs GmbH, Hamburg[1)]	100.00	40.00	EUR	15,000,493.84	– 171,506.86
66	GB Deutschland Fund GmbH & Co. KG, Hamburg[1)]	4.69	0.00	EUR	14,036,312.97	277,601.15
67	GLB GmbH & Co. OHG, Frankfurt am Main	15.77	15.77	EUR	6,235,539.93	494,038.34
68	GLB-Verwaltungs-GmbH, Frankfurt am Main	15.80	15.80	EUR	51,742.97	1,990.81
69	Global Format GmbH & Co. KG, Munich	28.57	28.57	EUR	1,991,526.98	170,098.26
70	Hamburgische Grundbesitz und Anlage GmbH & Co. Objekte Hamburg und Potsdam KG, Hamburg	5.15	5.16	EUR	9,842,394.16	1,080,534.31
71	HAMMONIA Schiffsholding AG (formerly HCI Hammonia Shipping AG), Hamburg	6.60	6.60	EUR	2,285,268.02	– 11,231,986.10
72	HGA Objekt Frankfurt GmbH & Co. KG i.L., Hamburg	5.97	5.97	EUR	52,696,461.66	36,624,547.52
73	HGA Objekt München GmbH & Co. KG, Hamburg	5.23	5.23	EUR	18,934,865.30	7,557,306.77
74	HGA Objekt Stuttgart GmbH & Co. KG, Hamburg	7.25	7.26	EUR	10,089,147.27	633,303.33
75	HGA Objekte Hamburg und Hannover GmbH & Co. KG, Hamburg	5.10	5.09	EUR	8,747,109.32	10,914,722.72
76	Hines European Development Fund Limited Partnership, Wilmington, USA[1)]	9.90	9.90	EUR	63,440,000.00	– 2,806,000.00
77	Liquiditäts-Konsortialbank GmbH i.L., Frankfurt am Main[8)]	1.68	1.68	EUR	230,536,114.28	– 5,996,151.33
78	Next Commerce Accelerator Beteiligungsgesellschaft mbH & Co. KG, Hamburg	16.39	16.39	EUR	[4)]	[4)]
79	Next Commerce Accelerator GmbH, Hamburg	16.67	16.67	EUR	[4)]	[4)]
80	RSU Rating Service Unit GmbH & Co KG, Munich	13.60	13.60	EUR	14,946,085.78	1,825,230.73
81	Scan Energy, Frederikshavn, Denmark	7.61	7.61	EUR	[12)]	[12)]
82	Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T. SCRL), La Hulpe, Belgium	0.04	0.04	EUR	415,332.00	26,219.00
83	True Sale International GmbH, Frankfurt am Main	7.69	7.69	EUR	4,808,895.86	179,702.41
84	UNI-ASIA GROUP LIMITED, Singapore, Singapore	2.66	2.66	USD	110,286,000.00	1,196,000.00
85	Vofü-Fonds I Hamburgische Grundbesitz und Anlage GmbH & Co. KG, Hamburg	5.10	5.09	EUR	– 895,289.44	824,696.46

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 02 November 2015 is available.
9) Only data as at 31 December 2015 is available.
10) Only data as at 31 July 2016 is available.
11) Only data as at 09 December 2016 is available.
12) No information available due to insolvency of the company.
13) Based on the contractual arrangement this is not an affiliated company, although HSH Nordbank AG holds 100 % of the voting rights.
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 2017

USA	USD	1.1993

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)	**31.12.2017**	31.12.2016
Assets	14,210,162	25,027,952
Liabilities	6,216,659	14,714,173

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)	**31.12.2017**			31.12.2016		
	Value before netting	**Netting**	**Value after netting**	Value before netting	Netting	Value after netting
Trading portfolio (assets)						
of which: derivative financial instruments	2,568,324	2,563,289	5,035	3,413,400	3,397,673	15,727
Other assets	1,860,670	597,409	1,263,261	3,053,242	966,415	2,086,827
Total assets	**4,428,994**	**3,160,698**	**1,268,296**	**6,466,642**	**4,364,088**	**2,102,554**
Trading portfolio (liabilities)						
of which: derivative financial instruments	2,803,100	2,779,394	23,706	4,127,185	4,111,654	15,531
Other liabilities	612,278	381,304	230,974	411,097	252,434	158,663
Total equity and liabilities	**3,415,378**	**3,160,698**	**254,680**	**4,538,282**	**4,364,088**	**174,194**

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 € 3,786 million as at 31 December 2017 (previous year: € 4,555 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	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Interest rate swaps	141,616	165,402	3,625	4,730	2,625	3,609
FRA	–	–	–	–	–	–
Interest rate options	–	–	–	–	–	–
Swaptions						
Long positions	2,053	2,847	72	150	15	24
Short positions	2,660	3,564	7	2	113	217
Caps, floors	10,941	7,569	28	40	43	27
Exchange-traded contracts	274	383	–	–	–	–
Other forward interest rate transactions	179	217	15	15	31	33
Interest rate risks	**157,723**	**179,982**	**3,747**	**4,937**	**2,827**	**3,910**
Interest rate/currency swaps	10,429	15,152	146	230	83	270
Interest rate and foreign exchange risks	**10,429**	**15,152**	**146**	**230**	**83**	**270**
Forward exchange transactions	1,937	2,158	24	61	26	58
Currency options						
Long positions	235	494	14	28	–	–
Short positions	213	685	–	–	6	19
Foreign exchange risks	**2,385**	**3,337**	**38**	**89**	**32**	**77**
Equity options						
Long positions	97	58	44	51	–	–
Short positions	96	60	–	–	43	51
Forward equity transactions	–	–	–	–	–	–
Exchange-traded contracts	23	6	–	–	–	–
Equity/index-based swaps	–	–	–	–	–	–
Commodity-based transactions	–	–	–	–	–	–
Equity and other price risks	**216**	**124**	**44**	**51**	**43**	**51**
Collateral provider	–	23	–	–	–	–
Collateral taker	54	168	11	26	–	–
Credit derivatives	**54**	**191**	**11**	**26**	**-**	**-**
Structured products	**1,651**	**2,003**	**113**	**156**	**209**	**249**
Total	**172,458**	**200,789**	**4,099**	**5,489**	**3,194**	**4,557**

