ECONOMIC REPORT

UNDERLYING ECONOMIC AND INDUSTRY CONDITIONS

MODERATE GLOBAL ECONOMIC GROWTH

The global economy grew in 2015 by about 3%, which means that it grew slightly less strongly than in the previous year. This growth rate fell slightly short of the forecasts of many institutions. Global growth was supported by the accelerating pace of the recovery of the US economy over the course of the year, although economic growth slowed again in the US in the last quarter. The US Federal Reserve increased the key interest rate in December 2015 for the first time since 2006, in view of the continuous improvement in the labour market.

Growth in emerging markets has slowed down over the past year. The sharp reduction in oil prices and other commodities, which led to a recession in economies dependent on commodity exports, contributed to this. The economic sanctions imposed by the EU and USA had an additional adverse impact in Russia. Growth also slowed down noticeably in China over the course of the year. The Chinese Central Bank therefore significantly devalued the yuan in several steps in order to boost exports of Chinese companies.

The eurozone economy continued to recover from a low level. The eurozone benefited from the low oil price, favourable refinancing terms and a weaker euro. The difficult and lengthy negotiations between Greece and its creditors regarding reform and savings measures created a climate of increased uncertainty until agreement was reached in the middle of the year. Inflation remained at a very low level in the eurozone and was even negative at times due to the collapse in commodity prices. Against this backdrop the European Central Bank extended in December 2015 its bond purchase programme set up in the spring until March 2017 and expanded its range of marketable bonds to include debt instruments issued by regional and local governments.

The German economy was able to grow at a rate of about 1.4% despite the difficult situation in many export countries. Growth was primarily driven by robust domestic consumption and higher government spending. The latter increased more sharply than planned against the backdrop of the immigration of around 1.1 million refugees. Investment activity decreased again during the course of the year following a positive start to the year. At the same time, exports clearly lost momentum in the second half of the year.

HIGH VOLATILITY IN THE FINANCIAL MARKETS

The financial markets were characterised in 2015 by unusually high fluctuations. This was mainly attributable to changing expectations regarding the timing of the first increase in the key interest rate in the US, some sharp falls in prices on the Chinese equity markets, the temporary worsening of the Greece crisis and expectations regarding the ECB's bond purchase programme.

In view of the increasing risk of deflation in the eurozone the ECB adopted a comprehensive bond purchase programme in the beginning of 2015 – particularly of euro government bonds – which was implemented in the market from March. The significance of the purchases led to the yield on ten-year government bonds falling to a record low of about 0.05%, and the yield on two-year government bonds even decreased significantly into negative territory. However, an improved economic outlook for the European Monetary Union for the following months caused the long end of the yield curve to increase to about 1%, whereas the short end has declined further with the prospect of further easing of the monetary policy of the ECB until the end of the year. Ten-year yields have also fallen over the course of the year from their high of 1% with the ECB's readiness to act. There were significant fluctuations in risk premiums for so-called periphery government bonds. As the Greece crisis worsened in summer, these premiums widened significantly and only returned to normal levels after a compromise had been reached.

In the US, the ending of the bond purchase programme at the end of 2014 and increasing speculation at the beginning of 2015 regarding an interest rate turnaround in the second half of the year resulted in an increase in yields – two-year bond yields in particular rose sharply at the year end. Following the US Federal Reserve's decision not to raise the key interest rates in September for the first time since 2006 in view of the turbulence in the financial markets, it increased key interest rates by 25 bps to rates ranging from 0.25% to 0.50% in December. At the same time, the Federal Reserve announced that it would continue its path of increasing interest rates in 2016. The DAX also recorded extraordinary sharp fluctuations and finally closed the year with a plus of around 10%. The EUR/USD exchange rate fell during the year to EUR/USD 1.09 compared to EUR/USD 1.21 as at the 2014 year end. The exchange rate reached its interim low of EUR/USD 1.06 in April. The oil price (Brent) fell sharply in 2015 to USD 38 per barrel as at the 2015 year end. This was primarily attributable to the continued high supply of oil from the US and the high level of oil production of OPEC and non-OPEC states.

UNEVEN TRENDS IN THE RELEVANT MARKETS

The shipping markets were very weak, particularly in the second half of the year 2015. The demand for container ships and bulkers fell far short of the expectations of market participants. Only the oil tanker market developed positively.

TREND OF TIME CHARTER RATES IN THE SHIPPING INDUSTRY

(Market average, USD/day)

Following the expected increase in charter rates in the container ship market in the first half of the year, the market slumped in the second half. As a result, the seasonal recovery usual in previous years did not materialise last year. The demand side was adversely impacted by, inter alia, the downturn in global economic growth emanating from the large emerging countries. Worldwide demand for container transport grew for the year as a whole at a markedly lower rate than had been expected at the beginning of the year. At the same time, the supply of ships increased more than twice as strongly as demand due to the high number of deliveries. Charter rates and ship values were thrown back as a consequence to the levels of 18 months ago. For the first time since 2009, also charter rates for large container ships fell to the level of operating costs. The number of unemployed container ships increased significantly at the same time.

The weak demand in the commodity markets was reflected in the bulker market. The weakness of the Chinese economy combined with structural difficulties had a negative impact. The volume of coal transports experienced its sharpest fall since the crisis year of 2009, whereas only modest growth was achieved for iron ore and smaller bulk commodities such as minerals and wood products.

Oil tankers benefited from a sharp fall in the oil price. Both the transported quantity and average distance travelled increased stronger than expected. The growing demand for floating storage also made a contribution to the positive development. The fleet increased disproportionately compared to demand. As a result, charter rates and ship values rose again above their long-term historical averages for the first time since 2009.

German real estate markets remained on an upward trend. Most residential real estate markets, primarily in large cities, benefited from a sustained high demand for housing. This continues to exceed construction activity, which has increased over recent years. Vacancy rates decreased again in the office real estate markets, as the demand for office space grew more strongly than the also increasing office completions. The retail sector benefited from strong private consumption and generated significant growth in sales in some cases, particularly in e-commerce. Retail stores also participated in this. Modern retail space remained in demand, especially in prime locations of large cities. As a result, prime rents in the retail sector also continued to rise in 2015, whereas office rents only increased moderately. The increase in residential rents in urban centres slowed down at an overall high level. Commercial property – as well as residential property – recorded further increases in value due to the high investor interest.

There was no common trend in the European real estate markets. Whilst vacancy rates have fallen and rents have increased for years in Great Britain – especially in London – due to the high demand, there was rent stagnation in many other markets such as in France on high vacancy levels. On the other hand, some markets, not least in Spain, began to show signs of a marked recovery. Prime properties in good locations in particular are much sought after throughout Europe as an investment. The upwards trend continued in the USA in both the office and residential real estate markets on a slight fall in vacancies and increasing rents and market values.

The development of renewable energies has progressed unevenly in the year under review. New installations of wind energy plants in Germany were even above the strong previous year's level. This was attributable to the offshore sector, whilst the capacity added onshore slowed down considerably. Capacity added in the rest of Europe has recovered slightly from the low of the previous year, which was also attributable to a higher number of new offshore installations.

The negative trend in the photovoltaic segment continued in Germany. As expected, net capacity added again decreased significantly compared to the previous year. This is the result, among other things, of the fact that there is currently a shift from statutory subsidies to a competitive bidding process.

The project financing volume for transport infrastructure increased very sharply in Europe in 2015 and in fact exceeded the pre-crisis volume of 2008. The proportion of public private partnership projects to the overall volume has increased significantly. The largest proportion of the financing was arranged for roads and in the railway sector. The regional focus of the activities was Great Britain, Turkey and Italy as well as France and Germany. The major institutional investors include pension funds and insurance companies, which regard infrastructure investments as an investment alternative in the low interest rate environment. Revenues in the logistics sector were somewhat more sluggish than in the previous year.

Production growth in the manufacturing industry was comparatively low. Trends were uneven in the individual sectors. Whilst production volume decreased in the chemicals and engineering sectors and the food industry recorded declining sales, the metal industry and electrical engineering achieved slight growth and companies in the pharmaceuticals and automobile industries even achieved strong growth. In the food industry sales of milk and dairy products as well as bakery products and pasta were down, which increased sales in the meat industry were not able to offset.

After a good start to the year wholesalers experienced increasing disillusionment. Overall, real sales declined slightly in 2015, which is primarily attributable to production-related wholesalers. Wholesalers for consumer-related goods have been able to increase their sales. Compared to the wholesale sector the retail sector can be very satisfied with its performance during the year. Both the food retail industry and other segments of the retail sector recorded increases in sales.

As a result of demographic trends and medical advances the German healthcare market is continuously growing, as is the hospital market. Nevertheless, the financial situation of many hospitals remains strained despite the constant increase in revenues. It is expected that this will be eased from 2016 with the implementation of hospital reforms.

CHALLENGING ENVIRONMENT FOR BANKS

PROGRESS MADE IN IMPLEMENTING EUROPEAN DIRECTIVES

The banking environment in 2015 was mainly characterised by regulatory changes as part of the continued implementation of the European Banking Union and Basel III. The expansion of the banking union and guarantee schemes is accompanied by the enhanced monitoring of banks; this applies both in the context of the guarantee schemes and by the bank supervisory authority. Regulatory monitoring is substantially increased for banks directly supervised by the ECB through the supervisory review and evaluation process (SREP). This includes in particular large-scale data analyses, so-called "short-term exercises". More strongly than in previous supervisory practice, the ECB as well as the national supervisory authorities will also review the business models, funding plans and internal risk models of the banks and draw on EU-wide benchmark analyses for their assessment, for example as part of the transparency exercise. The objective of the more comprehensive regulatory monitoring approach is to identify failings at banks at an early stage and to take appropriate countermeasures. Against this backdrop, in November 2015 the ECB notified the banks supervised by it of the institution-specific minimum requirements for capital and liquidity backing.

At the same time, market transparency is to be strengthened by the increase in disclosure obligations. The implementation of MIFID 2 (Markets in Financial Instruments Directive), which is aimed at improving the market infrastructure, provides a higher level of transparency and greater investor protection. As part of the harmonisation of European deposit guarantee schemes the new deposit insurance law (Einlagensicherungsgesetz) came into force in Germany at the beginning of July 2015, which transposes the requirements of the European Deposit Guarantee Directive. According to this, national deposit guarantee schemes are to achieve a level of funds of 0.8% of the covered deposits by 2024 by means of contributions made by their member banks. Within the framework of the implementation of the Bank Recovery and Resolution Directive (BRRD) the institutions had to pay the European bank levy for the first time in the year 2015, which will be used to build up the European resolution fund from 2016 onwards.

As part of this development and harmonisation of the European deposit guarantee schemes the German Savings Banks Finance Group approved at the end of the first half of the year a realignment of its joint liability scheme, which includes the guarantee schemes of savings banks, Landesbanks and Landesbausparkassen. The joint liability scheme regulations were supplemented by the strengthening of the governance rules for the institution guarantee, increased risk monitoring and a stronger risk- and deposit-based focus of the contribution regime. The funding of the deposit guarantee scheme of the German Savings Bank Finance Group is strengthened in accordance with the requirements by the contributions payable by member institutions for the first time in 2015, which were recalculated on this basis.

In Germany, the Act on the Recovery and Resolution of Credit Institutions (Sanierungs- und Abwicklungsgesetz (SAG)) came into force at the beginning of 2015 – a year earlier than provided for at the European level. SAG is the German implementing act to transpose the European Bank Recovery and Resolution Directive (BRRD) into German law, under which common rules are created throughout Europe for failing banks. A key tool is the participation in losses of equity and debt capital providers. The development of comprehensive recovery and resolution plans for the first time by German banks was another milestone in the implementation of the BRRD and SAG. These include measures for stabilising banks in distress and strategies for the resolution of banks including potential participation in losses by investors. Whilst the recovery plans are prepared by the banks themselves, the final responsibility for the resolution plans rested with the Resolution Authority (FMSA) in 2015 but was transferred to the European Single Resolution Board (SRB) as at 1 January 2016.

In view of the introduction of the BRRD the rating agencies, as announced, reassessed in the second quarter of 2015 the so-called state support, that is, the probability of state support being provided to failing banks and issued new bank ratings. The reduction of the support uplift integrated in the long-term ratings of most banks was partially offset by changes to the methodological approaches applied. At the beginning of 2016, a further comprehensive rating action was carried out by Moody's, which took account of the realignment of the liability cascade with regard to a potential losses participation by providers of equity and debt capital in the event of restructuring or resolution under Section 46f KWG to be applied from 2017. This provides for the subordination of senior bonds (financial instruments classified as senior unsecured) to deposits and a greater differentiation between institutional and non-institutional investors (banks and institutions versus private investors and small and medium-sized enterprises).

