FORECAST, OPPORTUNITIES AND RISKS REPORT

FORECAST REPORT INCLUDING OPPORTUNITIES AND RISKS

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

The estimates regarding the long-term trend in loan loss provisions as well as the planning for payment defaults and, consequently, the actual drawdown of the second loss guarantee are subject to significant uncertainty due to the very long planning horizon, which can influence the future development of the Bank to a greater degree than expected. Significant uncertainty factors result, for example, from the movement in key market parameters such as freight and charter rates, second hand prices as well as the US dollar exchange rate. A key driver of the amount of loan loss provisions is also the breakdown of impaired loan commitments into "capable of recovery" (and therefore recognition of an individual valuation allowance based on the assumption of the continuation of the borrower's business) or "not capable of recovery" (and therefore recognition of an individual valuation allowance based on the assumption of a workout). The estimates concerning long-term loan loss provisions are based on the assumption of a recovery in the shipping markets and/or a significant recovery in the container shipping industry as well as the continuation in general of the current recovery strategy and therefore the assumption of HSH Nordbank's willingness to continue to finance problem loans remaining after the planned transactions have been executed in order to achieve the planned significant reversals of impairment losses in the future.

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

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

The following forecast relates solely to HSH Nordbank's future operating company following the legal separation of the present HSH Nordbank into an operating company and holding company provided for under the informal agreement and the formal decision of the EU Commission which is based on the informal agreement, if nothing to the contrary is expressly stated below. The purpose of this separation is to relieve HSH Nordbank from the additional premium obligations, the obligation to pay base premiums on the drawn down portions of the guarantee and the base premium payable for the undrawn portions of the guarantee from 2016 onwards. Corresponding obligations are to be assumed by the holding company. Furthermore, the operating company is to be relieved of mainly non-performing loan portfolios in the amount of up to € 8.2 billion by corresponding transfers to a workout institution of the federal states of Hamburg and Schleswig-Holstein and by sales in the market.

ANTICIPATED UNDERLYING CONDITIONS

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

Slow economic growth expected

Global economic growth is likely to slow down over 2016 as a whole compared to the previous year. HSH Nordbank expects growth both in emerging countries and industrial nations to be weaker. In this context the Bank expects the growth rate in the USA to be higher than that in the eurozone.

The financial markets showed a volatile trend at the beginning of 2016: Equity markets fell sharply, safe investments such as US Treasuries and German government bonds benefited by massive inflows and risk premiums temporarily increased strongly. The oil price continued its downward trend at the beginning of the year and has recovered since then to an overall low level. This seems to suggest that a global recession has been increasingly factored in. Although HSH Nordbank considers this scenario to be too pessimistic, it should be noted that the downside risks have increased on at times weaker US economic data and greater economic weakness in emerging countries. The gloomy outlook has also been reflected in higher risk premiums for debt instruments of European banks since the beginning of 2016.

The US Federal Reserve Bank has indicated that it wants to increase the key interest rate several times in 2016, if the US economy recovers further. However, there is a case for a path of very gradual interest rate hikes in view of the global growth risks. The ECB again agreed a comprehensive package of monetary measures, which includes interest rate cuts, an increase in the monthly volume of bond purchases, extension of the purchase programme to corporate bonds and a new round of long-term tenders. The objective of the new quantitative easing steps is to counteract the declining inflation expectations.

Additional ECB measures cannot be excluded if the downside risks for inflation increase.

Yields on long-term US and European government bonds should slightly increase in the wake of the economic recovery and as a result of a moderate increase in inflation and expected increases in the US key interest rate. However, on balance, an overall low level of interest rates is also to be expected over the coming years. The Bank has accordingly taken this into account in the planning period.

The US dollar should continue to be strongly influenced by central bank policy as well could therefore be subject to larger fluctuations. HSH Nordbank's plans for 2016 and the subsequent years of the planning horizon until 2018 are based on an exchange rate of EUR/USD 1.10.