NON-TRADING PORTFOLIO

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Interest rate swaps	3,167	4,403	148	207	677	829
FRA	–	–	–	–	–	–
Interest rate options	–	–	–	–	–	–
Swaptions						
Long positions	–	–	–	–	–	–
Short positions	–	–	–	–	–	–
Caps, floors	7	143	–	–	–	–
Exchange-traded contracts	–	2,509	–	–	–	–
Other forward interest rate transactions	–	–	–	–	–	–
Interest rate risks	**3,174**	**7,055**	**148**	**207**	**677**	**829**
Interest rate/currency swaps	64	164	–	–	27	125
Interest rate and foreign exchange risks	**64**	**164**	**–**	**–**	**27**	**125**
Forward exchange transactions	5,297	9,309	34	18	28	74
Currency options						
Long positions	–	73	–	29	–	–
Short positions	–	100	–	–	–	40
Foreign exchange risks	**5,297**	**9,482**	**34**	**47**	**28**	**114**
Equity options						
Long positions	16	13	–	1	–	–
Short positions	–	–	–	–	–	–
Equity/index-based swaps	80	84	13	11	–	–
Commodity-based transactions	–	–	–	–	–	–
Equity and other price risks	**96**	**97**	**13**	**12**	**–**	**–**
Collateral provider	13	13	–	–	–	–
Collateral taker	380	–	–	–	–	–
Credit derivatives	**393**	**13**	**–**	**–**	**–**	**–**
Structured products	**647**	**1,569**	**28**	**33**	**126**	**243**
Total	**9,671**	**18,380**	**223**	**299**	**858**	**1,311**

II. Breakdown by counterparty

TRADING AND NON-TRADING PORTFOLIO

(€ m)	Nominal values		Positive market values		Negative market values	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
OECD banks	78,615	115,582	1,720	2,745	2,704	4,109
Non-OECD banks	96	87	2	3	1	–
Non-banks (incl. stock exchanges)	98,415	97,964	2,366	2,760	1,070	1,421
Public authorities	5,003	5,536	234	280	277	338
Total	**182,129**	**219,169**	**4,322**	**5,788**	**4,052**	**5,868**

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	
	2017	2016	**2017**	2016	**2017**	2016	**2017**	2016	**2017**	2016
Residual maturity										
Up to 3 months	15,995	17,070	–	–	6,601	10,689	223	9	39	45
Up to 1 year	27,599	46,385	–	45	1,008	1,937	18	4	57	334
Up to 5 years	79,091	90,205	13	38	73	193	66	198	568	1,220
Over 5 years	48,705	48,693	434	121	–	–	5	10	1,634	1,973
Total	**171,390**	**202,353**	**447**	**204**	**7,682**	**12,819**	**312**	**221**	**2,298**	**3,572**

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 2017, the net amount of reconciliation items shown under Other assets amounted to € 9 million (previous year: € 15 million) and the reconciliation items shown under Other liabilities amounted to € 33 million (previous year: € 108 million).

(€ m)	Option premiums paid		Option premiums received	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016
Interest rate contracts	–	–	–	–
Currency contracts	–	10	–	11
Equity and other contracts	7	7	–	–
Total	**7**	**17**	**–**	**11**

We have created provisions for contingent losses in the amount of € 25 million (previous year: € 28 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 PfandBarwertV[1] are as follows:

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Mortgage bonds	4,380	5,067	4,537	5,308	4,537	5,308
Cover funds	4,798	5,703	5,155	6,117	5,144	6,098
thereof: Derivatives	–	–	–	–	–	–
Surplus coverage	**418**	**636**	**618**	**809**	**607**	**790**

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Public-sector mortgage bonds	3,784	3,802	4,359	4,684	4,176	4,358
Cover funds	4,115	4,222	4,861	5,475	4,513	4,873
thereof: Derivatives	–	–	–	–	–	–
Surplus coverage	**331**	**420**	**502**	**791**	**337**	**515**

(€ m)	Nominal value		Net present value		Risk-adjusted net present value incl. currency stress	
	31.12.2017	31.12.2016	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Ship mortgage bonds	1,163	1,553	1,178	1,581	1,174	1,549
Cover funds	2,176	2,248	2,312	2,393	2,124	2,109
thereof: Derivatives	–	–	–	–	–	–
Surplus coverage	**1,013**	**695**	**1,134**	**812**	**950**	**560**

COMPOSITION OF THE ADDITIONAL COVER ASSETS

(€ m)		Receivables within the meaning of Section 19 (1) No. 2 PfandBG			Mortgage bonds
Registered receivables **2017**	Equalisation claims	Total	thereof covered debentures	Receivables within the meaning of Section 19 (1) No. 3 PfandBG	**Total**
Germany	–	20	–	145	165
Total	**–**	**20**	**–**	**145**	**165**

[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				Mortgage bonds
Registered receivables 2016	Equalisation claims	Total	thereof covered debentures	Receivables within the meaning of Section 19 (1) No. 3 PfandBG	**Total**
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).