The comprehensive and stricter regulatory requirements have made a significant contribution to strengthening the stability of the European banking system. Against the backdrop of stricter capital requirements through the gradual implementation of Basel III and the planned introduction of additional regulatory capital buffers German banks have further strengthened their capital base in 2015. In addition to capital measures taken in the market the reduction of balance sheet risk positions and retained earnings also contributed to this. With the overall improvement in their capitalisation the banks have the key prerequisites for prevailing in the sustained difficult competitive environment in the German banking market.

BANK EARNINGS UNDER PRESSURE FROM LOW INTEREST RATES AND COMPETITIVE SITUATION

The low interest rate environment, which puts pressure on net interest income of banks via a flatter yield curve, was an increasingly negative factor in 2015. In addition to a decline in earnings from maturity mismatches in the refinancing and lending business the return on equity of banks also decreased. In view of the continued sluggish and subdued loan demand against the backdrop of global uncertainty and the currently good equity base of companies, the options for increasing interest income, which is an important source of income for the majority of German banks, therefore remained limited. The difficult demand and competitive situation entails the danger that loan financing in the banking market is not priced on a risk commensurate basis.

The constantly increasing regulatory requirements together with the bank levy on institutions were reflected on the cost side. Against this backdrop many banks initiated comprehensive cost and efficiency programmes in order to be able to generate adequate returns on a sustained basis.

Many German institutions were affected by the debt moratorium announced by the Austrian financial market authority at the beginning of March 2015 for Heta Asset Resolution AG (HETA), which required higher write-offs of the existing loans and advances to HETA from institutions. The nominal value of the portfolio of securities and bonds of HETA held by the Bank totalled € 220 million. At the beginning of January 2016 the Austrian federal province of Carinthia submitted a buyback offer to the HETA creditors, which is based on the solution reached between Austria and Bavaria in July. The offer comprised the repurchase of the securities at a price of 75% regardless of the default guarantee issued by the Austrian federal province of Carinthia. The buyback offer of the federal province of Carinthia failed in March 2016 due to its rejection by the creditor banks. At the beginning of April 2016 the Austrian Financial Market Authority (FMA) announced a new debt haircut, which, at only 46% for the holders of senior bonds and a full waiver for holders of subordinated bonds, is significantly below the previous offer. All coupon payments payable from 1 March 2015, the start of the legally enacted debt moratorium, were also cancelled in full and the maturity of all bonds was extended to 31 December 2023. In May 2016, the federal province of Carinthia and the creditor banks seemed to be close to an agreement.

HSH NORDBANK'S BUSINESS IMPACTED BY UNDERLYING CONDITIONS

Against the backdrop of the overall subdued loan demand of companies with a simultaneous solid demand for real estate loans and the deliberate restrictions placed on new business in the shipping sector, new business concluded with HSH Nordbank clients last year was slightly below the previous year's level. The uncertainty felt by the market before the reaching of the informal agreement with the EU Commission probably contributed at times to the reticence of clients.

In the face of the subdued overall market the Bank was nevertheless able to confirm its good positioning in the target markets whilst complying with strict risk and earnings requirements. One focus was on real estate financing. However, the subdued demand for bank loans was clearly felt in the traditional corporate clients business, although new business – particularly in the project financing business – increased towards the year end. Transactions were concluded on a selective basis in the shipping sector. At the same time there was intense competition in all divisions. Overall, Core Bank earnings benefited noticeably from the development of new business. However, the solid financial position of many clients enabled them to make investments from their own resources and repay loans early. This partially offset the positive earnings effect of the increase in Core Bank's new business.

In view of the persistent adverse trend in the shipping industry and the impact of the informal agreement and the formal decision of the EU Commission on the portfolios to be sold HSH Nordbank has once again recognised extraordinarily high loan loss provisions for the legacy portfolios concerned in 2015 most of which, however, were compensated for by the guarantee. HSH Nordbank also drew on the forecast data of the leading market research institutes, Marsoft and MSI, for this.

The significant slowdown in economic growth in China in particular had a negative effect on the demand side in the shipping markets and the low interest rate environment had a negative effect on the supply side, as the favourable refinancing conditions have supported further increases in the fleet. However, the strong earnings, particularly of German companies, enabled reversals of loan loss provisions to be made in respect of corporate loans.

The further appreciation and high volatility of the US dollar against the euro also had an impact on earnings, net assets and the financial position. Net trading income was adversely impacted by IFRS measurement effects, particularly with regard to the hedging of equity holdings denominated in foreign currency, which, however, were more than offset by other, positive effects in net trading income.

The appreciation in the US dollar required a higher amount of cash collateral to be provided for the derivative US dollar funding. HSH Nordbank counteracted this adverse impact by implementing targeted measures on the asset and liability side. These included accelerated sales of troubled assets denominated in US dollar the Restructuring Unit, restrictions placed on new US dollar business and an increase in the US dollar deposit volume.

An appreciable amount of liquidity was freed up by means of these measures. Despite the additional negative effect arising from the maturity in 2015 of the majority of bonds covered by the guarantor liability appropriate liquidity ratios were disclosed at all times. Furthermore, the planned sales of portfolios totalling € 8.2 billion to the federal states and in the market will significantly ease future funding requirements and the future liquidity position.

Despite the continuing low level of interest rates, customer business margins were maintained at stable levels for the most part. Nevertheless, the results were adversely impacted by the low level of interest rates. The decrease in risk premiums had a positive effect as at the 2015 year end on the measurement of high-risk securities portfolios, from which the internal workout bank, the Restructuring Unit, benefited in particular.

The multitude of new regulatory requirements also tied up a significant amount of resources at HSH Nordbank in the past year and involved additional costs. Nevertheless, total administrative expenses were further reduced significantly compared to the previous year as a result of the implementation of the cost savings programme.

The European bank levy and contribution to the deposit guarantee scheme also resulted in higher costs.

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 2015 REPORTING YEAR

INFORMAL AGREEMENT REACHED WITH EU COMMISSION

On 19 October 2015, the majority owners of HSH Nordbank, Hamburg and Schleswig-Holstein, the Federal Republic of Germany and the EU Commission reached an informal agreement in the pending EU state aid proceedings to provide relief to the Bank's operating business from the adverse impact of legacy portfolios and guarantee fees, which, following the implementation of the individual measures, should improve the financial and risk situation and form the basis for a sustainable and viable structure of HSH Nordbank. It is also envisaged that HSH Nordbank be privatised by the year 2018. HSH Nordbank and its majority owners have been thoroughly preparing for the implementation of the informal agreement over the past few months.

FORMAL DECISION 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. The formal decision confirms the informal agreement and defines it in principle in concrete terms. It is based on a catalogue of conditions and commitments provided by the Federal Republic of Germany to the EU Commission.

Sale of non-performing loans of up to € 8.2 billion

Under the informal agreement HSH Nordbank AG is to be relieved of some of its troubled legacy portfolios. Following the informal agreement, the Bank was able to transfer non-performing loans in the amount of up to € 6.2 billion at market prices to the federal state owners and to sell an additional portfolio volume of € 2 billion in the market. Any resulting losses should be charged against the second loss guarantee under the current conditions of the guarantee agreement and would therefore result in a higher drawdown of the guarantee. The aim is that the volume of non-performing loans will decrease clearly thanks to these measures. The largest portion of the portfolios to be sold is accounted for by non-performing shipping loans, which should reduce the impact of the very difficult shipping market and volatile US dollar on the Bank's operating performance.

Further points relating to the sale of non-performing loans were specified as part of the formal decision taken in May 2016. Accordingly, it is planned to transfer portfolios of an initial amount of € 5 billion to the federal states in the middle of 2016. The transfer will be made at market values determined by the EU Commission from a state aid point of view. Furthermore, it is planned on the basis of the formal decision of the EU Commission to sell portfolios of up to € 3.2 billion in the market.

Reduction in guarantee fees and establishment of a holding structure

A further key point of the informal agreement with the EU Commission is the future structure of the guarantee fees together with the establishment of a holding company and a subsidiary, which will comprise HSH Nordbank's operating business and is to be privatised. The operating company is to pay a significantly lower level of guarantee fees in the future. The base premium for the guarantee is to decrease by 1.8% to 2.2% (from a current 4%) and is solely payable on the portion of the guarantee not made use of, i.e. not drawn down, and no longer on the guarantee facility of € 10 billion. The base premium of currently about € 400 million is to decrease over the coming years as planned after the portfolio transactions have been implemented.

In the new structure the current additional premium for the guarantee shall no longer apply to the operating company. The reduction in guarantee fees should significantly ease the strain on the results of HSH Nordbank's operating company. This company would be structurally in a much better position in future to strengthen its capital from own resources and therefore meet the increasing banking supervision and market requirements. As the assets to be sold will mainly comprise US dollar transactions, the sensitivity of capital ratios to the volatile US dollar will also decrease noticeably.

Furthermore, the operating company's funding requirements, particularly in the US dollar business, will also decrease due to the sale of the loan portfolios. This will also strengthen the Bank's liquidity position affected by movements in the US dollar in the future.

The holding company still to be formed is to significantly relieve the operating company of all other fee components of the second loss guarantee base premium on the portion of the guarantee drawn down, base premium of 1.8% on the portion of the guarantee not drawn down and the current additional premium.

It was further specified in the formal decision that HSH Nordbank provides the holding company with liquidity of € 50 million to ensure its operations. Furthermore, the operating company must make a one-off payment of € 210 million to the holding company.

Privatisation of the operating company

Under the formal agreement, a period of 24 months following the binding decision of the EU Commission was provided for the sale of the operating company. Delays for reasons outside the control of the Bank or the federal states were meant to allow extending the period by up to six months. The federal states of Hamburg and Schleswig-Holstein may retain a shareholding of a maximum of 25% for up to four years following the sale. The success of the sales process was meant to be assessed by the EU Commission as part of a further future decision in the light of the privatisation, in which the Commission would analyse and assess the viability of the newly established entity following the sale.

The company to be sold is to be reorganised in such a way that a successful sales process is promoted. Further cost savings and measures to strengthen the capital base will be implemented for this purpose. According to the informal agreement, a dividend ban was to apply during the privatisation period and a distribution ban on the issued hybrid instruments during the entire restructuring period.

Under the formal decision a deadline of 28 February 2018 is set for the sale of the operating company (i.e. up to the signing of the acquisition agreement). This divestiture period may be extended by up to six months with the agreement of the EU Commission, where there are delays in the technical implementation of the model for reasons outside the control of the federal states. The sale will be executed as part of an open, non-discriminatory, competitive and transparent process. The participating bidders, who must be independent of HSH and the public sector, must have the necessary financial resources and proven sector expertise to manage the operating company as a profitable and active competitor. A sale to other Landesbanks is possible. Public savings banks may also take a minority interest in an acquisition by a private third party or by one or several Landesbanks.

Following the successful completion of the sales process resulting in an offer that does not require state aid and an offer price that is positive (while retaining the guarantee) the intended acquisition will be subject to a viability assessment of the new corporate structure by the EU Commission prior to implementation and has to be approved by the EU Commission. Further information on the agreed privatisation can be found in the section Formal decision in the EU state aid proceedings in the Forecast report.

The formal decision of the EU Commission also provides for setting out the informal agreement in more detail regarding the dividend and distribution ban: During the divestiture period the operating company may not make any payments 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 permitted by law from the operating company to the holding company to be formed.

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

Further key points of the formal decision pursuant to the catalogue of conditions and commitments

Under the catalogue of conditions and commitments set out in the formal decision the operating subsidiary will maintain the regulatory liquidity ratios net stable funding ratio (NSFR) and liquidity coverage ratio (LCR) in a range of 80% to 120% at the year end of the 2016 and 2017 financial years, respectively. Furthermore, provisions regarding the reduction in total assets and business model (including expansion of the business approach in the area of corporate clients compared to the previous list of EU conditions under the original EU proceedings and continuation of the ban on proprietary trading and asset-based aircraft financing and setting of a maximum possible new business volume in Shipping) are to be complied with and the restriction on external growth through the acquisition of control in other companies is also to be observed. Further information on the formal decision is set out in the Forecast, opportunities and risks report section.

Implementation of the informal agreement and inclusion in the 2015 Group financial statements

In November 2015 the federal states of Hamburg and Schleswig-Holstein confirmed in a binding statement to HSH Nordbank that they will implement the informal agreement as quickly as possible and initiated – as far as needed – the necessary parliamentary legislative procedures. These parliamentary legislative procedures were completed last year with the consent of the parliaments of Hamburg (Bürgerschaft) and Schleswig-Holstein (Landtag). The impact of the informal agreement and the binding undertaking of the federal states of Hamburg and Schleswig-Holstein on net assets, financial position and results of operations was taken into account in the 2015 annual and Group financial statements in accordance with the accounting rules to be applied.

In summary, the envisaged structural measures mainly affect the following items in the 2015 income statement: loan loss provision expense (valuation allowances recognised as a result of the changed measurement of the portfolios to be sold due to the revised commitment strategy and the offsetting compensation under the second loss guarantee, reversal of future premiums and debt waivers in the compensation item with the exception of the one-off payment to be expected after the formal decision of the EU Commission and the provision of liquidity to the holding company in the total amount of € 260 million), net interest income (revaluation of hybrid instruments due to coupon defaults) and tax result (elimination of deferred taxes on temporary differences as a result of the reversal of obligations in connection with the additional premium).