Macroeconomic risks arise, inter alia, from the interest rate hikes to be expected in the USA and associated dangers for financial market stability, uncertainty regarding the growth path of the global economy, from a stronger than expected slowdown in growth in emerging countries, particularly in China, geopolitical conflicts in the Middle East as well as the negative impacts of an oil price that continues its downward trend. There are also risks in the near future relating to the referendum that takes place on 23 June 2016 on whether Great Britain remains in or leaves the European Union (EU). The so-called "Brexit" could lead in particular to a slowdown in growth and turbulence on the financial markets. In its base scenario, the Bank assumes that Great Britain remains in the EU, particularly because of the incalculable consequences of a Brexit.

Outlook for relevant markets

In view of the overall weak developments in the shipping markets over the past year the future outlook has also become much gloomier.

A significant acceleration in demand for container ships in 2016 compared to the previous year cannot be expected given the very difficult global economic environment, whereas the supply side is likely to grow in 2016 as well, as orders have been placed for many large and very large container ships. As a result, charter rates and ship values should at best recover over the course of 2016 from their very low levels at the end of 2015, but in annual average remain below the level of the previous year.

The weak demand trend for bulkers is also expected to continue, with stagnating or falling imports of iron ore and coal into China being likely to have an adverse effect. The contribution of India should be minor as well, as its policy is likely to increasingly rely on domestic raw materials. However, the supply of tonnage should again increase faster than demand due to the upcoming ship deliveries. As a result, it can be expected that charter rates and ship values will stagnate at the low levels of 2015 in the course of the year 2016.

The oil tanker market will cool down compared to the very favourable market situation at the 2015 year end. For the demand for oil tankers a growth rate above its long-term historical averages is also expected in 2016 that should be lower than in the previous year, however. Demand was driven in 2015 by many one-off effects such as storage, which are not likely to be repeated in the same way. The sharp fall in the oil price should hardly have any impact on demand in the oil tanker market in 2016. The market situation resulted at the same time in many new orders, some of which will already be delivered in 2016. As a result, supply should grow faster than demand, which will probably lead to charter rates and ship values falling back from their recovered levels.

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

The performance of the real estate markets in Germany should also be largely positive in 2016. The excess demand in residential markets in most of the large cities will continue due to the continued high influx of migrants and despite the increased construction activity. The retail sector will continue to benefit from the positive consumer sentiment and increasing household income. On the office property markets, only slightly decreasing vacancies are to be expected with a noticeable higher number of completed properties and a falling demand for surfaces.

Office rents in central locations should, however, increase moderately while growth in secondary locations is likely to fade out. Rents for commercial and residential property should also increase at a markedly slower rate given the growing number of completions. In some residential markets, the statutory limits placed on rent increases should have a dampening effect on the re-letting market.

The outlook for the expansion of renewable energies is mixed over the medium-term notwithstanding the most recent declarations of intent of the large industrial nations (G7) to reduce carbon dioxide emissions. Whilst the capacity added is stagnating at a good level in Europe, there are definitely growth opportunities globally. The substantial increase in capacity added in the German wind energy segment over recent years is likely to be slowed by regulatory requirements including the reduction in the remuneration for wind-generated electricity. In the rest of Europe new installations should reach a low in 2016 as a result of a sharp reduction in the offshore sector, but increase again in the subsequent years. The absolute increase in generation capacity in the solar energy sector in Germany – and also in Europe as a whole – should stabilise at a moderate level over the coming years. The implemented and intended restrictions on state subsidies in particular make it difficult to make predictions.

In transport infrastructure the growth in transport demand in a stable economic environment on the one hand and high maintenance requirements on the other are still generating positive stimulus for investment. Institutional investors will continue to be important. In the year 2016, revenues of companies in the logistics sector should increase faster than in 2015, supported by strong economic developments. However, this cyclical sector is subject to the risks of a general macro-economic downturn and a weakening in global trade.

The economic slowdown in China is worrying for heavily export-oriented sectors of the manufacturing industry such as automotive, engineering, electronics and chemicals. The sanctions imposed on Russia are also a cause of concern for companies. However, economic developments in the USA and eurozone as well as the weak euro should provide support. Overall, slightly positive growth rates can be expected, whereby the automobile sector should record the strongest growth despite the exhaust emission scandal. It is expected that growth will decline in the metal industry. The food industry should benefit on the one hand from the pleasing consumer behaviour of private households and on the other will continue to be slowed by lower growth in export markets.