(€ m)		Receivables within the meaning of Section 20 (2) No. 2 PfandBG		Public-sector mortgage bonds
Registered receivables **2017**	Equalisation claims	Total	thereof covered debentures	**Total**
Germany	–	2	–	2
Total	**–**	**2**	**–**	**2**

(€ m)		Receivables within the meaning of Section 20 (2) No. 2 PfandBG		Public-sector mortgage bonds
Registered receivables 2016	Equalisation claims	Total	thereof covered debentures	**Total**
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 26 (1) No. 3 PfandBG				Ship mortgage bonds
Registered receivables **2017**	Equalisation claims	Total	thereof covered debentures	Receivables within the meaning of Section 26 (1) No. 4 PfandBG	**Total**
Germany	–	–	–	493	493
Total	**–**	**–**	**–**	**493**	**493**

(€ m)		Receivables within the meaning of Section 26 (1) No. 3 PfandBG			Ship mortgage bonds
Registered receivables 2016	Equalisation claims	Total	thereof covered debentures	Receivables within the meaning of Section 26 (1) No. 4 PfandBG	**Total**
Germany	–	–	–	75	75
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).

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

(€ m)	Mortgage bonds		Cover funds	
Nominal value	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Up to 6 months	9	545	201	508
Between 6 and 12 months	585	142	277	529
Between 12 and 18 months	257	9	204	235
Between 18 months and 2 years	641	585	140	554
Between 2 years and 3 years	716	898	709	495
Between 3 years and 4 years	646	716	749	796
Between 4 years and 5 years	590	646	575	734
Between 5 years and 10 years	936	1,526	1,914	1,795
More than 10 years	–	–	29	57
Total	**4,380**	**5,067**	**4,798**	**5,703**

(€ m)	Public-sector mortgage bonds		Cover funds	
Nominal value	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Up to 6 months	109	216	77	130
Between 6 and 12 months	624	199	188	176
Between 12 and 18 months	294	108	168	38
Between 18 months and 2 years	9	624	285	168
Between 2 years and 3 years	719	322	354	218
Between 3 years and 4 years	602	219	421	195
Between 4 years and 5 years	325	602	304	194
Between 5 years and 10 years	624	800	1,205	905
More than 10 years	478	712	1,113	2,198
Total	**3,784**	**3,802**	**4,115**	**4,222**

(€ m)	Ship mortgage bonds		Cover funds	
Nominal value	**31.12.2017**	31.12.2016	**31.12.2017**	31.12.2016
Up to 6 months	515	247	335	398
Between 6 and 12 months	540	143	171	179
Between 12 and 18 months	20	515	186	294
Between 18 months and 2 years	15	540	161	158
Between 2 years and 3 years	15	35	404	380
Between 3 years and 4 years	30	15	352	393
Between 4 years and 5 years	5	30	237	204
Between 5 years and 10 years	23	28	330	236
More than 10 years	–	–	–	6
Total	**1,163**	**1,553**	**2,176**	**2,248**

The proportion of fixed-interest-bearing cover assets in the corresponding cover funds and the ratios of fixed-interest-bearing bonds to the liabilities to be covered are as follows:

	Mortgage bonds	
(in %)	**31.12.2017**	31.12.2016
Proportion of fixed interest-bearing cover funds	40	36
Ratio of fixed interest-bearing bonds	97	97

	Public-sector mortgage bonds	
(in %)	**31.12.2017**	31.12.2016
Proportion of fixed interest-bearing cover funds	93	88
Ratio of fixed interest-bearing bonds	97	96

	Ship mortgage bonds	
(in %)	**31.12.2017**	31.12.2016
Proportion of fixed interest-bearing cover funds	11	–
Ratio of fixed interest-bearing bonds	52	56

The following tables show the net present value for each foreign currency:

(€ m)	Mortgage bonds	
Foreign currency	**31.12.2017**	31.12.2016
CHF	8	9
GBP	82	86
JPY	–	5
SEK	14	18

(€ m)	Public-sector mortgage bonds	
Foreign currency	**31.12.2017**	31.12.2016
CHF	123	135
JPY	23	161

(€ m)	Ship mortgage bonds	
Foreign currency	**31.12.2017**	31.12.2016
CHF	9	16
USD	1,626	1,873

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	
Nominal value	**31.12.2017**	31.12.2016
Up to € 300,000 €	22	25
Between € 300,000 and € 1 million	100	119
Between € 1 million and € 10 million	1,399	1,541
Over € 10 million	3,112	3,092
Total	**4,633**	**4,777**

(B) PUBLIC-SECTOR MORTGAGE BOND

(€ m)	Covering mortgages	
Nominal value	**31.12.2017**	31.12.2016
Up to € 10 million	155	146
Between € 10 million and € 100 million	1,294	1,038
Over € 100 million	2,664	3,029
Total	**4,113**	**4,213**

(C) SHIP REGISTER

(€ m)	Covering mortgages	
Nominal value	**31.12.2017**	31.12.2016
Up to € 500,000 €	1	5
Between € 500,000 and € 5 million	297	270
Over € 5 million	1,385	1,898
Total	**1,683**	**2,173**