Furthermore, the informal agreement and binding statement of the federal states of Hamburg and Schleswig-Holstein had an impact on the capital ratio (positive income effect due to the reversal of additional premiums and regulatory adjustment items).

Selection and measurement of the transaction portfolios

The commitments to be transferred to the winding down institution formed by the federal state owners with an initial volume of € 5 billion were identified as part of a portfolio selection process. The selected portfolio of non-performing shipping loans is to be transferred from the Restructuring Unit and the Core Bank's recovery unit at the end of the first half of 2016. The impact of the shipping market and volatile US dollar on the Bank's operating performance is likely to decrease markedly as a result of this measure.

In addition, the commitments of up to € 3.2 billion to be sold in the market have already been identified by the Bank. In contrast to the portfolio to be sold to the federal states, the market portfolio also comprises loans from the areas of real estate, energy and aviation in addition to shipping loans.

In the 2015 Group financial statements, the expected market values for the transaction portfolios as at the respective transaction date were incorporated in the calculation of the respective loan loss provisions under the changed commitment strategies. This measurement resulted in the need to recognise additional impairment losses in the Group financial statements. Losses incurred on the sale of the portfolios are to be settled under the current terms and conditions of the continuing second loss guarantee agreement. Accordingly, the need for additional impairment losses was compensated for in the income statement.

The guarantee is technically split into a financial guarantee and a credit derivative for the compensation of loan loss provisions. This compensation under the guarantee relating to the financial guarantee is accounted for in loan loss provisions and that relating to the credit derivative in a separate line item Hedging effect of the credit derivative second loss guarantee. The settlement of the losses resulting from the transfer of the commitments results in a higher and earlier actual drawdown of the guarantee compared to the previous plan.

Acquisition and management of the split off shipping loans with an initial volume of € 5 billion by an institution of the federal states

The portfolio to be sold to the federal state owners is to be acquired by HSH Portfoliomanagement AöR, an institution under public law. The institution is owned by both federal states and has its registered office in Kiel. It was established to take care of the management and winding down of the assets taken over while minimising losses. The environment necessary for setting up the institution was established by the conclusion of a treaty between Hamburg and Schleswig-Holstein in December 2015 with the consent of both state parliaments.

Essential services are to be initially provided to HSH Portfoliomanagement AöR (loan processing, portfolio management, IT etc.) by HSH Nordbank on an interim basis until the longer-term servicing arrangements are secured under normal procurement procedures. Preparations necessary for the operational start of the interim servicing arrangements in the middle of 2016 have already been initiated.

The portfolio remaining at HSH Nordbank under the guarantee will continue to be hedged by the continuing guarantee facility in the proven way. This will continue to provide increased stability in the income statement and regulatory capital backing even under crisis market conditions.

Implementation of the holding structure

The planned legal separation of HSH Nordbank into an operating company and a holding company and the associated reduction in guarantee fees is to be achieved by the Bank's existing shareholders contributing their shares to a new holding company to be established. This holding company will in future bundle together the shares contributed by all owners.

In addition to the principal owners, Hamburg and Schleswig-Holstein, minority shareholders have also confirmed to the Bank that they will contribute shares to the holding company. It is intended that the 5.3% shareholding in the Bank held by the Savings Banks Association for Schleswig-Holstein (Sparkassen- und Giroverband) and 4.2% shareholding held by private investors advised by J.C. Flowers & Co. LLC be transferred to the holding company. Furthermore, the private investors advised by J.C. Flowers & Co. LLC are to hold a 5.1% shareholding directly in the operating company.

Start of the privatisation process

In view of the time limit, the first steps for the sales process have already been initiated in addition to the preparations and specifications for the implementation of the planned structural measures. In the first half of 2016, an investment bank is to be appointed by the federal states to support a successful sales process. An investment bank will also be appointed by HSH Nordbank to provide support in this process.

Further strategic and operational improvements are planned at the Bank over and above the implementation of the structural measures. The foundations of a permanently viable business model and the starting point for a successful privatisation of HSH Nordbank have been further improved by these additional optimisations.

Details regarding the accounting treatment of the agreed structural measures in the Group financial statements are set out in the Earnings, net assets and financial position section.

OVERVIEW OF BUSINESS PERFORMANCE IN 2015

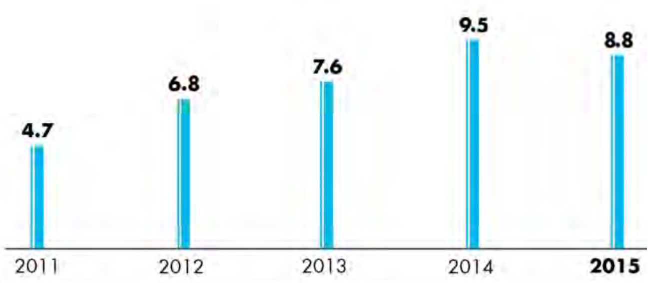
HSH Nordbank's operating activities were vigorously driven forward in the past year regardless of the issues surrounding the pending EU proceedings. The focus was on generating new business with solid income and risk profiles in a very challenging market environment. At the same time legacy portfolio items were further reduced significantly in the Restructuring Unit with a focus on winding down shipping and real estate loans as well as capital markets positions. The implementation of the plans drawn up as part of the cost reduction programme initiated in 2014 also progressed according to plan. Administrative expenses were further reduced markedly as a result of this despite the significant adverse impact of regulatory requirements.

Focused development of new business

In the past year, HSH Nordbank generated new business of € 8.8 billion in the Core Bank. Taking the strict internal risk and income requirements and the particular challenges faced last year into account, this was slightly below the high volume of € 9.5 billion transacted in the previous year and planned volume. This development reflects the targeted reduction in new business in particular in the shipping division against the backdrop of the very difficult market situation in the shipping industry and volatile movement in the US dollar. On the other hand, the focus on transactions with an adequate risk and income profile was noticeable in the Corporate Clients division in addition to the market-related subdued loan demand. There was also uncertainty in the market because of the EU proceedings. New business transacted with corporates – mainly in the project financing business (energy, infrastructure) – gained new momentum, in particular towards the end of the year. Business expansion was strong and above plan in view of the favourable market situation and strong position in the real estate clients business.

NEW BUSINESS OF THE CORE BANK

(€ bn)



The share of the Core Bank client business generated by the respective divisions is broadly balanced with regard to total loans and advances. The share of loans and advances to real estate clients amounted to 29%, the share of the Corporate Clients division to 32% and the share of the Shipping division to 39% (Shipping including the commitments to be transferred to the federal states).

It was possible to increase the share of new loans disbursed in new business transacted (disbursement ratio) compared to the previous year and it is now above the target level. The overall stable and above plan trend in interest margins achieved was encouraging. The slight reduction in new business compared to the previous year was offset by the increased disbursement ratio. Details on new business transacted in the individual divisions, which was satisfactory overall taking the particular challenges faced in the year 2015 into account, are set out in the Segment reporting section of this report.

Cross-selling income arising from various banking services offered in addition to loan financing was increased significantly to € 242 million compared to the previous year and was above plan thanks to more extensive product sales in the Core Bank (previous year: € 227 million). Risk hedging as well as transaction banking and investment products were among the services in demand with Core Bank customers. Thanks to increased product sales in the Core Bank it was possible to strengthen the sustainability of client relationships further. This increase in the Core Bank was offset by a decrease in cross-selling income in the Restructuring Unit from € 42 million to € 26 million, where lower loan restructuring fees were received due to the progress made in reducing risk. At the Group level cross-selling income in the total amount of € 268 million was at about the previous year's level (€ 269 million).

New business concluded in accordance with the margin and risk requirements and product sales had a positive impact on the Core Bank's operating earnings. The Core Bank's portfolio quality benefited from new business with comparatively better income and risk parameters and the reduction in high-risk troubled assets.

HSH Nordbank was therefore able to make considerable progress in implementing the Core Bank's client-based strategy and thereby further consolidating the anchoring of the client divisions in their target markets despite the deliberate restrictions placed on business activities in some cases and a challenging environment.

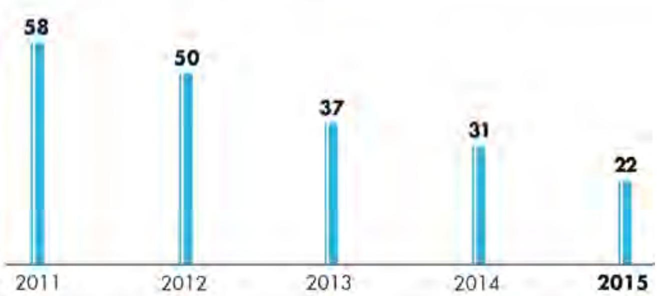
Total assets of the Core Bank amounted to € 70 billion as at 31 December 2015 (31 December 2014: € 76 billion) against the backdrop of the business developments and movement in the EUR/USD exchange rate (portfolio effect: € 1.2 billion). The increase in the portfolio due to the new business transacted was more than offset by scheduled and unscheduled loan principal repayments and the reduction in the surplus liquidity built up in advance of the maturities of bonds covered by the guarantor liability.

Accelerated winding down of legacy portfolios

HSH Nordbank consciously intensified its efforts to wind down the legacy portfolios, particularly in the second half of the 2015 financial year.

RESTRUCTURING UNIT: SEGMENT ASSETS (EXCLUDING CONSOLIDATION)

(€ bn)



A focus was on reducing the troubled assets denominated in US dollars against the backdrop of sharp fluctuations in the exchange rate. At the same time the accelerated winding down resulted in a release of liquidity against the background of the extensive maturities of bonds covered by the guarantor liability as at the 2015 year end.

The winding down measures taken in the year under review in part exceeded the loss-minimising winding down provided for under the guarantee agreement. In some cases, these winding down measures were associated with significant charges to the Bank's earnings.

On the other hand, it was possible to clearly reduce legacy portfolio items in the statement of financial position ahead of schedule.

Against the background of a market environment that continues to be very difficult in shipping one focus of active portfolio reduction continued to be on the winding down of non-performing ship financings by means of structured solutions for shipping loans. These solutions transfer shipping loan tranches to investors thus reducing the risks of the Bank in the portfolio. At the same time, the Bank in the course of the transactions secures the option to benefit from a recovery of the shipping industry. Nine transactions of this type were concluded in the 2015 financial year. Furthermore, shipping loans with a volume of about € 0.6 billion were wound down in 2015. Sales were also actively generated to a greater extent in the Real Estate USA and Energy & Infrastructure USA divisions. In these two divisions loans with a total volume of about € 0.5 billion were sold primarily in the second half of 2015. At the same time HSH Nordbank was successful in the reporting year in significantly reducing its Dutch real estate portfolio in a continuing difficult market environment.

Taking account of winding-down measures in other areas (Restructuring Unit and Core Bank) it was possible to wind down a loan volume of around € 1.4 billion in addition to scheduled principal repayments.

Furthermore, HSH Nordbank used the overall positive market environment to significantly reduce the capital markets portfolios in the Restructuring Unit. The credit investment portfolio was further reduced by around € 2.2 billion in addition to scheduled repayments in the year 2015.

As forecast, total assets of the Restructuring Unit further decreased significantly to € 27 billion as a result of the portfolio reduction in the year 2015 taking account of the offsetting effect of the appreciation in the US dollar (portfolio effect: € +0.8 billion). Consolidation items accounted for € 5 billion of those assets. As a result, the balance sheet assets of the Restructuring Unit segment (excl. consolidation items) amounted to € 22 billion (31 December 2014: € 31 billion, 31 December 2009: € 83 billion).

Successful cost savings and process optimisation measures

HSH Nordbank continued to implement the cost reduction programme initiated in 2014 for the years 2015 to 2017 in line with the plan in 2015. The action plans have been successfully implemented in the area of operating and personnel expenses and at the process level. The targeted management of individual operating expense items and reduction in staff related to the restructuring have contributed to a further significant decrease in administrative expenses in the reporting year. Key milestones reached at the process level are in particular efficiency improvements across divisions in the lending and loan processing. The organisational structure in the staff divisions was also streamlined inter alia as part of the enhancements to the management systems of the Bank. The Bank further reduced the size of its branch in New York during the course of the year and converted it into a representative office at the end of 2015.

The further reduction in staff initiated at the beginning of the reporting year is progressing according to schedule. A large part of the planned reduction has already been agreed with the employees concerned. Details regarding the implementation of the reduction in staff are governed by a reconciliation of interests (Interessenausgleich), on which the Management Board and Works Council have agreed. In addition, the framework social plan in place since 2011 remains valid and contains the tools to be used for a socially acceptable reduction in staff, such as severance, early retirement and part-time work agreements. Employees are also provided with support in developing new career plans.