Weaker international business in the industry sector also makes wholesale and foreign trade companies a little less confident about their future prospects. This applies in particular to production-related wholesalers.

The retail sector will continue to benefit from the strong labour market, minimum wage, recent high wage agreements and influx of asylum seekers. E-commerce will grow particularly strongly.

Companies across all sectors are planning to increase their capital expenditure in 2016, which could have a positive impact on the demand for loans at banks. As competition between banks remains intense in Germany, the pressure on credit margins will continue.

Ongoing challenging environment for banks

The overall economic environment will remain challenging for banks in 2016 against the backdrop of ongoing geopolitical tensions, the significant slowing down of growth in important emerging countries as well as the probable continuing high level of volatility in the financial markets. In view of the macroeconomic uncertainty, the ECB in particular is likely to maintain its expansive monetary policy with the effect that the pressure on net interest income resulting from the low interest rate environment will continue to increase gradually. Institutions will attempt to offset this negative effect on profitability by expanding income sources not dependent on interest rates (e.g. commission income) and by further reducing costs.

Intense competition for medium-sized clients and continuing subdued loan demand, particularly in Germany, are putting additional strain on the earnings of banks. In addition, the comprehensive regulatory requirements, which are taking up increasingly more resources, are being translated into administrative expenses of the institutions. The European bank levy for the Single Resolution Fund is also making itself felt, which is now significantly higher than the German bank levy payable prior to 2015.

New challenges result from the Supervisory Review and Evaluation Process (SREP) in the Banking Union, which will be stepped up noticeably this year. The ECB has already set out its priorities at the beginning of 2016 for the topics to be examined in detail in the SREP process. The five priorities identified by the supervisory authorities are a review of the business models of banks, credit risk, appropriateness of capital and liquidity resources as well as governance and data quality. The main focus will be on risks associated with the business models and earnings weakness in the low interest rate environment. The review of credit risk will focus on the treatment of and reduction in non-performing loans.

In July 2015, the EBA had already published details on the stress test announced for 2016. The ECB and EBA are aiming to achieve closer integration with the SREP process here. The stress test was preceded by a comprehensive data collection process and the preparation and publication of banking data as part of the “transparency exercise”. The “transparency exercise” was based on the 2014 annual financial statements as well as the half-yearly financial statements for 2015 and was published in November. The subsequent stress test started in the first quarter of 2016 with the publication of the methodology and scenarios and will be completed in the third quarter of 2016. Whilst only a selection of European banks with total assets in excess of € 100 billion are to participate in the EBA stress test, other banks directly supervised by the ECB must go through a so-called SREP stress test, the contents of which are to essentially correspond to those defined in the EBA stress test, which, based on currently available information, is not to be published for the institutions that do not take part in the EBA stress test. HSH Nordbank participates in the ECB stress test as part of the SREP process.

The key substantive areas of focus in the stress test are directly linked to the current challenges in the banking environment. The stress test provides in particular for the modelling of the effects of the low interest rate environment, currency fluctuations and exposure to legal risk. The stress test results will be incorporated by the supervisors into the assessment of the business models of banks as part of the SREP process. At the same time, both the banking supervisory authorities and market participants are likely to focus in the stress test results on the appropriateness of capital resources with regard to future regulatory requirements.

Besides the introduction of additional capital buffers (capital retention, early warning and systemically relevant buffers) this is particularly important regarding the extent to which banks are prepared for future regulatory standards for bail-in eligible liabilities. These relevant capital requirements that form part of the resolution mechanism include in particular the institution-specific minimum requirements for regulatory capital and eligible liabilities (MREL) to be defined by the national banking supervisory authorities and resolution authorities in the second half of the year.

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

In addition, more focus is placed on preparations for the new requirements for accounting for financial instruments under IFRS 9 that are expected to come into effect from 2018. They will be associated with changes in the classification of financial assets and determination of loan loss provisions. A major uncertainty regarding this is the amount of loans that may have to be measured at fair value in the future, which could lead to future charges against capital and earnings in the lending business as a result of the fair value measurement.