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)	31.12.2017	31.12.2016
Used for residential purposes	852	985
Used for commercial purposes	3,781	3,792

(€ m) **2017**	Apartments	Single and semi-detached dwellings	Multiple dwellings	Office buildings	Retail properties	Industrial premises	Other commercial properties	Unfinished new-buildings	Building plots	**Total**
Germany	–	1	833	1,274	1,157	1	780	190	38	4,274
France	–	–	–	245	–	–	–	–	–	245
Great Britain / Northern Ireland / Channel Islands	–	–	–	81	–	–	–	–	–	81
Netherlands	–	–	–	21	–	–	–	–	–	21
Sweden	–	–	–	–	12	–	–	–	–	12
Total	**–**	**1**	**833**	**1,621**	**1,169**	**1**	**780**	**190**	**38**	**4,633**

(€ m) 2016	Apartments	Single and semi-detached dwellings	Multiple dwellings	Office buildings	Retail properties	Industrial premises	Other commercial properties	Unfinished new-buildings	Building plots	**Total**
Germany	–	3	982	1,246	1,099	2	605	263	35	4,235
France	–	–	–	363	–	–	–	–	–	363
Great Britain / Northern Ireland / 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)	31.12.2017	31.12.2016
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:

		31.12.2017	31.12.2016
Total amount of receivables that exceed the limits set out in Section 13 (1) PfandBG	€ m	–	–
Volume-weighted average age of the receivable	in years	4	5
Average weighted loan-to-value ratio	in %	57	56

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
2017	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed		
Germany	105	13	2,102	39	514	63	191	500	3,527	127
Belgium	250	–	–	10	–	–	–	–	260	–
Great Britain/ Northern Ireland/ Channel Islands	–	–	–	–	–	–	10	–	10	–
Italy	–	–	12	–	–	–	–	–	12	–
Luxembourg	–	–	–	–	–	–	48	–	48	–
Poland	22	–	–	–	–	–	–	–	22	–
Switzerland	–	–	90	–	–	–	–	–	90	–
Austria	–	144	–	–	–	–	–	–	144	–
Total	**377**	**157**	**2,204**	**49**	**514**	**63**	**249**	**500**	**4,113**	**127**

(€ m)	Country		Regional public authority		Local public authority		Other		**Total**	thereof guarantees received for export promotion reasons
2016	owed	guaranteed	owed	guaranteed	owed	guaranteed	owed	guaranteed		
Germany	–	15	2,184	86	311	82	140	516	3,334	137
Belgium	250	–	–	11	–	–	–	–	261	–
Great Britain/ Northern Ireland/ 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**

The following amounts are in arrears concerning these loans and advances:

(€ m) **2017**	Country	Regional public authority	Local public authority	Other	**Total**
Total of payments at least 90 days in arrears	–	–	–	–	–
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	–	–	–	–	–

(€ m) 2016	Country	Regional public authority	Local public authority	Other	**Total**
Total of payments at least 90 days in arrears	–	–	–	–	–
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	–	–	–	–	–

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

(€ m)	**31.12.2017**		31.12.2016	
	Ocean-going vessels	Inland water vessels	Ocean-going vessels	Inland water vessels
Bahamas	49	–	64	–
Germany	418	–	684	–
Greece	101	–	120	–
Hong Kong	55	–	52	–
Liberia	340	–	365	–
Malta	139	–	168	–
Marshall Islands	296	–	439	–
Sweden	21	–	–	–
Norway	–	–	2	–
Panama	112	–	94	–
Singapore	50	–	85	–
Cyprus	102	–	100	–
Total	**1,683**	**–**	**2,173**	**–**

The following amounts are in arrears concerning these loans and advances:

(€ m)	**31.12.2017**	31.12.2016
Marshall Islands	1	–
Liberia	1	–
Total of payments at least 90 days in arrears	**2**	**–**
Germany	2	–
Marshall Islands	1	–
Liberia	1	–
Total amount of these receivables provided that the amount in arrears accounts for at least 5 % of the receivable	**4**	**–**

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

Number **2017**	Commercial	Residential	Ocean-going vessels	Inland water vessels	**Total**
Pending foreclosures and judicially enforced receiverships	–	–	–	–	–
Foreclosures completed	–	–	–	–	–
Land and ships acquired to prevent losses	–	–	–	–	–

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	–	–	–	–	–

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

(€ m) **2017**	Commercial	Residential	Ocean-going vessels	Inland water vessels	**Total**
Total amount of arrears on interest to be paid	–	–	–	–	–

(€ m) 2016	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 € 198 million (previous year: € 377 million), and € 11,859 million of loans and advances to customers (previous year: € 14,388 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) 31.12.2017	Gross carrying amount of financial assets	Accumulated valuation allowance affecting P&L	Carrying amount of financial assets following valuation allowance	Fair value of assets
Portugal	**232**	**6**	**226**	**249**
Public sector	185	–	185	208
Corporates/Other	47	6	41	41
Italy	**580**	**289**	**291**	**297**
Public sector	19	–	19	20
Banks	3	–	3	3
Corporates/Other	558	289	269	274
Greece	**929**	**273**	**656**	**657**
Corporates/Other	929	273	656	657
Russia	**46**	**–**	**46**	**46**
Corporates/Other	46	–	46	46
Spain	**1,010**	**233**	**777**	**779**
Public sector	86	–	86	90
Banks	11	–	11	11
Corporates/Other	913	233	680	678
Cyprus	**418**	**40**	**378**	**381**
Corporates/Other	418	40	378	381
Croatia	**94**	**–**	**94**	**94**
Corporates/Other	94	–	94	94
Turkey	**232**	**80**	**152**	**152**
Banks	59	–	59	58
Corporates/Other	173	80	93	94
Total	**3,541**	**921**	**2,620**	**2,655**