The number of employees decreased as planned to 2,384 (31 December 2014: 2,579) – calculated in FTE – at the end of the year 2015 as a result of the ongoing reduction in staff within the HSH Nordbank Group. Changes to the scope of consolidation also had an impact on the headcount. The number of employees (FTE) at HSH Nordbank AG (single entity) decreased to 2,117 by the end of 2015 (31 December 2014: 2,265).

The background to the cost reduction programme is, on the one hand, the increasing pressure on earnings in the competitive banking market and, on the other, rising costs due to the increasing regulatory requirements. HSH Nordbank is improving cost efficiency and reducing administrative expenses in the long-term through the cost-cutting measures currently being implemented.

NUMBER OF EMPLOYEES REDUCED

	31.12.2015	31.12.2014
Full-time equivalents (FTE) in the Group[1]	**2,384**	**2,579**
of which: Women	891	965
Men	1,493	1,614
Employees in Germany	2,264	2,422
Employees abroad	120	157
Total number of employees in the Group [2]	2,838	3,072
New employees	88	130

[1] Total number of employees excluding trainees, temporary staff and interns (previous year adjusted).
[2] Headcount (previous year's number adjusted).

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

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

Progress made in implementing the IT strategy

Significant progress has been made in 2015 in implementing the IT strategy defined in 2014 and to be implemented by 2018. A central project in the reporting year was the modernisation of the IT infrastructure. A target solution was also developed for the consolidation of capital markets IT. Further implementation successes were achieved inter alia in focusing on the provision of services and the establishment of a central customer support.

Management Board of HSH Nordbank strengthened

The Supervisory Board of HSH Nordbank AG appointed Ulrik Lackschewitz as Chief Risk Officer (CRO) of HSH Nordbank in its meeting of 29 May 2015. He took over this role with effect from 1 October 2015 from Stefan Ermisch, Chief Financial Officer (CFO), who was temporarily responsible for the Bank's risk function since June 2015 following the departure of Edwin Wartenweiler. In Ulrik Lackschewitz, HSH Nordbank has gained a proven expert who has extensive experience in risk management and recognised expertise in shipping portfolios.

Furthermore, the Supervisory Board has extended the contracts with Stefan Ermisch, Chief Financial Officer, and Matthias Wittenburg, responsible for capital markets and corporate client business. Stefan Ermisch was also appointed as Deputy Chairman of the Management Board.

EARNINGS, NET ASSETS AND FINANCIAL POSITION

OVERVIEW OF THE RESULTS FOR THE GROUP, CORE BANK AND RESTRUCTURING UNIT

Agreed structural measures reflected in the positive results

HSH Nordbank's net income for the 2015 financial year mainly reflects the overall satisfactory operating performance of the Core Bank (with the exception of the Shipping division) and the accounting impact of the informal agreement reached with the EU Commission and the binding statement of the federal states of Hamburg and Schleswig-Holstein to implement the planned measures. Overall, the informal agreement which was basically confirmed by the formal decision had a significant positive impact on the earnings situation, whereby the Restructuring Unit benefited significantly more from the recognition of the effects of the measures than the Core Bank of HSH Nordbank.

Material effects were recognised in this connection in loan loss provisions, in which the impact of the guarantee and the debt waiver of the guarantors are also disclosed. The existing additional premiums and future guarantee premium obligations were released to income and the debt waiver was cancelled and recognised as expense except for the payments still to be expected after the formal decision of the EU Commission (one-off payment and provision of liquidity to the holding company). At the same time, impairment losses had to be recognised for the portfolios to be transferred or sold due to the changed commitment strategies that take market values at the planned date of sale into account, which together with the loan loss provisions recognised for the other troubled assets in the shipping loan division, were largely compensated for by the hedging effect of the guarantee with the exception of certain losses in the market portfolio that were determined on the basis of an estimate and were related to credit ratings. Furthermore, the remeasurement of hybrid instruments due to the current corporate planning had a positive impact on net interest income assuming elimination of future coupon payments taking the informal agreement and the formal decision into account. In addition, deferred taxes were reversed due to the informal agreement, which resulted in significant tax expense.

At the same time, the operating progress made in the client business and cost saving measures implemented were reflected in the earnings performance.

This overall noticeable positive impact was offset by charges arising from the measures implemented last year to wind down troubled assets, the high base premium for the guarantee for the past year as well as the European bank levy and contribution to the deposit guarantee scheme that were payable for the first time. In addition, the Bank had to recognise extensive portfolio valuation allowances in order to reflect the risks arising from the very challenging environment, particularly in the shipping markets, and take account of the new standards to be applied to the shipping industry.

Net income before taxes of HSH Nordbank amounted to € 450 million compared to € 278 million in the previous year. After deducting the comparatively high tax expense of € -352 million attributable to an increase in deferred tax expense recognised as part of the structural measures Group net income of € 98 million remained for the year 2015 (previous year: € 160 million).

Significant increase in total income

Total income of HSH Nordbank increased in the 2015 reporting year to € 1,296 million compared to € 908 million in the previous year. In the previous year the forecast was based on a more or less stable total income only.

A sharp increase in net interest income to € 1,032 million, which benefited at the operating level from the positive income impact of the development of new business at overall stable margins, made the largest contribution to this. This was offset by the negative impact of the most recent accelerated reduction in high risk legacy portfolios and loan principal repayments by clients. The remeasurement of hybrid instruments also had a positive impact on net interest income as a result of the assumption that more coupon payments will be cancelled in the future based on the current planning of the Bank, taking the informal agreement as well as the formal decision into account, among other things (effect: € +214 million).

Net trading income, which was affected by volatile developments on the financial and currency markets, increased to € 84 million (previous year: € 61 million) due to the overall improvement in measurement gains and losses for, inter alia, EUR/USD basis swaps. As expected, net income from financial investments of € 54 million for the past year fell significantly short of the net income of € 169 million for the previous year, which benefited more strongly from reversals of impairment losses and gains on disposals. Write-downs of equity holdings as well as losses on the disposal of positions held in the credit investment portfolio had a negative impact in the reporting year 2015.

The accelerated reduction in legacy loans in various asset classes (particularly real estate, shipping and energy loans) also had a negative impact on income in the reporting year (disclosed mainly under Other operating income). The additional winding down measures resulted in a greater reduction in high-risk portfolios and the release of liquidity in view of the maturity of the majority of bonds covered by the guarantor liability during the past year. The focus here was on the reduction in US dollar positions against the backdrop of the negative impact of volatile exchange rate movements.

The marked reduction in personnel and operating expenses including depreciation of property, plant and equipment also made a contribution to the positive results against the backdrop of the ongoing cost savings programme. As expected, total administrative expenses decreased sharply to € –634 million compared to € –724 million in the previous year. HSH Nordbank will initiate further measures to reduce costs and improve efficiency in order to ensure a sustainable, competitive cost structure.

Loan loss provisions taking account of market values of transaction portfolios as at the planned time of sale and reversal of guarantee premium obligations

Loan loss provisions are characterised considerably by the effects of the informal agreement with the EU Commission, the compensation effect of the guarantee and additional loan loss provisions created for risk associated with the legacy portfolios. Total loan loss provision expense before compensation under the guarantee and taking the reversal of the guarantee premiums and debt waiver into account amounted to € –3,020 million (of which in the Restructuring Unit: € –1,119 million) and therefore reached an extraordinarily high level and was higher than the planned risk costs.

On the one hand, this reflected additional loan loss provisions recognised due to the changed commitment strategies for the portfolios to be transferred and sold to the federal states agency and in the market (loan loss provisions: € –1,584 million), respectively, taking account of the expected market values as at the planned date of sale. On the other hand, loan loss provisions had to be increased for the shipping loans remaining at the Bank. Through these especially high valuation adjustments HSH Nordbank has taken particular account of a further significant deterioration in the market conditions in the shipping industry, in particular the weak charter rate trend for container ships and bulkers. Furthermore, HSH Nordbank has been able to make significant reductions in the legacy portfolio of troubled assets in the past year – even over and above the portfolio sales provided for in the informal agreement.

In contrast, the risk trend in other business sectors of HSH Nordbank remained largely insignificant. Net reversals of loan loss provisions were recognised in total for the Corporate Clients division loan portfolio.

Expenses for valuation adjustments and direct write-downs, not taking the transaction portfolios into account, amounted in total to € –1,436 million. Comprehensive portfolio valuation allowances were accounted for here. They were created in order to reflect the risks arising from the very challenging environment, particularly in the shipping markets, and take account of the new standards to be applied to the shipping industry.

The guarantee is technically split into a financial guarantee and a credit derivative for the compensation of loan loss provisions. The guarantee is essentially accounted for as a financial guarantee. This implies in particular that the commitments can be declared due as at the planned date of sale. This is not possible at the planned transfer dates for all commitments included in the portfolio transactions due to, inter alia, the ongoing restructuring agreements. The hedging effect of the guarantee in particular for these portfolios is therefore accounted as a credit derivative.

Loan loss provisions for commitments hedged by the financial guarantee are largely compensated for in the reporting year by the compensation item disclosed under loan loss provisions (income statement effect: € 2,666 million including currency translation gains or losses), apart from certain losses not caused by credit ratings in the market portfolio determined based on an estimate.

In contrast, the compensation effect for the commitments hedged under the credit derivative is accounted for in a separate line item Hedging effect of the credit derivative second loss guarantee (compensation effect: € 658 million).

At the same time, the reduction in guarantee fees provided for under the informal agreement was included in the compensation effect of the guarantee in loan loss provisions. This is due to the fact that it has become unlikely that, in light of the binding statement given by the federal states of Hamburg and Schleswig-Holstein to implement the informal agreement, payment of the additional premium and base premiums on the utilised portion of the guarantee will be claimed from HSH Nordbank, apart from payments still to be expected after the formal decision of the EU Commission (one-off payment and provision of liquidity to the holding company in a total amount of € 260 million). The release to income of future guarantee premium obligations offset by the cancellation of the debt waiver and recognition as an expense resulted in a total reduction of € 665 million in loan loss provision expense (of which € 11 million were accounted for in Net interest income). As a result, loan loss provisions of € –354 million compared to € 576 million in the previous year were disclosed after taking the hedging effect of the guarantee into account. Including the hedging effect of the credit derivative total loan loss provisions amounted to a positive value of € 304 million (previous year: € 577 million).

Adverse impact of bank levy, deposit guarantee scheme and current base premium

The expenses for the European bank levy and the contribution to the deposit guarantee scheme in the total amount of € –50 million compared to € -1 million in the previous year, had a clearly more negative impact.

The relief provided by the guarantee continued to be partially offset in 2015 by high premium expense for the guarantee. Net income of HSH Nordbank was adversely impacted by the base premium of € –473 million (previous year: € –521 million) payable for the guarantee facility provided. The planned reduction in the base premium to be paid by the operating company in the future should gradually lead to a significantly lower charge to income from 2016 onwards.

Net income of Core Bank dominated by effect of the recognition of the structural measures and operating successes

The Core Bank disclosed a significant increase in net income before taxes to € 397 million as at the 2015 year end (previous year: € –120 million), which is characterised by an overall satisfactory development of the operative business (apart from the Shipping division) as well as the implementation of the informal agreement.

The significant increase in total income of the Core Bank from € 590 million to € 995 million, as forecast in the previous year, reflected, on the one hand, the positive income impact of new business of € 8.8 billion transacted with clients, which was only slightly below the high level of the previous year (€ 9.5 billion) due to the particular challenges faced and the targeted restriction imposed on new business, particularly new shipping transactions, in the past year and, on the other, the increase in the positive effect of the revaluation of hybrid instruments with a total amount of € 214 million. The positive income effects were offset by the negative impact of higher loan principal repayments and write-offs relating to equity holdings. Winding down measures for restructuring loans also had a negative impact in the reporting year.

The item loan loss provisions in the Core Bank amounted to € –217 million at the end of 2015 compared to € –65 million in the previous year. This includes, to the extent allocated to the Core Bank, the effects recognised in loan loss provisions under the informal agreement (in particular the reversal of guarantee premiums and cancellation of debt waiver, calculation of risk provisions with changed commitment strategies taking the market values of the portfolios to be transferred as at the planned date of the sale into account), which in total had a significantly positive impact of € 143 million on the Core Bank (of which € 3 million in Net interest income). The risk trend in the corporate and real estate clients portfolios remained largely insignificant. Loan loss provisions recognised in previous periods were released on a net basis in some cases.

Net income of the Restructuring Unit reflects structural measures and reduction in the portfolio

Net income before taxes of the Restructuring Unit for the past year, including consolidation effects, amounted to € 53 million (previous year: € 398 million). This includes effects of € 522 million (of which € 8 million in Net interest income) resulting from the implementation of the informal agreement (in particular reversal of guarantee premiums and cancellation of debt waiver).