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

The introduction of a tax on trading in financial instruments (financial transaction tax), which is currently under discussion, would result in a significant reduction in income from the capital markets business.

In view of the varied regulatory requirements accompanied, on the one hand, by noticeably higher costs and, on the other, by exacting regulatory requirements for capital resources banks will be required to continuously review their business models and constantly improve efficiency to be able to ensure sufficient profitability and maintain the ability to build up capital from their own resources.

The Bank is making appropriate preparations targeted at the above-mentioned regulatory and accounting requirements and already initiated implementation projects for the introduction of IFRS 9 and BCBS 239, among other things. Also with regard to the challenges posed by the low interest rate environment, the necessary management impulses were provided an early stage. Additional requirements should arise from the further development of the Basel III Framework (Basel IV), for example for securitisations such as HSH Nordbank’s second loss guarantee and capital backing under the credit risk standard approach. The focus is placed in this context on the detailed definition of the requirements for HSH Nordbank and on ensuring that the new standards are applied on a timely basis. In general, any quantitative effects, if known, arising, for example, from the expected IFRS 9 or Basel IV requirements have been included in HSH Nordbank’s bank planning.

EXPECTED BUSINESS DEVELOPMENT OF HSH NORDBANK

2016 characterised by the implementation of the agreed structural measures

The individual planned structural measures will continue to be progressed vigorously over the coming months, so that they can be implemented as planned after the final conclusion of the current EU proceedings that has in the meantime been reached. The foundation for a sustainable business model is to be laid by the associated significant improvement in the Bank’s risk and financial situation. At the same time, the further expansion of new client business, continued winding down of high risk portfolios and significant progress made at the cost and process level should contribute to a successful privatisation process, preparations for which are to be intensified over the coming months.

Earnings forecast

In 2016, HSH Nordbank expects to be able to continue to moderately develop new business and cross-selling further. The planning certainty increased on the conclusion of the currently pending EU proceedings should have a positive effect. HSH Nordbank still expects to achieve risk-commensurate margins for new business that reflect the competitive environment in the target markets. At the same time, sales of the range of services offered over and above loan financing will continue to be driven forward to optimally exploit the business and earnings potential.

The earnings side is strengthened by the focused increase in new business and product sales. This serves to offset the loss of income resulting from the implementation of the portfolio transactions with a volume of € 8.2 billion provided for under the informal agreement reached with the EU Commission as well as the formal decision of the EU Commission, the winding down of non-strategic portfolios and the increase in impaired shipping loans. In total, HSH Nordbank expects a clear decline at the Group level and a noticeable decrease for the Core Bank, in total income, which benefited from non-recurring items (primarily remeasurement of hybrid instruments) in the financial year 2015. In the Core Bank, the positive operating earnings performance will be driven by the Corporates, Real Estate Clients and Shipping divisions.

A further significant reduction in the Restructuring Unit's balance sheet is planned in order to reduce risk positions. This will focus on winding down measures in different asset classes under which a significant reduction in risk is to be achieved. Total income in the Restructuring Unit will continue to decrease through the continuous winding down of the portfolio in the future.

The commitments undertaken in accordance with the catalogue of conditions and commitments were reflected in the Bank's planning. Under these the Bank is required to limit annual new shipping business to € 1.2 billion. Furthermore, total assets may not exceed € 98 billion at the end of 2017 (on an average USD exchange rate of 1.10). Asset-based aircraft financing business, which had already been discontinued, will not be resumed. The existing restriction on external growth by prohibiting the acquisition of control in other companies and extension of the ban on proprietary trading will continue to apply. Furthermore, the catalogue of conditions and commitments contains conditions regarding the corporates business (restricted to German clients and their investments in Germany and abroad and to foreign clients, provided that they are seeking transactions in Germany), which includes an increase in business opportunities relating to foreign activities compared to the previous EU catalogue of conditions and commitments.

In the first quarter of 2016, new business concluded in an overall highly competitive environment, particularly in the corporate clients sector, is below that of the same period in the previous year.