(€ m) 31.12.2016	Gross carrying amount of financial assets	Accumulated valuation allowance affecting P&L	Carrying amount of financial assets following valuation allowance	Fair value of assets
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**

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:

	2017			2016		
	Male	Female	Total	Male	Female	Total
Full-time employees	1,001	381	1,382	1,147	435	1,582
Part-time employees	109	429	538	113	477	590
Total	**1,110**	**810**	**1,920**	**1,260**	**912**	**2,172**
Apprentices/trainees	18	16	34	20	14	34

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 conformity 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 2017 Annual Report. The declaration of conformity does not form part of these notes to the accounts.

76. REMUNERATION PAID TO MEMBERS OF THE MANAGEMENT BOARD AND SUPERVISORY BOARD

The remuneration paid to the Management Board of HSH Nordbank AG is still limited to € 500,000 per year under the guarantee agreement (total fixed remuneration) as long as HSH Nordbank AG is not capable of making dividend distributions. Remuneration payable for secondary employment undertaken by the Management Board 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 a pension contribution in the amount of 20% of the annual fixed income, as well as reasonable benefits in kind.

Any variable remuneration extending beyond this is currently excluded under the terms of the guarantee agreement. The Management Board waived a premium for successful privatisation that was possible under the EU decision of 2 May 2016.

There are no other long-term incentives, such as share option schemes.

It is planned to revise the Management Board remuneration system after removal of the current restrictions, adapt it to match the legal and regulatory requirements and include a variable remuneration component.

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)	2017	2016
Total remuneration of active members of executive bodies		
Management Board	2,548	3,024
Supervisory Board	468	477
Total	**3,016**	**3,501**
Total remuneration of former members of executive bodies and their surviving dependants		
Management Board	2,787	3,708

As at 31 December 2017, a total of €k 44,647 (previous year: €k 42,673) was added to provisions for pension obligations relating to former members of the Management Board and their surviving dependants.

As was the case in the previous year, there were no advances, loans and other liabilities to members of the Management Board as at 31 December 2017. Advances, loans and other liabilities to members of the Supervisory Board amounted to €k 54 (previous year: €k 150). In the 2017 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 2019. Loans to members of the Supervisory Board were at arm 's length conditions with an interest rate of 3%.

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 96 in total in 2017 (previous year: €k 319) .

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 2016 financial year was therefore paid in the 2017 reporting period. Appropriate provisions have been recognised in the 2017 Annual Accounts for the 2017 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:

REMUNERATION SYSTEM

(€) **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 Codetermination 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 564 of the amount provided for in the 2016 financial year (€k 567, thereof value-added tax: €k 91), was paid to the members of the Supervisory Board in the reporting period. This includes €k 87 of value-added tax.

€k 557 have been provided for activities of the Supervisory Board (thereof value-added tax: €k 89) which will be disbursed after the Annual General Meeting provided a corresponding resolution is passed by the Annual General Meeting 2018. Remuneration (excl. VAT) is expected to be distributed among the members of the Supervisory Board as follows:

MEMBERS OF THE SUPERVISORY BOARD

(€)	Fixed remuneration		Attendance fee		Total	
	2017	2016	**2017**	2016	**2017**	2016
Dr Thomas Mirow, Chair	59,000	59,000	6,000	7,250	65,000	66,250
Olaf Behm, Deputy Chair	44,000	44,000	6,500	8,000	50,500	52,000
Stefanie Arp[1)]	15,682	18,000	3,000	2,750	18,682	20,750
Sabine-Almut Auerbach[2)]	–	2,712	–	500	–	3,212
Peter Axmann	18,000	18,000	3,250	3,000	21,250	21,000
Simone Graf	30,000	30,000	5,250	7,250	35,250	37,250
Silke Grimm	16,000	16,000	2,250	2,000	18,250	18,000
Cornelia Hintz[3)]	11,000	6,841	2,500	1,500	13,500	8,341
Stefan Jütte	26,000	26,000	3,500	3,250	29,500	29,250
Dr Rainer Klemmt-Nissen	30,000	30,000	5,750	7,250	35,750	37,250
Rieka Meetz-Schawaller	18,000	18,000	3,500	3,750	21,500	21,750
Bert Michels[4)]	2,049	–	250	–	2,299	–
Dr David Morgan[5)]	18,000	25,000	1,750	5,250	19,750	30,250
Dr Philipp Nimmermann	37,000	30,000	5,500	6,500	42,500	36,500
Stefan Schlatermund	18,000	18,000	3,750	3,500	21,750	21,500
Klaus-Dieter Schwettscher	11,000	11,000	2,500	2,250	13,500	13,250
Elke Weber-Braun	26,000	26,000	3,500	3,500	29,500	29,500
Jörg Wohlers	25,000	25,000	4,500	5,750	29,500	30,750
Total	**404,731**	**403,553**	**63,250**	**73,250**	**467,981**	**476,803**

1) until 14 November 2017.
2) until 31 March 2016.
3) from 18 May 2016.
4) from 15 November 2017.
5) 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 2017. 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 Supervisory Board