Additional loan loss provision expense for shipping loans held in the Restructuring Unit which were caused by the significant deterioration in market conditions in the shipping industry sector were largely compensated for under the guarantee. Overall, loan loss provisions in the Restructuring Unit were significantly higher in 2015 than in the previous year due to the sharp increase in impairment losses relating to the recognition of the portfolio transactions provided for under the informal agreement. A reduction was planned compared to the previous year, which was characterised by a high debt waiver amount. Total income also decreased due to the significant winding down of the portfolio in the reporting year.

Further details on the reasons underlying the business performance are set out in the earnings, net assets and financial position and segment reporting sections.

EARNINGS SITUATION

INCOME STATEMENT

(€ m)	**2015**	2014	Change in %
Interest income	4,397	5,138	– 14
Interest expense for investments and derivatives	– 55	– 19	> 100
Interest expense	– 3,443	– 4,332	– 21
Interest income from investments and derivatives	29	6	> 100
Net income from hybrid financial instruments	104	– 207	> 100
Net interest income	**1,032**	**586**	**76**
Net commission income	114	130	– 12
Result from hedging	12	– 40	> 100
Net trading income	84	61	38
Net income from financial investments	54	169	– 68
Net income from financial investments accounted for under the equity method	–	2	– 100
Total income	**1,296**	**908**	**43**
Loan loss provisions	– 354	576	> 100
Hedging effect of credit derivative second loss guarantee	658	1	> 100
Administrative expenses	– 634	– 724	– 12
Other operating income	38	123	– 69
Expenses for bank levy and deposit guarantee fund	– 50	– 1	> 100
Net income before restructuring	**954**	**883**	**8**
Result from restructuring	– 31	– 84	63
Expenses for government guarantees	– 473	– 521	– 9
Net income before taxes	**450**	**278**	**62**
Income taxes	– 352	– 118	> 100
Group net result	**98**	**160**	**– 39**
Group net result attributable to non-controlling interests	– 1	1	>– 100
Group net result attributable to HSH Nordbank shareholders	99	159	– 38

Significant increase in total income

Total income for the past year increased above plan to € 1,296 million compared to € 908 million in the previous year.

Total income for the reporting year was primarily driven by net interest income, which increased sharply to € 1,032 million compared to € 586 million in the previous year. New business concluded at mostly stable margins and loan prolongations had a positive effect. An increase in new business margins in the shipping sector was offset by a reduction in the highly competitive corporate clients business. Margins remained stable in the real estate clients sector compared to the previous year. The positive income effects generated by client business were partially offset by the increased winding down of the Restructuring Unit portfolio, higher loan principal repayments as well as the increase in the impaired loan volume and associated negative impact on the interest-bearing loan volume.

The results of the Bank's planning and impact of the informal agreement and formal decision on this planning resulted in the cancellation of two coupon payments as a result of the remeasurement of hybrid financial instruments. The change made in the estimates of future coupon and principal payments against this backdrop resulted in a positive effect of € 214 million in the result from hybrid financial instruments.

Other exceptional items, which contributed to the increase in net interest income, include, inter alia, the effect of the adjustment to the effective interest rate applied to hybrid instruments that was made in the previous year in accordance with the contractual terms, which had an adverse impact on the results for the previous year (€ -84 million). A one-off hedge accounting effect relating to interest rate movements over the past year was also recognised in 2015. This resulted in net interest income of € +49 million. This was offset by a corresponding charge of € -8 million recognised in net trading income. Lastly, HSH Nordbank received a distribution of € 19 million from an equity holding.

Net commission income amounted to € 114 million as at 31 December 2015 compared to € 130 million as at the previous year end. This decrease is in line with the plan and is primarily attributable to lower restructuring fees in the Restructuring Unit associated with the significant portfolio reduction. Cross-selling of services in connection with new business in addition to loan financing had a positive impact.

The following items had a significant positive impact on net trading income (€ 84 million compared to € 61 million in the previous year: Measurement results recognised on EUR/USD basis swaps (€ 52 million) and increases in the value of debt instruments (€ 20 million) had a positive impact. Net operating trading income includes in particular operating successes generated in the client business and amounted to € 95 million. Net trading income was adversely impacted by € -79 million of foreign exchange rate effects. Net trading income was also negatively impacted by valuation adjustments of € -36 million, particularly for funding costs and benefits for OTC derivatives (funding valuation adjustments).

As expected, net income from financial investments of € 54 million for the past year fell significantly short of the net income of € 169 million for the previous year, which benefited more strongly from reversals of impairment losses and gains on disposals. Write-downs of equity holdings had an adverse impact in the 2015 reporting year. Losses incurred on the sale of positions in the credit investment portfolio (CIP) that were carried out to further reduce the high-risk portfolios over and above the reduction provided for under the guarantee agreement whilst maximising value and could not be invoiced under the guarantee also had to be taken into account. This was offset by measurement effects in the CIP, which resulted in an overall net loss from CIP financial investments of € -22 million.

The sale and measurement of other securities portfolios had a positive income effect of € 78 million on net income from financial investments. The gain on disposal in the amount of € 39 million included in this amount was offset by the interest effect arising from the reversal of hedge adjustments of € -26 million.

HSH Nordbank continued to measure the securities portfolio of Heta Asset Resolution AG (HETA) at current market value as at the balance sheet date. This resulted in a write-up of € 20 million being recognised in Net income from financial investments as at 31 December 2015. Due to the hedging of transactions under the second loss guarantee, this write-up was offset by the recognition of an expense in the equivalent amount resulting from a corresponding reduction in the hedging effect of the second loss guarantee in loan loss provisions.

Loan loss provision expense includes the effect of the transaction portfolios and reversal of guarantee premiums

Loan loss provisions are mainly characterised by the impact of the changed commitment strategies taking market values as at the planned date of sale of the transaction portfolios into account, loan loss provisions recognised on the Bank's remaining shipping loan portfolio as well as the reversal of the guarantee premiums except for the payments to be expected after the formal decision of the EU Commission (one-off payment and provision of liquidity to the holding company) and cancellation of the debt waiver.

Loan loss provision expense amounted in total to € -3,020 million before taking the compensation effects under the guarantee and reversal of the guarantee premiums into account. This includes high loan loss provisions of € -1,584 million recognised as a result of the changed commitment strategies that take account of market values as at the planned date of sale of the portfolios to be transferred to the federal states agency (shipping loans) or sold in the market (shipping, real estate and energy loans).

Furthermore, loan loss provisions had to be increased much more than planned for shipping loans not included in the transaction portfolios.

The continued gloomy market situation and worsened outlook in shipping was taken into account by HSH Nordbank through the higher loan loss provisions for shipping loans. The additional loan loss provision expense for legacy shipping portfolios was mainly accounted for by loans for bulkers and container ships due to the weak charter rate trends in these ship segments. The other loan portfolios of the Bank continued to develop comparatively unremarkable Net reversals of loan loss provisions were recognised in total for the Corporate Clients loan portfolio.

Expenses for valuation adjustments and direct write-downs, not taking the transaction portfolios into account, amounted in total to € -1,436 million. These include expenses of € -308 million for comprehensive portfolio valuation allowances. They were created in order to reflect the risks arising from the very challenging environment, particularly in the shipping markets, and take account of the new standards to be applied to the shipping industry.

The loan loss provisions recognised in particular for the legacy shipping portfolios and the additional loan loss provisions recognised due to the changed commitment strategies that take account of market values as at the planned date of sale for the transaction portfolios were largely compensated for by the guarantee. Gross compensation for the financial guarantee amounted to € 2,666 million after taking currency translation gains and losses into account. The compensation effect resulting from the fair value measurement of the credit derivative amounted to € 658 million.

The relief provided to the Bank from the adverse impact of guarantee fees had a positive effect of € 654 million on loan loss provisions (an additional € 11 million is disclosed in Net interest income) and comprises the reversal of future guarantee premiums (€ 1,695 million) through profit or loss with the exception of payments still expected to be made under the formal decision of the EU Commission (one-off payment of € 210 million and provision of liquidity of € 50 million to the holding company) offset by the reversal of the debt waiver through profit or loss (€ -781 million).

HSH Nordbank disclosed total loan loss provision expense as at the 2015 year end of € -354 million (previous year: € 576 million), taking the hedging effect of the financial guarantee into account. Including the hedging effect of the credit derivative loan loss provision income would amount to a positive value of € 304 million which would be higher than planned.

LOAN LOSS PROVISIONS BEFORE AND AFTER EFFECT OF THE GUARANTEE

(€ m)	**2015**	2014
Loan loss provisions before currency translation and compensation (net), of which:	**– 3,020**	**– 486**
Core Bank	**– 1,901**	**– 461**
Shipping (including recovery unit)	– 1,511	– 402
Real Estate Clients	–	– 1
Corporates	51	– 57
Other	– 441	– 1
Restructuring Unit	**– 1,119**	**– 25**
Shipping loans	– 1,037	– 187
Real estate loans	– 64	138
Corporate loans	63	13
Other	– 81	11
Loan loss provisions before currency translation and compensation (net) incl. credit derivative, of which	**304**	**577**
Core Bank	65	– 64
Restructuring Unit	239	641

The hedging effect of the guarantee has still not given rise to a cash drawdown of the guarantors as at the 2015 year end. The Bank's first loss piece (€ 3.2 billion) was utilised by actual payment defaults in the amount of € 2.2 billion as at the reporting date (losses submitted for settlement). In view of the expected losses arising from the agreed portfolio sales to the federal states and in the market the payment defaults in the portfolio covered by the second loss guarantee will increase in 2016 to above the Bank's first loss piece of € 3.2 billion and then result in actual payments by the guarantors under the guarantee.

The expected actual payments under the guarantee are offset by the significant fees already paid in recent years for the guarantee, through which HSH Nordbank made a high contribution to compensating the federal states of Hamburg and Schleswig-Holstein for the state aid granted.

Base premiums recognised through profit or loss by HSH Nordbank and payable to the guarantors (excluding the one-off payment of € 0.5 billion) have increased to € 2.7 billion as at the 2015 year end (current base premium plus subsequent base premium payment for the replenishment of the guarantee facility in the middle of 2013).

Administration expenses significantly reduced by cost saving measures

Administrative expenses decreased above plan to € –634 million (previous year: € –724 million). This reflects the cost savings successes achieved under the ongoing cost reduction programme.

Personnel expenses, which decreased from € -296 million to € –277 million, were mainly affected by the number of employees that was reduced even further, according to plan. Compared to the end of 2014, the number of employees within the Group declined by 195 to 2,384 (computed on a full-time equivalent (FTE) basis).

Operating expenses (excluding depreciation/amortisation) decreased to € –302 million compared to € -303 million in the previous year. An increase was avoided despite higher costs incurred in connection with changes in supervisory and accounting-related requirements, including for IFRS 9 (Financial Instruments) and SREP. Savings were achieved in particular by reducing building costs. Costs for the ECB special audit were also recognised in the same period in the previous year.

Depreciation of property, plant and equipment and amortisation of intangible assets decreased to € –55 million compared to € –125 million in the previous year. This was mainly attributable to significantly lower special depreciation allowances recognised for subsidiaries in connection with the scope of consolidation extended by IFRS 10 since 2014. Depreciation/amortisation for the IT area also decreased.

Result from restructuring decreased to € –31 million (previous year: € –84 million), as personnel expenses relating to the reduction in headcount under the current cost reduction programme were recognised in the previous year.

Changes in the scope of consolidation and winding down measures included in other operating income

Other operating income amounted to € 38 million (previous year: € 123 million). It benefited from total income of € 33 million arising on the deconsolidation of subsidiaries (mainly K/S Angered, Copenhagen; LCG Finance, Luxembourg), offset by the expense recognised on the complete write-off of the goodwill in the amount of € –13 million arising on the first-time consolidation of a company in the Group financial statements (GmbH Altstadt Grundstücksgesellschaft, Mainz). Furthermore, other operating income includes charges arising from the accelerated winding-down of legacy loans in different asset classes (particularly real estate, shipping and energy loans). Details regarding the winding-down measures can be found in the Business developments section.

Expenses for bank levy and deposit guarantee fund

Expenses relating to the payment of the European bank levy of € 36 million had to be recognised in 2015. The contribution to the deposit guarantee scheme of the German Savings Banks Finance Group amounted to € 14 million. These items are recorded separately in the Expenses for the bank levy and deposit guarantee scheme line item.

High base premium expense

An expense of € –473 million (previous year: € –521 million) was incurred last year for the base premium for the second loss guarantee. The reduction in the base premium expense compared to the previous year is attributable to a lower amount of the subsequent payment of the base premium in connection with the replenishment of the guarantee facility in the middle of 2013 being recognised through profit or loss according to plan.

Positive Group net income after recognising the effect of the structural measures

Overall, HSH Nordbank generated positive net income before income taxes of € 450 million in the year 2015 after taking account of the effect of the informal agreement and the corresponding specification in the EU proceedings as well as operating developments, which was significantly above plan (previous year: € 278 million). After deducting tax effects there remains Group net income of € 98 million (previous year: € 160 million).