Opportunities and risks in the earnings forecast

Opportunities

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

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

Furthermore, a sharper, strategic focus of the Corporate Clients division on the renewable energy sector among others as well as other possible strategic alignments such as, for example, the planned expansion of asset management activities for institutional clients could have a positive impact on the Core Bank's total income. A sharper than planned increase in the US dollar viewed in isolation would have a positive impact on income generated by the US dollar business.

Risks

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

The Bank's increased funding costs due to its restricted access to the capital markets and resulting increased margin requirements may limit the volume of new business planned and, as a result, reduce the earnings base.

Despite the significant reduction in the amount of high risk securities held higher measurement losses on debt instruments and derivatives arising as a consequence of market developments or tensions in the financial markets also cannot be ruled out. IFRS measurement effects resulting from movements in the US dollar or interest rates as well as basis swaps could have a more adverse impact than expected, although US dollar sensitivity will decrease markedly after the planned portfolio transactions have been executed. Future planned results may be adversely impacted – as a result of possible additional winding down measures – by a further appreciation of the US dollar.

The implementation of the commitments as part of the formal decision, particularly in relation to the business model and reduction in total assets, may have an adverse impact on the development of new business, cross-selling and refinancing of the Bank and thereby also on the Bank's earnings situation. Furthermore, the existing restrictions may have a negative effect on potential transactions. Implementation of the agreed relieving measures at a later date than assumed in the Bank's planning could also adversely impact the Bank's future earnings situation. In particular, the delayed settlement of losses under the guarantee arising on the planned sale of loan portfolios to HSH Portfoliomanagement AöR and in the market would have a significant negative impact on HSH Nordbank's earnings situation (for example, as a result of the reduction in the relief from the adverse impact of premium payments for the guarantee).

Should uncertainties arise in relation to the risks described in the Capital and RWA forecast and formal decision in the EU state aid proceedings sections, this may result in a significant negative effect on the earnings situation. Even in the event that the viability review of the new corporate structure and approval of the acquisition by the EU Commission that is required in connection with the privatisation process to be concluded by 28 February 2018 is not or not fully successful or not successful within the specified time frame, this may then have a significant adverse impact on the development of new business, cross-selling, and the refinancing of the Bank and lead to a burden on the future earnings situation.

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

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

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

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

Forecast for administrative expenses

The aim of HSH Nordbank on the cost side is to continue to gradually reduce administrative expenses significantly, in order to achieve an appropriate cost-income ratio on a sustained basis of no more than 50% until the end of the planning horizon 2018 for the Bank.

HSH Nordbank is assuming a further moderate reduction in administrative expenses for 2016 compared to 2015. Planning is based on the cost reduction programme initiated in 2014 and other measures still to be defined in detail. Against the backdrop of the already implemented portfolio reduction and planned federal state and market transactions it is therefore intended, for example, to more closely integrate the Restructuring Unit into the CRO's area of responsibility in order to better exploit efficiency potential across divisions. In principle, the Bank undertakes under the catalogue of conditions and commitments, which forms the basis for the formal decision of the EU Commission, to gradually reduce administrative expenses during the divestiture period to € 540 million (excluding any potential IFRS 10 effects) in 2017.

The aim of the cost reduction programme is, inter alia, the further streamlining of the organisational structure, simplification of key processes, optimisation of the product portfolio and realignment of the Bank's IT and has already had an effect in the past year. Administration expenses decreased significantly in 2015 compared to the previous year.

Additional expenses arising from the consolidation of companies upon application of IFRS 10 have to be taken into account again in this context. These additional expenses are largely offset in the Group by income from these companies (Other operating income). Further extraordinary restructuring expenses are expected to be incurred in subsequent years for the implementation of the cost reduction programme. After mainly provisions for the personnel measures implemented had to be recognised in the 2014 annual financial statements it is expected that in particular restructuring expenses were incurred in 2015 in operating expense categories, particularly in the IT area, based on the measures initiated.

The bank levy determined for the first time in 2015 on the basis of the Bank Recovery and Resolution Directive (BRRD) and harmonised at the EU level as well as the contribution to the deposit guarantee fund of the Savings Banks Finance Group (disclosed on a separate line item) are also payable in subsequent years.