(b) Employees

Peter Axmann
Sprinkenhof GmbH, Hamburg
Member of the Supervisory Board

HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

Olaf Behm
HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

Simone Graf
HSH Beteiligungs Management GmbH, Hamburg
Member of the Supervisory Board

Jan Erik Gross
HSH Nordbank Securities S.A., Luxembourg
Member of the Supervisory Board

Jan Lührs-Behnke
HSH Nordbank Securities S.A., Luxembourg
Member of the Supervisory Board

Patrick Miljes
Buss Investment GmbH, Hamburg
Member of the Supervisory Board

Thomas Rabehl
HSH Nordbank Securities S.A., Luxembourg
Member of the Supervisory Board

Katrin Wächter
Technosis AG, Hamburg
Member of the Supervisory Board

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
(until 14 November 2017)
Employee of HSH Nordbank AG

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
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 Beteiligungs Management mbH

Rieka Meetz-Schawaller, Kiel
Employee of HSH Nordbank AG

Bert Michels, Hamburg
(from 15 November 2017)
Employee of HSH Nordbank AG

Dr David Morgan, London
Managing Director of 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 Philipp Nimmermann

Stefan Schlatermund

(b) Members of the Audit Committee

Elke Weber-Braun
Chair

Stefanie Arp
(until 14 November 2017)

Peter Axmann

Olaf Behm

Bert Michels
(from 28 November 2017)

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
Chair

Oliver Gatzke
Born in 1968
Chief Financial Officer

Ulrik Lackschewitz
Born in 1968
Chief Risk Officer

Torsten Temp
Born in 1960
Management Board member responsible for the Market divisions

Hamburg/Kiel, 17 April 2018

Stefan Ermisch Oliver Gatzke

Ulrik Lackschewitz Torsten Temp

INDEPENDENT AUDITOR'S REPORT

To HSH Nordbank AG, Hamburg und Kiel

REPORT ON THE AUDIT OF THE ANNUAL FINANCIAL STATEMENTS AND OF THE MANAGEMENT REPORT

Opinions

We have audited the annual financial statements of HSH Nordbank AG, Hamburg and Kiel, which comprise the balance sheet as at 31 December 2017, the statement of profit and loss for the financial year from 1 January 2017 to 31 December 2017, and notes to the financial statements, including the recognition and measurement policies presented therein. In addition, we have audited the management report at HSH Nordbank AG, Hamburg and Kiel, for the financial year from 1 January 2017 to 31 December 2017. In accordance with the German legal requirements, we have not audited the content of the Management Declaration pursuant to Section 289f (2) nos. 4 and 6 of the German Commercial Code (Handelsgesetzbuch – HGB), which is included in the management report. In our opinion, on the basis of the knowledge obtained in the audit

- the accompanying annual financial statements comply, in all material respects, with the requirements of German commercial law applicable to business corporations and give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2017 and of its financial performance for the financial year from 1 January 2017 to 31 December 2017 in compliance with German Legally Required Accounting Principles, and
- the accompanying management report as a whole provides an appropriate view of the Company's position. In all material respects, this management report is consistent with the annual financial statements, complies with German legal requirements and appropriately presents the opportunities and risks of future development. Our opinion on the management report does not cover the content of the Management Declaration mentioned above.

Pursuant to Section 322 (3) sentence 1 HGB, we declare that our audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report.

Basis for the Opinions

We conducted our audit of the annual financial statements and of the management report in accordance with Section 317 HGB and the EU Audit Regulation No. 537/2014 (referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law and German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the annual financial statements and on the management report.

Material uncertainty in connection with the ability to continue as a going concern

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" and in the notes to the annual financial statements under "Accounting principles", in which the management states that the going concern assumption for accounting and measurement purposes, as well as the continued survival of HSH Nordbank is based, in particular, on the share purchase agreement concluded on 28 February 2018, by means of which HSH Beteiligungs Management GmbH sold 94.9 % of the shares in HSH Nordbank AG to various funds of Cerberus European Investments LLC, J.C.Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K.AG (hereinafter referred to as the "bidders") being closed and implemented. This is subject, in particular, to the proviso that

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,
- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,
- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) grant the necessary approvals,
- the European Commission approves the proposed new corporate structure after performing a viability review,
- the German Savings Banks Association (DSGV) confirms that HSH Nordbank can keep its full membership of the institutional protection scheme of the German Savings Banks Finance Group (SFG) for another three years after the conclusion of the share purchase agreement (closing),
- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and
- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank 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, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

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

As set out in the comments in the management report in the section "Opportunities and risks resulting from the formal decision in the EU state aid proceedings" and in the notes to the annual financial statements under "Accounting principles", this indicates material uncertainty that may cast significant doubt on the Bank's ability to continue as a going concern, as well as a risk that threatens its survival within the meaning of Sec. 322 (2) sentence 3 HGB. Our audit opinions are not modified with regard to this matter.

Other Key Audit Matters in the Audit of the Annual Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from 1 January 2017 to 31 December 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our opinion thereon, we do not provide a separate opinion on these matters.

Appropriateness of the individual valuation allowances set up on loans and advances to customers resulting from ship financing

For information on the accounting and measurement principles used by HSH Nordbank for individual valuation allowances, we refer to section "7. Valuation allowances and provisions in the lending business (loan loss provisions)" in the notes to the annual financial statements. For information on the forecast uncertainties associated with the loan loss provisions, we refer to the sections entitled "Forecast for loan loss provisions" and "Opportunities and risks in the loan loss provision forecast" of the management report.