The return on equity for the Group calculated on the basis of net income before income taxes is 9% (previous year: 6%). The cost-income ratio improved to an above plan 48% due to the reduction in administrative expenses and a higher level of total income (previous year: 70%).

The income taxes line item includes deferred income tax expense of € –339 million, which is mainly attributable to the reversal of deferred tax assets in connection with the informal agreement. This relates in particular to reversals of deferred taxes on loss carryforwards due to the planned change in shareholders on the formation of the holding structure as well as reversals due to the reduction in temporary differences as a result of the reversal of the future guarantee premium obligations. Total tax expense after taking account of current taxes amounted to € –352 million (previous year: € –118 million).

NET ASSETS AND FINANCIAL POSITION

MATERIAL ITEMS ON THE STATEMENT OF FINANCIAL POSITION

(€ m)	2015	2014	Change in %
Assets			
Cash reserve	3,394	5,967	– 43
Loans and advances to banks	5,595	6,915	– 19
Loans and advances to customers	56,575	67,336	– 16
Loan loss provisions	– 1,065	– 2,061	– 48
Credit derivative under the second loss guarantee	663	3	>100
Trading assets	7,356	9,160	– 20
Financial investments	16,636	18,688	– 11
Non-current assets held for sale and disposal groups	5,082	34	>100
Other assets	2,737	4,040	– 32
Total assets	**96,973**	**110,082**	**– 12**
Liabilities			
Liabilities to banks	14,398	14,547	– 1
Liabilities to customers	44,567	43,165	3
Securitised liabilities	18,616	27,634	– 33
Trading liabilities	6,758	9,246	– 27
Liabilities relating to disposal groups	1	–	> 100
Subordinated capital	3,452	5,507	– 37
Equity	4,885	4,672	5
Other liabilities	4,296	5,311	– 19
Total equity and liabilities	**96,973**	**110,082**	**– 12**

Decrease in total assets

Total assets decreased significantly in the 2015 financial year to € 96,973 million (31 December 2014: € 110,082 million). What was decisive in this context was the accelerated reduction in risk positions in particular in the Restructuring Unit.

Key balance sheet items on the asset side decreased against this backdrop. Loans and advances to banks decreased to € 5,595 million (31 December 2014: € 6,915 million), primarily as a result of lower call deposits held at other banks. Loans and advances to customers also declined sharply to € 56,575 million (31 December 2014: € 67,336 million). Part of this decrease stems from the reclassification of loan portfolios intended for sale to the federal states agency into the Assets held for sale and disposal groups balance sheet line item. The increased winding down in the Restructuring Unit and loan principal repayments in the client divisions also reduced the loans and advances outstanding. These decreases exceeded the effect of the new business transacted in the past year.

Total loan loss provisions (after compensation effects) decreased significantly to € -1,065 million (31 December 2014: € -2,061 million). Obligations under the additional premium recognised in the past in the compensation item and the debt waiver of the guarantors with the exception of payments still expected to be made under the formal decision of the EU Commission (one-off payment of € 210 million and provision of liquidity of € 50 million to the holding company) were reversed on the basis of the informal agreement reached with the EU Commission in October 2015 and the existing binding commitment of the federal states to implement the informal agreement. This resulted on balance in a significant increase in the compensation item. Excluding the compensation total loan loss provisions increased to € 8,227 million (31 December 2014: € 6,135 million). The hedging effect for the portions of the loan portfolio that fall under the credit derivative is disclosed in a new balance sheet line item Credit derivative second loss guarantee.

Financial investments decreased to € 16,636 million (31 December 2014: € 18,688 million). The winding down of securities portfolios, in particular the credit investment portfolio, had a noticeable impact in this regard.

Liabilities to banks decreased slightly to € 14,398 million (31 December 2014: € 14,547 million). Whereas call deposits placed by other banks decreased, time deposits and securities repurchase agreements increased. Liabilities to customers increased to € 44,567 million (31 December 2014: € 43,165 million). This reflected in particular higher term deposits from institutional investors. Securitised liabilities amounted to € 18,616 million (31 December 2014: € 27,634 million). The expiry of the guarantor guarantee obligation and associated maturities made a significant contribution to this reduction.

Subordinated capital decreased significantly to € 3,452 million (31 December 2014: € 5,507 million). Maturities during the course of 2015 were the main reason for this. Reported equity capital increased to € 4,885 million (31 December 2014: € 4,672 million), which was mainly attributable to the Group retained earnings disclosed.

Due to declining total assets, business volume decreased to € 106,176 million (31 December 2014: € 119,879 million). Irrevocable loan commitments of € 6,370 million were also lower than at the previous year end (31 December 2014: € 7,081 million). However, sureties and guarantees of € 2,833 million were slightly below the previous year’s level (31 December 2014: € 2,716 million).

STRUCTURE OF LIABILITIES BY FINANCIAL INSTRUMENTS

(€ m)	31.12.2015		31.12.2014	
	Total	**of which > 1 year**	Total	of which > 1 year
Secured: Covered bonds and asset-based funding	17,161	14,415	16,312	14,301
Covered bonds	10,653	8,887	10,782	9,558
Other secured funding	6,508	5,528	5,530	4,743
Unsecured liabilities	40,068	1,596	33,453	1,667
Unsecured (senior unsecured)	19,746	16,446	34,953	18,150
Profit participation certificates and other subordinated liabilities	2,122	2,105	4,155	2,100
Silent participations	1,936	1,936	1,980	1,980
Total	**81,033**	**36,498**	**90,853**	**38,198**

The above table breaks down HSH Nordbank's liabilities by financial instrument and thereby takes into account the requirements of capital markets participants. Liabilities with a maturity of more than one year are separately shown. The financial instruments may be reconciled to the balance sheet line items liabilities to customers, liabilities to banks, securitised liabilities and subordinated capital. The carrying amounts of financial instruments excluding principal repayments and accrued interest are assigned to maturity bands in the above table.

One focus within the framework of long-term liabilities are securitised debt instruments (covered bonds, asset-based funding). These mainly include debt instruments issued under Pfandbrief programmes (mortgage, public sector and ship Pfandbrief programmes) as well as other asset-based funding issues, repo transactions and deposits from development banks. The total amount of secured debt instruments outstanding was € 17.2 billion as at the year end.

Unsecured liabilities include call and time deposits comprising mainly client deposits, bearer and registered bonds and other unsecured financing instruments and amounted to € 40.1 billion as at the reporting date. Call and time deposits account for most of the client deposits. The volume of bearer and registered bonds (senior unsecured) amounted to € 19.7 billion as at the 2015 year end.

The two line items Profit participation certificates and other subordinated liabilities (€ 2.1 billion) as well as Silent participations (€ 1.9 billion) in total represent subordinated capital. Of the Silent participations € 606 million is disclosed for hybrid financial instruments (Resparc I and Resparc II) under the Securitised liabilities balance sheet line item.

Capital and funding

REGULATORY CAPITAL RATIOS
(SAME PERIOD CALCULATION)

(%)	**31.12.2015**	31.12.2014
Total capital ratio	20.6	18.7
Tier 1 capital ratio	16.4	14.4
CET1 ratio	12.3	10.0 (+ 2.6 pp)
CET1 ratio (full implementation of Basel III)	11.6	10.0 (+ 1.3 pp)
Leverage ratio	6.3	4.8

ELIGIBLE CAPITAL
(SAME PERIOD CALCULATION)

(€ bn)	**31.12.2015**	31.12.2014
Regulatory capital	7.7	7.4
of which: Tier 1 capital	6.1	5.7
of which: CET1 capital	4.6	4.0
of which: additional Tier 1 capital	1.5	1.7
of which: supplementary capital	1.6	1.7
Risk assets (RWA)	37.4	39.5
of which: risk assets counterparty default risk	26.8	30.8
Leverage exposure	97.6	117.8

CET1 ratio increases significantly to 12.3% after taking into account the effect of the informal agreement

The CET 1 ratio (under the Basel III transitional arrangement, phase-in) improved to 12.3% as at 31 December 2015 and therefore reached an adequate level as expected. This development compared to the previous year (10.0% plus a 2.6 percentage point buffer from the additional premium) comprises a lower RWA as part of the ongoing reduction in the portfolio as well as the net income for the year 2015. Net income for the year also includes income arising from the reversal of obligations for the additional premium payable to the guarantors and future expected obligations for guarantee premiums (except for the expected one-off payment and liquidity backing of the holding company). The reversal of additional premiums under the debt waiver of the guarantors if the CET 1 ratio falls below 10% was presented in past reporting periods as the so-called "additional premium buffer" with regard to the capital ratio.

Even under the assumption of full implementation of the Basel III rules (fully loaded) HSH Nordbank's CET1 ratio amounted to an adequate 11.6%.

As part of the supervisory process in the Banking Union, HSH Nordbank was assigned an individual minimum ratio by the ECB that is reviewed annually in the SREP process. This ratio was adhered to at all times in the 2015 financial year.

RWA have decreased compared to 31 December 2014 by € 2.1 billion to € 37.4 billion. An increase due to new business transactions and the appreciation of the US dollar (EUR/USD 1.09 as at 31 December 2015 versus EUR/USD 1.21 as at 31 December 2014) is more than offset by the RWA reduction attributable to the significant reduction in the portfolio. In its previous year's plan the Bank had expected a slight increase in RWA compared to the previous year. The trend of HSH Nordbank's key risk parameters was largely stable.

The regulatory minimum risk weight of 20% is applied to the senior tranche of the second loss guarantee. About 0.3% has been calculated as the risk weight as at 31 December 2015 (previous year: 0.7%). This results in an additional guarantee buffer, which means that negative risk trends in the guaranteed portfolio do not have a material impact on the capital ratios, as long as the regulatory minimum risk weight for the senior tranche of the guarantee structure is below 20%.

HSH Nordbank's leverage ratio was 6.3% as at 31 December 2015 (31 December 2014: 4.8%). A statutory binding minimum leverage ratio value has not yet been defined.

Funding activities expanded

HSH Nordbank has successfully continued to drive its funding strategy forward as planned in the reporting period by using different sources of funding.

A further focus in the past year was the sale of bond products for the client business of the savings banks and other associations and financial institutions as well as the placement of bonds with institutional investors. The total volume of new uncovered bonds (senior unsecured) issued amounted to around € 3.3 billion (previous year € 4.5 billion).

The issuance of secured debt instruments continued to be a core focus of the Bank's refinancing mix. The sale of ship Pfandbriefe amounted to about € 1.3 billion, including a benchmark transaction with a volume of € 500 million. The Bank also placed two mortgage Pfandbriefe of € 500 million in each case on the capital markets and thereby extended the maturity spectrum of the benchmark bonds outstanding.

Asset-based funding (ABF) is a further important refinancing instrument for the Bank. Two large volume transactions were concluded in 2015 via the ABF platform: Castellum ABF in the amount of USD 360 million is secured by commercial real estate properties in the United Kingdom, Entrance in the amount of USD 415 million by real estate portfolios comprising properties in different European countries. At the beginning of 2016 the Bank concluded a further transaction in the amount of USD 200 million. A long-term infrastructure loan was used for the first time as collateral in this case. Furthermore, primary US dollar refinancing was strengthened by the conclusion of longer-term repo transactions.

The need for derivative foreign currency refinancing was reduced by the increase in primary US dollar refinancing. Nevertheless, HSH Nordbank made great efforts during the reporting year to further reduce the proportion of US dollar assets in the legacy portfolios on the balance sheet in order to lessen the impact of exchange rate changes on the Bank's liquidity resulting, inter alia, from the provision of collateral for currency derivatives. The liquidity position was strengthened by the winding-down measures and the reduction in the proportion of US dollar assets. Shipping, real estate and energy loans as well as the credit investment portfolio were the main focus of the additional winding-down measures. Restrictions were also placed on new US dollar business. Furthermore, the planned sales of portfolios totalling up to € 8.2 billion to the federal states and in the market will significantly ease funding requirements and future liquidity position in the future.

Besides the issuing activities, the level of deposits contributed to the implementation of the funding strategy. Total deposits amounted to € 35 billion as at 31 December 2015 (31 December 2014: € 31 billion). Furthermore, at the 2015 year end, the Bank held liquidity reserves in the form of credit balances at central banks in the total amount of € 2.7 billion and collateral eligible for refinancing at central banks in the amount of € 12.4 billion, which the Bank can access at any time.

The majority of the bonds covered by the guarantor liability (GL) matured in 2015 (€ 18 billion). There still remain GL bonds of € 3 billion, which mature over the coming years. Maturities of guarantor liability bonds in the past year were offset by the accelerated winding-down of the legacy portfolios, implementation of funding measures and surplus liquidity built up in previous periods.