As regards the planned temporary servicing of HSH Portfoliomanagement AöR by HSH Nordbank the Bank assumes that any additional expenses incurred for IT, personnel etc., will be settled taking applicable fiscal requirements into account.

The number of employees will be gradually reduced further by 2017 as part of the cost reduction measures. An additional moderate reduction is planned for the year 2016. However, there remains the important task of retaining qualified staff at HSH Nordbank in order to secure key competences and limit operational risk.

Opportunities and risks in the forecast for administrative expenses

Opportunities

HSH Nordbank is confident that the savings targets set will be achieved. These targets may also be exceeded if the measures are implemented consistently and additional savings are identified. Successful implementation of the programme would make a substantial contribution to increasing the efficiency of the Bank on a sustained basis.

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

Also with regard to the expected reduction in the number of employees the Bank is assuming that measures initiated to reduce costs will be implemented successfully.

Risks

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

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

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

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

Forecast for loan loss provisions

HSH Nordbank assumes that further loan loss provisions will have to be recognised for 2016 as a whole. The Bank expects that net additions to be recognised in the Group and Restructuring Unit will be significantly below the extraordinarily high levels in the 2015 financial year, even after adjusting for the loan loss provisions (€ -1,584 million) for the transaction portfolios. In 2016, the focus of the loan loss provisions will continue to be on problem shipping loan commitments, especially in the container and bulker market segments. It can be expected that loan loss provision measures will also be required especially in the shipping industry for transactions not covered by the guarantee in view of the very difficult sector environment. Loan loss provisions recognised for legacy portfolios covered by the guarantee will be largely compensated for under the guarantee.

The currency translation gain or loss recorded in loan loss provisions is strongly influenced by the movement in the EUR/USD exchange rate and would have a significant impact on loan loss provisions before compensation under the second loss guarantee on an increasing weakness of the euro, although the effect of the exchange rate movement will be gradually reduced accordingly by the further reduction in the US dollar legacy portfolios. If the currency translation relates to guaranteed portfolios, it is compensated for by the guarantee. For foreign exchange positions held in portfolios not covered by the guarantee, hedging instruments continue to be used.

Loan loss provisions to be recognised for legacy portfolios covered by the guarantee in 2016 will be largely compensated for under the guarantee. Compared to the disclosure of loan loss provision income after compensation under the guarantee in 2015, a significant reduction in the positive figure disclosed for the Group for 2016 is expected, as the one-off reversal of future premiums disclosed under loan loss provision expense in the 2015 Group financial statements will no longer apply in future due to the informal agreement reached with the EU Commission. In view of the expected losses arising from the intended portfolio sales to the federal states and in the market, the payment defaults in the portfolio covered by the second loss guarantee will already 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 loan loss provision plan is based on valuation models that also take into account the regulatory environment, the expected development of risk parameters over time as well as the Bank's empirical values in critical situations in addition to portfolio developments and key macroeconomic data (including the EUR/USD exchange rate, charter rates and second hand prices). A key driver of the amount of loan loss provisions is also the breakdown of impaired loan commitments into "capable of recovery" (and therefore recognition of an individual valuation allowance based on the assumption of the continuation of the borrower's business) or "not capable of recovery" (and therefore recognition of an individual valuation allowance based on the assumption of a workout). The estimates concerning long-term loan loss provisions are based on the assumption of a recovery in the shipping markets and/or a significant recovery in the container shipping industry as well as the continuation in general of the current recovery strategy and therefore the assumption of HSH Nordbank's willingness to continue to finance problem loans remaining after the planned transactions have been executed in order to achieve the planned significant reversals of impairment losses in the future.

Details on the loan loss provision plan and expected payment defaults are set out in the Default risk section (Planning for loan loss provisions and losses) in the risk report of the 2015 management report.

Opportunities and risks in the forecast for loan loss provisions

Opportunities

Loan loss provisions would be lower than expected, if the relevant market parameters and macroeconomic environment developed more favourably than assumed. It is conceivable that the world economy could grow more strongly in 2016 than forecast, which in turn could support a gradual recovery of the shipping markets.