THE FINANCIAL STATEMENT RISK

HSH Nordbank has activities in the ship financing business. A substantial part of the individual valuation allowances on receivables in the ship financing business relates to receivables from the loan portfolio whose sale has been agreed as part of a portfolio transaction in connection with the privatisation process (see audit matter "Impact of privatisation on accounting"). Another part of the individual valuation allowances on receivables in order to take account of acute default risks relates to individual valuation allowances for ship financing in Bank's portfolio which does not form part of the portfolio transaction and is subject to the comments set out below.

Calculating the necessary individual valuation allowances for ship financing is subject to discretion. The process requires forward-looking estimates of expected contractual cash flows and/or the expected cash flows from the realisation of loan collateral or the sale of loan exposures. The cash flows are estimated taking into account the probable development of essential value assumptions and parameters. These include, in particular, the commitment strategy (continuation or realisation strategy), the future development of charter rates and operating costs of the vessels financed, as well as the anticipated proceeds that can be generated from the realisation of collateral. These estimates are subject to considerable uncertainty.

Incorrect assumptions regarding the amount of the expected cash flows (among other things depending on forecasts on the future development of charter rates, operating costs and ship values) can mean that the receivables are not valued correctly, meaning that the counterparty default risks are not taken into account in an appropriate amount. As a result, it was of particular importance in the context of our audit to ensure that the assumptions regarding the above-mentioned parameters had been properly derived and applied in accordance with applicable accounting principles.

OUR AUDIT APPROACH

Using the risk-based audit approach, we based our audit opinion on both control-based audit procedures, as well as on statement-related audit procedures.

The first step involved gaining an overview of the development of the shipping markets, an insight into the development of the Bank's shipping loan portfolio, the associated counterparty default-related risks, the methods used to calculate individual valuation allowances, as well as the internal control system in respect of the calculation of individual valuation allowances on ship financing. We conducted interviews and consulted the written regulations in order to assess the adequacy of the internal control system with regard to the determination of individual valuation allowances on ship financing.

We then verified the implementation and effectiveness of the relevant controls designed to ensure the appropriate determination of individual valuation allowances in accordance with the accounting regulations. In respect of the IT system used in this regard, we assessed the effectiveness of the system and application control with the involvement of our IT specialists.

Our audit activities with regard to the parameters for the calculation of loan loss provisions also related to the validations performed by HSH Nordbank with regard to its estimates of future charter rates, operating costs and the development of ship values.

On the basis of a conscious selection of single exposures from the ship financing business, which was made based on materiality and risk-related aspects, we reviewed the adequacy of the loan loss provisions set up with regard to these receivables and the value-determining factors on which the recognition of individual valuation allowances was based. In this regard, we verified whether the restructuring and workout strategy on which the valuation was based is consistent with the actual conditions and is plausibly justified. Based on this, we assessed, in particular, the adequacy of the estimate of the contractual cash flows still to be expected and/or the expected cash flows from the realisation of loan collateral or the sale of loan exposures. This includes, in particular, reviewing whether the future development of charter rates and operating costs of the vessels, as well as the anticipated proceeds that can be generated from the realisation of collateral, have been taken into account appropriately.

When reviewing the anticipated proceeds that can be generated from the realisation of collateral, insofar as this was significant for the purposes of the valuation scenario being audited, our opinion was based on valuation reports prepared by independent experts commissioned by the Bank. Finally, we checked whether the required individual valuation allowance had also been calculated correctly.

OUR OBSERVATIONS

The assumptions and parameters used to calculate the amount of the individual valuation allowances in the ship financing business were properly selected and were used in accordance with the accounting principles to be applied to the calculation of individual valuation allowances.

Impact of the implementation of structural measures on accounting

For information on the impact of structural measures on accounting, we refer to the section entitled “Successful winding-down strategy and winding-down by the Bank itself” in the management report. For information on the accounting and measurement principles used, we refer to the comments made in the notes to the annual financial statements in section “6. Receivables”.

THE FINANCIAL STATEMENT RISK

In order to implement the structural measures provided for as part of the 2016 decision of the EU Commission on the replenishment of the second loss guarantee, the legal transfer of the loan portfolio sold to HSH portfoliomanagement AöR in the 2016 financial year (“federal state portfolio transaction”) was largely completed in the reporting year, and further loan portfolio sales were executed on the market (“market portfolio transactions”).

With regard to the completed structural measures, there is a risk for the annual financial statements in particular in the sense that sold assets may not have been accounted for correctly with regard to the requirements for, or the timing of, derecognition.

OUR AUDIT APPROACH

Using the risk-based audit approach, we based our audit opinion on both control-based audit procedures, as well as on statement-related audit procedures.

The first step involved using ongoing surveys and discussions with the management, as well as consulting committee meeting minutes, Management Board minutes and documentation to identify the relevant transactions for the implementation of structural measures.

We also assessed the adequacy of the processes and controls established by the Bank in connection with the accounting of corresponding sale transactions, and reviewed the implementation and effectiveness of relevant controls designed to ensure the correct application of the accounting regulations with regard to corresponding transactions. On the basis of a conscious selection of transactions, which was made based on materiality and risk-related aspects, we reviewed the corresponding contractual agreements with regard to the requirements for, or the timing of, derecognition.

In addition, we verified the correct derecognition of the receivables in the Bank’s accounting system.

OUR OBSERVATIONS

The asset derecognitions resulting from the implementation of structural measures were carried out in accordance with the applicable accounting principles.