The regulatory requirements concerning the liquidity ratios of HSH Nordbank have been complied with at all times in the reporting period despite the challenges presented by the increased volume of maturing liabilities covered by the guarantor liability and US dollar volatility. The measures stepped up in the year to date to reduce risk positions, thereby releasing liquidity, had a positive impact. As expected, the liquidity ratio as defined in the German Liquidity Regulation (LiqV) declined as at the year end to 1.89 (31 December 2014: 1.99), which was therefore within plan and significantly above the regulatory minimum requirements. The liquidity coverage ratio (LCR, short-term minimum liquidity ratio) reached 112% as at 31 December 2015 under the QIS (Basel framework), and therefore also is significantly above the minimum requirements.

Further information on liquidity and funding is set out in the Risk report section of this management report.

Changes in HSH's ratings were heavily influenced in the past year both by market-wide so-called bulk actions and bank-specific rating measures in the course of the EU proceedings. As expected, Moody's and Fitch concluded in the second quarter of 2015 the review of bank ratings in Europe, which was carried out against the backdrop of the adoption of the EU Bank Recovery and Resolution Directive (BRRD) and new methodological approaches. At Fitch, the rating action resulted in rating downgrades based on the assumption that there is a reduced probability of state support being provided for future restructurings, including German Landesbanks. HSH Nordbank's long-term rating was changed as a result of this action to investment grade rating BBB- with stable outlook. At Moody's, the Bank's investment grade rating of Baa3 benefited from an improved assessment of its individual financial strength in expectation of the implementation of the structural measures, which was able to balance the impact of the expected lower state influence on the rating.

As expected, the informal agreement reached with the EU Commission in October resulted in further rating changes. Both Moody's and Fitch assess the structural measures agreed as part of the agreement in principle reached between the EU Commission and HSH Nordbank's majority owners as positive and see it as a strengthening of the Bank's financial and risk profile. The agencies have differences in emphasis regarding the privatisation and or disposal requirement.

Moody's upgraded the long-term rating from "Baa3, negative" to "Baa3, developing". The revised outlook reflects both the structural improvements, which have to be analysed in detail according to Moody's, and the medium-term uncertainty surrounding the privatisation and/or disposal requirement. Fitch also assesses the structural measures agreed as positive. Notwithstanding this, the agency changed the outlook for the long-term rating from "BBB-, stable" to "BBB-, negative" and focuses in particular on the uncertainty regarding the future ownership structure.

At the end of January 2016, Moody's also carried out a rating action regarding the redefinition of the liability cascade under the revised Section 46f KWG that is applicable from 2017. For German banks this tended to improve deposit ratings and downgrade the senior unsecured ratings especially relevant for refinancing on the capital markets for some banks due to the subordination provided therein of senior bonds (financial instruments classified as senior unsecured) relative to deposits. Moody's confirmed both HSH Nordbank's deposit rating and senior unsecured rating at the current level of Baa3. HSH Nordbank's subordinated bonds were downgraded by a notch from B1 to B2 due to the high level of maturities in 2015.

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

FINAL ASSESSMENT OF HSH NORDBANK'S POSITION

The extensive structural relief provided for under the informal agreement with the EU Commission which in principle is confirmed and set out in detail within the context of the formal decision, should result in an improved financial and risk situation and create the basis for a long-term, viable structure and the privatisation of HSH Nordbank.

At the same time, HSH Nordbank was further strengthened by the operating successes achieved. Of particular note in this regard is the focused development of new business under difficult market conditions combined with the increase in product sales as well as the further winding down of high-risk legacy portfolios, although this was partly associated with significant charges to income. The cost reductions implemented and ongoing optimisation of processes and organisational structures are also contributing towards sustainable development. The fact that the Bank successfully coped with the large number of maturities of guarantor liability bonds at the 2015 year end is to be seen as positive.

HSH Nordbank's Group financial statements are significantly impacted by the recognition of the effects under the informal agreement. Irrespective of this, the results of the Core Bank show that the market successes and efficiency improvements achieved in the business divisions in the past year under demanding framework conditions (including deterioration in market conditions in the shipping industry, extensive maturities of guarantor liability bonds, EU proceedings) are having an impact on the divisions and HSH Nordbank is also on the right track concerning the operating business with the implementation of the business model.

The very difficult market conditions in the shipping industry, which required further additions to loan loss provisions for legacy portfolios, also within the framework of the intended portfolio transactions, nonetheless had an adverse impact in the reporting year. However, this was largely compensated for by the guarantee. Against this backdrop and because of the volatile movement in the US dollar HSH Nordbank deliberately placed restrictions on new shipping business in particular. Furthermore, subdued client demand and a difficult competitive environment in the German banking market were felt in the corporate clients business. Despite the difficult underlying conditions HSH Nordbank's new business was in total only slightly below the 2015 planned volume due to the pleasingly strong new business in the Real Estate Clients division.

HSH Nordbank assesses its performance in the past year as satisfactory overall taking into account the informal agreement reached with the EU Commission and operating progress achieved.

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

SEGMENT REPORTING

Net income of Core Bank dominated by the recognition of the effect of the structural measures and operating successes

The Core Bank, in which HSH Nordbank combines its strategic divisions, made progress in implementing its client-based strategy despite the partly very challenging environment and was therefore able to consolidate its position in the target markets.

As at 2015 year end, the Core Bank disclosed a clearly increased net income before taxes of € 397 million (previous year: € -120 million), which is characterised by a largely satisfactory operative trend – apart from Shipping – as well as to a considerable extent by the effects of the informal agreement, as is Group net income. This gives a return on equity for the Core Bank of 18%. The cost-income ratio of the Core Bank was 43%.

Total income of the Core Bank which increased to € 995 million (previous year: € 590 million) reflected, on the one hand, the positive income impact of new business of € 8.8 billion transacted with clients, which was slightly below the high level of the previous year (€ 9.5 billion) due to the particular challenges faced and the targeted restriction imposed on new business, particularly new shipping transactions, in the past year and, on the other hand, the one-off effect of the informal agreement reached with the EU Commission (remeasurement of the hybrid instruments as a result of the elimination of additional coupon payments on these instruments during the disposal period) and other exceptional items. The positive income effects were offset by the negative impact of higher loan principal repayments and write-offs relating to equity holdings. Winding down measures for restructuring loans also had a negative impact.

The Core Bank disclosed € -217 million for loan loss provisions for 2015 compared to € -65 million in the previous year. This includes, to the extent allocated to the Core Bank, the effects recognised in loan loss provisions under the informal agreement (reversal of guarantee premiums and cancellation of the debt waiver apart from the one-off payments and liquidity backing of the holding still to be expected after the formal decision of the EU Commission, changed commitment strategies that take account of the expected market values of the portfolios to be transferred as at the planned date of sale). In addition, the hedging effect of the credit derivative amounted to € 282 million (previous year: € 1 million).

Moreover, the Bank also adjusted the internal key for allocating the guarantee between the Core Bank and Restructuring Unit in the reporting year. The percentage of the first loss piece of the guarantee to be borne by the Core Bank and Restructuring Unit, respectively (Core Bank 23%, Restructuring Unit 77%) was determined this way. The first loss piece percentages were previously determined on the basis of the respective utilisation in the Core Bank and Restructuring Unit. This recent determination enables a more appropriate coverage of the troubled assets by the guarantee to be achieved than in previous periods. In the reporting year the adjustment resulted in a benefit of € 391 million for the Core Bank, which partially offsets the disadvantage suffered by the Core Bank in previous periods.

Furthermore, higher loan loss provision expense was recognised in the Core Bank's legacy portfolio of shipping loans assigned to the recovery unit in order to take account of the further deterioration in market conditions in the shipping industry. In contrast, the risk trend in the corporate and real estate client portfolios remained largely insignificant.

Against the backdrop of the business performance and movements in the USD exchange rate, total assets of the Core Bank amounted to € 70 billion as at 31 December 2015 (31 December 2014: € 76 billion). The increase attributable to new business was offset by scheduled and unscheduled loan principal repayments. The reduction in the surplus liquidity built up in connection with the maturities covered by the guarantor liability also contributed to the decrease.

Further information can be found in the explanatory comments on the individual segments.

SEGMENT OVERVIEW[1)]

(€ m) 2015		Shipping, Project & Real Estate Financing	Corporates & Markets	Corporate Center	Consoli-dation Core Bank	**Total Core Bank**	Restructuring Unit	Consoli-dation Restructuring Unit	**Total Restructuring Unit**
Total income	**2015**	**476**	**434**	**213**	**– 128**	**995**	**257**	**44**	**301**
	2014	476	431	– 111	– 206	590	324	– 6	318
Loan loss provisions (including credit derivative)	**2015**	– 1,511	51	– 403	1,928	65	– 1,119	1,358	239
	2014	– 403	– 56	63	332	– 64	– 25	666	641
Administrative expenses	**2015**	– 139	– 283	– 15	– 6	– 443	– 191	0	– 191
	2014	– 161	– 310	24	12	– 435	– 289	0	– 289
Net income before taxes	**2015**	**– 1,203**	**213**	**– 166**	**1,553**	**397**	**– 1,045**	**1,098**	**53**
	2014	– 84	95	– 36	– 95	– 120	104	294	398
Segment assets (€ bn)	**31.12. 2015**	24	26	17	3	70	22	5	27
	31.12. 2014	25	31	18	2	76	31	3	34

[1)] including hedging effect of credit derivative

SHIPPING, PROJECT & REAL ESTATE FINANCING SEGMENT

As at 31 December 2015, the Shipping, Project & Real Estate Financing segment included business conducted with shipping clients, including that under the responsibility of the shipping recovery unit in the Core Bank, business with real estate clients as well as the Corporate Finance product division, which provides support to the customer divisions in the form of special financing and advisory solutions and within the framework of syndications.

SHIPPING, PROJECT & REAL ESTATE FINANCING SEGMENT

(€ m)		**Shipping, Project & Real Estate Financing**	Shipping	Real Estate Clients	Corporate Finance
Total income	**2015**	**476**	**240**	**228**	**8**
	2014	476	282	194	–
Loan loss provisions before currency translation gains or losses and compensation	**2015**	**– 1,511**	**– 1,511**	**–**	**–**
	2014	– 403	– 402	– 1	–
Administrative expenses	**2015**	**– 139**	**– 90**	**– 50**	**1**
	2014	– 161	– 111	– 50	–
Other operating income	**2015**	**– 29**	**– 31**	**2**	**–**
	2014	4	3	1	–
Net income before taxes	**2015**	**– 1,203**	**– 1,392**	**180**	**9**
	2014	– 84	– 228	144	–
Segment assets (€ bn)	**31.12.2015**	**24**	**13**	**11**	**–**
	31.12.2014	25	14	11	–

Good earnings trend in Shipping, Project & Real Estate Financing segment – Significant increase in loan loss provisions for shipping portfolio

The Shipping, Project & Real Estate Financing segment benefited from a significant expansion in new real estate clients business, which was reflected in an increase in the segment's net interest income. This resulted in a stable total income of € 476 million (previous year: € 476 million) despite a marked level of loan principal repayments by clients, winding down measures for restructuring loans and write-offs recognised for equity holdings.

The changed measurement of the transaction portfolios due to the revised commitment strategies that take account of expected market values at the planned date of sale and ongoing need to restructure loans in the Core Bank's shipping loan recovery unit (legacy portfolio) resulted at the same time in a strong increase in loan loss provisions to € -1,511 million (previous year: € –403 million) in the segment before the hedging effect of the guarantee, which is included in the Core Bank's consolidation item. Winding down measures undertaken in the recovery unit also had a negative impact. As a result, income before taxes of € -1,203 million of the Shipping, Project & Real Estate Financing segment was considerably lower than that of € -84 million for the previous year despite the operating successes achieved.

The increase in loan loss provisions in the shipping loan recovery unit in the Shipping division resulted in a significant decrease in net income before income taxes to € -1,392 million (previous year: € -228 million). Income was negatively impacted last year by the deliberate restrictions placed on new shipping business due to the ongoing very difficult market environment. The deliberately reduced new business volume of € 0.8 billion in 2015 was significantly below that of the previous year (€ 1.5 billion). The focus was on a further diversification of the portfolio through domestic and international commitments with counterparties of good credit standing.

Total earnings in the Real Estate Clients division was increased clearly to € 228 million. Earnings before taxes grew disproportionately to € 180 million compared to € 144 million in the same period of the previous year and therefore made the largest earnings contribution in this segment. This was driven by the large volume of new business in 2015, which increased to a higher than planned amount of € 4.5 billion (previous year: € 4.1 billion). In the past year the division benefited from its very strong market position as a major real estate financing partner in Germany and the favourable market environment. New clients have also contributed to the success such as transactions concluded with international institutional investors. The focus of the business activities continued to be the core region of Northern Germany and metropolitan regions in Western Germany.

The Corporate Finance product division, which has been assigned to the Shipping, Project & Real Estate Financing segment since the beginning of 2015, has successfully supported the client business in particular in the fields of M&A, capital structuring and loan syndication divisions and in total made a higher contribution to earnings than in the previous year. The Corporate Finance results are assigned for the most part to the client divisions under the bank management policy.