This would provide relief to HSH Nordbank primarily in the form of lower loan loss provision expense in the non-guaranteed portfolio.

A greater level of restructuring successes than expected and a rapid winding down of the problem loan portfolios in the Restructuring Unit could reduce loan loss provisions in the future more sharply than expected.

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

The results from settling losses arising on the drawdown of the second loss guarantee may be higher compared to the assumptions made by the Bank regarding the hedging effect of the guarantee and may lead to a reduction in loan loss provisions.

Risks

Estimates regarding the long-term trend in loan loss provisions as well as loss planning and, consequently, the final drawdown of the second loss guarantee are subject to considerable uncertainty due to the long planning horizon. This applies in particular to the movement in the US dollar exchange rate and key market parameters in the shipping industry such as cargo and charter rates as well as second hand prices, which are key input parameters for determining the loan loss provisions. In view of the existing or increasing overcapacity in the shipping markets, also due to low liquidity costs, it cannot be ruled out that the extent and timing of the market recovery and recoverability of individual commitments may not be achieved in the planning period as assumed in the loan loss provision plan. Due to this, and in particular in the case of falling charter rates, loan loss provisions required may continue to increase significantly. This could have a substantial impact over the long-term on the total expected payment defaults and therefore on the expected drawdown of the guarantee and, in this regard, also on the guarantee premiums payable by the Bank in the future. A higher drawdown of the guarantee will result in a reduction of the guarantee premiums payable in the future. Financial burdens for HSH Nordbank would mainly arise from higher than planned loan loss provisions in the non-guaranteed portfolio.

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

Furthermore, it can also not be ruled out that the euro debt crisis will once again become the centre of attention, which would lead to a weakening in the Bank's relevant markets. This in tum could result in additional impairment losses having to be recognised. Market turbulence in emerging countries as well as geopolitical risks, such as those surrounding Russia and Ukraine, could have a negative impact.

Further financial burdens may arise if the alternative structured solutions to further reduce risk positions, especially in the shipping loan portfolio (Nautilus structures), cannot be implemented as planned. Under these structures ships are transferred from insolvent companies and companies facing insolvency to new structures with new equity and debt capital and the existing loan financing is partially replaced or written off with the effect that HSH Nordbank no longer has a commitment for the original loan amount. Against this backdrop it cannot be excluded that additional loan loss provisions would have to be recognised in the future.

Further significant loan loss expense could arise in connection with the transfer of loan portfolios to the federal state owners of an initial amount of € 5 billion as provided for under the informal agreement reached with and decision of the EU Commission, if the transaction is not executed by 31 August 2016 and a reassessment of the portfolio by the EU Commission would become necessary. With regard to the sale of loan portfolios totalling € 3.2 billion in the market this could lead to material loan loss provision expenses, if the actual transaction prices are lower than the prices assumed by the Bank as at the respective transaction date on which the loan loss provision calculation is based. Additional loan loss provision expense could also be incurred in connection with changes in the composition of the portfolios selected by the Bank (for example, due to transfer obstacles on individual assets).

There is also the risk that, contrary to the Bank's assumptions, losses arising on the transfer or sale of the transaction portfolios, which are hedged under the guarantee, might not be settled under the guarantee in the amount assumed by the Bank, if for example, a so-called loan value based on the credit rating is higher than the respective transaction price or certain losses are not recognised by the guarantor. In these cases, the hedging effect of the guarantee only includes the difference between the loan value based on creditworthiness and the nominal value less any loan loss provisions existing at the time the guarantee was issued. This rule is intended to prevent losses not based on creditworthiness (such as fluctuations in base rate, currency or other market parameters) from being settled under the guarantee. If the loan value based on the credit rating, which is still to be agreed with the guarantor, is higher than the transaction price or the loss actually incurred on the sale is higher than the loss based on the credit rating, a reduction in the assumed hedging effect could have a significant adverse impact on loan loss provision expense.

The results from settling losses arising on the drawdown of the second loss guarantee may be lower compared to the assumptions made by the Bank regarding the hedging effect of the guarantee and may lead to an increase in loan loss provisions.