Impact of privatisation on accounting

For information on the impact of privatisation on accounting, we refer to the sections entitled “Sale of HSH Nordbank AG on 28 February 2018” and “Additional elementary winding-down of legacy burdens as part of the privatisation process” of the management report. For information on the accounting and measurement principles used, we refer to the notes to the annual financial statements in section “7. Valuation allowances and provisions in the lending business (loan loss provisions).”

THE FINANCIAL STATEMENT RISK

On 28 February 2018, HSH Beteiligungs Management GmbH concluded a share purchase agreement on the sale of its shares in HSH Nordbank to several investors. At the same time, HSH Nordbank concluded a portfolio transaction with a special-purpose entity from the sphere of the investors on 28 February 2018 relating to the sale of a loan portfolio earmarked for winding down and consisting largely of non-performing ship, real estate and corporate financing with an exposure at default (EAD) of € 6.3 billion. The closing and, as a result, the transfer of beneficial ownership with regard to the receivables affected by the portfolio transaction are subject, in particular, to the condition precedent that the share purchase agreement (SPA) is closed.

The change in shareholder and the sale of a loan portfolio earmarked for winding down could have a significant impact on accounting. As far as the annual financial statements are concerned, there is a risk that the loan portfolio sale for the loan portfolio earmarked for winding down has not been taken into account, either at all or sufficiently, within the context of the determination of the individual valuation allowances. In addition, there is a risk for the annual financial statements that the tax-related consequences of the change in shareholder and the tax losses resulting from the sale of the loan portfolio earmarked for winding down have not been taken into account correctly for the purposes of calculating deferred taxes.

OUR AUDIT APPROACH

Using a risk-based audit approach, we based our audit opinion on both control-based audit procedures, as well as on statement-related audit procedures.

The first step involved using ongoing surveys and discussions with the management, as well as consulting committee meeting minutes, Management Board minutes and documentation, as well as consulting the agreement on the sale of the shares in HSH Nordbank and the agreement on the sale of a loan portfolio earmarked for winding down to a special-purpose entity to assess the fundamental impact of privatisation on the accounting as at 31 December 2017. Then, based on our understanding of the process, we assessed the implementation and effectiveness of the Bank's internal controls to take account of the impact of the sale of the loan portfolio within the context of the calculation of individual valuation allowances on receivables.

On the basis of a conscious selection of individual exposures to be sold, which was made based on materiality and risk-related aspects, we verified that the agreed purchase price for the loan portfolio had been taken into account correctly in the context of calculating the loan loss provisions on these receivables. With regard to the appropriate allocation of the purchase price for the overall portfolio to the individual receivables, we used an expert opinion commissioned by HSH Nordbank issued by another auditing firm, for the purposes of our review.

With regard to the tax-related consequences of the privatisation process, we first of all verified the implementation and effectiveness of relevant controls designed to ensure the correct accounting of deferred taxes.

Our audit activities with regard to the adequacy of the inclusion of the tax-related consequences of the change in shareholder and the tax losses resulting from the sale of the loan portfolio earmarked for winding down in the determination of deferred taxes involved using binding information issued by the tax authorities, as well as assessing whether deferred taxes on tax loss carryforwards had been valued correctly in light of the change in shareholder.

OUR OBSERVATIONS

The sale of the loan portfolio earmarked for winding down that was agreed on 28 February 2018 in the context of the portfolio transaction was taken into account in the calculation of individual valuation allowances and the valuation of deferred taxes in accordance with the applicable accounting principles.

Other Information

Management is responsible for the other information. The other information comprises:

- the Management Declaration, and
- the remaining parts of the annual report, with the exception of the audited annual financial statements and management report and our auditor's report.

Our opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

- - is materially inconsistent with the annual financial statements, with the group report or our knowledge obtained in the audit, or
- - otherwise appears to be materially misstated.

Responsibilities of Management and the Supervisory Board for the Annual Financial Statements and the Management Report

Management is responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law applicable to business corporations, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, management is responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, management is responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, management is responsible for the preparation of the management report that, as a whole, provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, management is responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional scepticism throughout the audit. We also

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems.
- Evaluate the appropriateness of accounting policies used by management and the reasonableness of estimates made by management and related disclosures.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner so that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.
- Evaluate the consistency of the management report with the annual financial statements, its conformity with German law, and the view of the Company's position it provides.
- Perform audit procedures on the prospective information presented by management in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by management as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

OTHER LEGAL AND REGULATORY REQUIREMENTS

Further Information pursuant to Article 10 of the EU Audit Regulation

We were elected as group auditor by the annual general meeting on 18 May 2017. We were engaged by the Chairman of the Supervisory Board on 21 November 2017. We have been the auditor of HSH Nordbank AG, Hamburg and Kiel, without interruption since the financial year 2008.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

GERMAN PUBLIC AUDITOR RESPONSIBLE FOR THE ENGAGEMENT

The German Public Auditor responsible for the engagement is Rainer Thiede.

Hamburg, 18 April 2018

KPMG AG
Wirtschaftsprüfungsgesellschaft

Leitz	Thiede
Wirtschaftsprüfer	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, 17 April 2018

Stefan Ermisch Oliver Gatzke

Ulrik Lackschewitz Torsten Temp

HSH NORDBANK AG

HAMBURG: Gerhart-Hauptmann-Platz 50,
20095 Hamburg, Germany
Phone +49 40 3333-0, Fax +49 40 3333-34001

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

HSH-NORDBANK.COM