CORPORATES & MARKETS SEGMENT

As at 31 December 2015 the Corporates & Markets combined the corporates client business with the Logistics & Infrastructure, Energy & Utilities, Commerce & Food, Industry & Services, Healthcare and Wealth Management business fields as well as the Capital Markets division, which is responsible for the development, sale and trading of financial products and the servicing of savings banks, banks and insurance companies.

CORPORATES & MARKETS SEGMENT

(€ m)		Corporates & Markets	Capital Markets	Corporates
Total income	**2015**	**434**	**122**	**312**
	2014	431	88	343
Loan loss provisions before currency translation gains or losses and compensation	**2015**	**51**	**0**	**51**
	2014	– 56	1	– 57
Administrative expenses	**2015**	**– 283**	**– 137**	**– 146**
	2014	– 310	– 151	– 159
Other operating income	**2015**	**11**	**1**	**10**
	2014	30	0	30
Net income before taxes	**2015**	**213**	**– 14**	**227**
	2014	95	– 62	157
Segment assets (€ bn)	**31.12.2015**	**26**	**14**	**12**
	31.12.2014	31	18	13

Higher net income in Corporates & Markets segment benefits from operating successes and solid risk profile of corporate clients

The Corporates & Markets segment generated net income of € 213 million in 2015 compared to € 95 million in the previous year. Segment net income benefited from operating successes achieved on the income and cost side and net releases of loan loss provisions.

Overall, the Corporates division in its new structure established in the reporting year developed satisfactorily and its net income before taxes amounted to € 227 million (previous year: € 157 million). This includes total income of € 312 million (previous year: € 343 million), in which new business developments are reflected in particular. The amount of new business commitments of € 3.2 billion was below the high amount of € 3.9 billion in the previous year despite the sharp increase in business towards the end of the year, particularly in project financing. This reflected the strict risk and income requirements in a competitive environment and subdued corporate demand for financing due to the high level of own liquidity resources of companies. The cross-selling contribution made by the Corporates division was increased despite subdued new business. Transaction Banking products, instruments for hedging currency fluctuations as well as deposit products were particularly in demand. The continuing solid business situation of many clients was reflected in the loan loss provision income of € 51 million (previous year: € -57 million). The reversal of loan loss provisions for corporate clients more than offset charges recognised for legacy loans in the Energy & Utilities business field. In addition, the improved cost situation had a positive impact against the backdrop of the ongoing cost reduction programme.

The Logistics & Infrastructure business field concluded new business volume of € 0.7 billion despite intensive competition. This business field performed well, especially in the area of project financing in the railway vehicle sector, and was able to further consolidate its good market position. Furthermore, the portfolio was further diversified with project financing transactions concluded in the pipeline and communication infrastructure sectors both in Germany and other European countries.

The Energy & Utilities business field generated new business of € 1.1 billion with successful projects. The focus was on structured project financing in Germany and the rest of Europe and on financing arrangements for public utilities. 90% of the financing projects in the Energy division related to wind energy installations on land (onshore projects). Following the successful market entry into Finland in 2014 a larger share of the new project financing business was concluded there in 2015. The core market of Germany accounted for a further high share. Furthermore, the Bank succeeded in entering the markets in Sweden and Ireland which made a contribution to portfolio diversification. The Trade business field entered into new commitments in the international commodity trading and textile sectors in particular on the basis of its industry specialisation and successfully developed business with services specific to the business field (including documentary business, hedging of exchange rates). Renowned new customers were acquired throughout Germany in the Food Industry business field with the focus on foodstuffs trading and production. Together, the Trade and Food Industry business fields were able to secure new business worth € 0.4 billion.

Providing assistance in challenging structuring mandates was the focal point in the Industry & Services business field this year. These were concluded both with new and existing customers. In the Healthcare Industry business field new business was concluded throughout Germany, primarily in specialist and rehabilitation clinics, nursing homes and medical technology. New business volume of the Industry & Services and Healthcare business fields amounted in total to € 1.0 billion.

The Wealth Management business field made a contribution to division earnings with operating successes in the securities, deposit and lending businesses. Since 2015 HSH Nordbank has been cooperating with Metzler Asset Management GmbH in the area of asset management, through which it provides its wealth management and investment advisory clients with even more added value.

The Capital Markets division generated net income of € -14 million (previous year: € -62 million). This division continued to be adversely impacted by a high level of administrative expenses due to the existing structure. The increase in net income compared to the previous year reflected the successes achieved in the operating trading business with clients as well as in the new issue and client deposit business with savings banks and institutional clients. Sales of risk management products benefited from the volatile financial and currency markets but remained slightly below the previous year's level due to subdued client demand. Net income for the previous year benefited more strongly from the sales of financial investments than net income for 2015.

The reduction in assets of the Corporates & Markets segment is attributable to the reduction in the surplus liquidity built up in connection with the maturity of bonds covered by the guarantor liability.

CORPORATE CENTER SEGMENT

The net income of the Corporate Center segment, which includes the overall bank positions and administration and service divisions including Transaction Banking, amounted to € -166 million compared to € -36 million in the previous year. This was mainly attributable to the recognition of portfolio valuation allowances to take account of the risks arising in the overall very challenging market environment. This was offset by the positive impact of the remeasurement of hybrid instruments in the context of the results of the Bank's planning and the effects of the informal agreement as well as the formal decision on the Bank's planning. In the previous year net income from hybrid instruments was negatively impacted mainly by an exceptional item relating to an adjustment of the effective interest rate applied to hybrid instruments (€ -84 million).

Transaction Banking generated product net income of € 24 million in the financial year 2015, which was significantly above the previous year's level of € 13 million. The positive developments in the division are attributable to a more extensive use of products by customers, which overall resulted in a higher level of income from payment transactions, account management (including investment products) and foreign trade transactions. The division was thus able to make a tangible contribution to the Bank's cross-selling income. Under the Bank's business management policy net income of the Transaction Banking product division is disclosed in the customer divisions.

In 2015 a quality management system was implemented in the Transaction Banking division in accordance with DIN EN ISO 9001:2008. In this connection the back office processes for payment transactions and trade finance were certified with a very good result. The certification confirms a high process quality. It is intended to also extend the methods used in the quality management system selected to other units within the Bank. This would also support the stabilisation of HSH Nordbank's lean management programme.

NET INCOME FOR THE CORE BANK TAKES CONSOLIDATION EFFECTS INTO ACCOUNT

The significantly positive compensation effect for loan loss provisions under the second loss guarantee as well as the reversal of the additional premiums apart from payments still to be expected after the formal decision of the EU Commission (one-off payment and liquidity backing of the holding company) and cancellation of the debt waiver had an overall positive impact on the Core Bank's consolidation item. Net income was adversely impacted by measurement effects recognised in net trading income to the extent that these were not allocated to the business segments.

Furthermore, the positions Result from restructuring and Expenses for government guarantees not allocated to the operating business had an impact on the consolidation column. In total, net income before taxes of the consolidation item amounted to € 1,553 million (previous year: € -95 million). This resulted in total net income before taxes of € 397 million for the Core Bank (previous year: € -120 million).

RESTRUCTURING UNIT SEGMENT

The Restructuring Unit is responsible for winding down credit and capital market business that is not continued as core business of HSH Nordbank.

RESTRUCTURING UNIT SEGMENT

(€ m)

Total income	**2015**	**257**
	2014	324
Loan loss provisions before currency translation and compensation	**2015**	**– 1,119**
	2014	– 25
Administrative expenses	**2015**	**- 191**
	2014	– 289
Other operating income	**2015**	**8**
	2014	94
Net income before taxes	**2015**	**- 1,045**
	2014	104
Segment assets (€ bn)	**2015**	**22**
	2014	31

Accelerated reduction in risk positions

Further progress was made in the past year in implementing the winding down strategy of the Restructuring Unit. Total assets of the Restructuring Unit decreased in the 2015 reporting year by € 9 billion to € 22 billion (excluding consolidation items of € 5 billion) compared to € 31 billion as at 31 December 2014. Total assets therefore fell more than planned in the reporting year despite the movement in the US dollar.

Total assets of the Restructuring Unit were about € 83 billion after the Restructuring Unit was formed at the end of 2009. Since then reclassifications from the Core Bank totalling about € 8.1 billion that increased assets have been made in order to implement the winding down measures agreed at the time with the EU Commission and as part of the portfolio adjustments in the Core Bank.

Besides the reduction due to scheduled and early loan principal repayments active measures have contributed to the decrease, which were driven forward in a consciously intensified manner over the course of the year. A focus was on reducing the troubled assets denominated in US dollars against the backdrop of sharp fluctuations in the exchange rate. At the same time, additional liquidity was released as a result of the accelerated winding down in order to take account of the extensive maturities of bonds covered by the guarantor liability as at the 2015 year end.

The winding down measures taken in the year under review in part exceeded the loss-minimising winding down provided for under the guarantee agreement. In some cases, these winding down measures were associated with significant charges to the Bank's earnings.

Net segment income reflects the effect of the informal agreement, additional loan loss provisions for shipping loans and accelerated winding down of the portfolio

Net income for the Restructuring Unit segment (excluding the relieving effect of the consolidation items) amounted to € -1,045 million (previous year: € 104 million). On the one hand, this reflected additional loan loss provisions recognised due to the revised commitment strategies that take into account market values as at the planned date of sale for the portfolios to be transferred and sold to the federal states institution and in the market, respectively. On the other hand, loan loss provisions had to be increased for the shipping loans remaining at the Bank. In total, loan loss provision expense amounted to € -1.119 million at the 2015 year end (previous year € -25 million) before taking the compensation effects under the guarantee and reversal of the guarantee premiums into account.

With the higher than planned loan loss provisions HSH Nordbank took into account the further deterioration in market conditions in shipping, in particular the weak charter rate trend for container ships and bulkers. Furthermore, HSH Nordbank has been able to make significant adjustments in the legacy portfolio of troubled assets in the past year – even over and above the portfolio sales provided for in the informal agreement. These had an overall negative impact on income. Measurement effects relating to interest rate/currency swaps and increase in value in capital markets portfolios, especially in the credit investment portfolio, had an overall positive impact.

The significantly positive compensation effect for loan loss provisions under the second loss guarantee as well as the reversal of the future guarantee premiums apart from one-off payments still to be expected and the liquidity backing to be provided for the holding company after the formal decision of the EU Commission and cancellation of the debt waiver had an overall positive impact on the Restructuring Unit's consolidation item. Including the hedging effect of the credit derivative, the restructuring unit would have loan loss provision expenses of € -137 million at the 2015 year end (previous year: € 641 million). After taking restructuring and guarantee expenses into account, net income before taxes of the Restructuring Unit amounted to € 53 million (previous year: € 398 million).

Winding down of portfolio supported by active measures

The material loan portfolios of the Restructuring Unit (real estate loans, shipping loans, corporate loans/LBO loans and aircraft loans) were characterised by the following developments.

HSH Nordbank continued to pursue various approaches to accelerate the reduction in risk positions in the Restructuring Unit's shipping loan portfolio (segment volume as at 31 December 2015: € 5.3 billion). These include the implementation of alternative structured solutions in the portfolio (so-called Nautilus structures), for which there was considerable investor interest in the year under review. Six transactions of this kind totalling USD 1.3 billion were concluded in the first half of the year. Furthermore, HSH Nordbank is also actively supporting the consolidation that is underway in the shipping industry. Both approaches – portfolio solutions and sector consolidation – will continue to be pursued in 2016.

HSH Nordbank was able to significantly reduce the Restructuring Unit's real estate loan portfolio (segment volume: € 4.7 billion). The favourable market environment in the USA was exploited to further reduce the portfolio in the third quarter of 2015 over and above the ongoing loan principal repayments. The real estate loan portfolios were also sharply reduced in the United Kingdom, Nordic countries and the Netherlands.

Loan volume was reduced further to € 1.6 billion for corporate loans and the LBO business in light of an improved situation in most sectors – primarily by means of early repayment by other lenders.

Furthermore, the aircraft loan portfolio was also reduced further. This portfolio has been reduced by to € 1.4 billion since being transferred to the Restructuring Unit in 2011.

Positive fair value trend in capital markets portfolios

The capital markets portfolios consolidated in the Restructuring Unit (segment volume: € 9 billion) primarily include the public sector financing business consisting of the cover pool portfolios for Pfandbrief issues and the credit investment portfolio that mainly contains ABS structures.

The risk premiums on high-risk debt instruments held in the portfolio declined during the year. The public sector financing portfolio in particular benefited from this. Developments in the credit investment portfolio continued to be positive. At the same time, favourable market conditions were exploited to actively reduce the portfolio further. In addition to scheduled repayments a further significant decrease was achieved in the credit investment portfolio, which fell to € 2.3 billion as at the 2015 year end (2014: € 4.6 billion).