Furthermore, unscheduled losses could also be incurred beyond 2016, if additional assets were to be sold at market value in an unfavourable environment as part of a further acceleration in the reduction in risk or the recovery strategy, particularly the Bank's willingness to continue to finance problem loans, were to be changed. A change in the recovery strategy and, as a result, the recognition of loan loss provisions based on the assumption of the resolution of loan commitments would restrict the recognition of planned future reversals of loan loss provisions due to the planned recovery in the shipping markets.

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

New accounting rules (such as IFRS 9 from 2018) may also adversely affect the loan loss provisions. For example, measurement at fair value that may be required under IFRS 9 under certain circumstances might adversely impact loan loss provisions. The adverse effects described above might, if they relate to the portfolio hedged by the second loss guarantee, result in higher balance sheet utilisation of the second loss guarantee from 2018 compared to the current loan loss provision plan.

Capital and RWA forecast

HSH Nordbank expects the capital ratios to remain at an adequate level in 2016. HSH Nordbank expects to be able to continue to disclose a regulatory CET1 ratio of above 12.0% at the level of the future operating company despite more stringent requirements resulting from the gradual implementation of Basel III in accordance with the Basel III transitional rules (phase-in). This demonstrates that HSH Nordbank is prepared for additional regulatory capital requirements in the year 2016, for example as a result of the Supervisory Review and Evaluation Process (SREP) in the Banking Union.

Changes in RWA are primarily influenced by new business, the further portfolio reduction including the planned portfolio transactions totalling € 8.2 billion, risk and market parameters, particularly the trend in charter rates, and the EUR/USD exchange rate. For 2016, HSH Nordbank expects, based on a stable EUR/USD exchange rate, largely stable RWA due to the planned new business taking into account the federal state transactions planned for 2016. The relief provided by the planned market transactions is not expected to take effect until a later date.

The transfer of the majority of the shares in HSH Nordbank AG from the current shareholders to the future holding company will result in the creation of a financial holding group subject to banking supervision, at the level of which banking supervision requirements, particularly minimum capital requirements (CET1 4.5%) as well as additional capital buffer requirements, are to be complied with. According to current planning at the level of the financial holding group the Pillar 1 minimum capital requirements pursuant to CRR (CET1 4.5%) will be complied with at this banking supervisory application level, which is temporarily relevant until the sale of HSH Nordbank AG is completed. In light of the gradual increase in the capital buffer requirements in accordance with the transitional provisions of Section 64r KWG the Bank currently expects that these will no longer be fully met in the year of the privatisation and associated elimination of the financial holding group.

The transposition of the Bank Recovery and Resolution Directive – BRRD) into national law (Recovery and Resolution Act – Sanierungs- und Abwicklungsgesetz – SAG) will result in new capital requirements in 2016. The European Single Resolution Board will set an institution-specific ratio for the regulatory capital and eligible liabilities to be maintained at a minimum for institutions directly supervised by the ECB and therefore for HSH Nordbank (Minimum Requirements on Eligible Liabilities – MREL). Based on current discussions with the supervisors HSH Nordbank expects to comply with the MREL requirements.

Opportunities and risks in the capital and RWA forecast

Opportunities

Opportunities for the capital ratios and RWA result from more favourable trends in the relevant market and risk parameters and a more rapid reduction in risk in the guaranteed legacy portfolio. The intended use of the RWA relief resulting from a volume of up to € 3.2 billion provided for under the informal agreement reached with the EU Commission and the formal decision of the EU Commission for the sale of receivables in the market could be used more quickly than previously planned.

Further improvements may arise as a result of a stronger euro against the US dollar, although the sensitivity to EUR/USD fluctuations will decrease following the execution of the planned transaction with the federal states institution and sale of receivables.

Risks

Material risks for the capital ratios and RWA result from a potential deterioration in market and risk parameters in the Bank's core markets including a stronger US dollar, a lower than planned reduction in the portfolios and the regulatory environment, for instance from supervisory audits. In 2015, the ECB carried out a review of the accounting applied to the second loss guarantee for regulatory purposes. The Bank expects that the ECB will inform the Bank of the implementation and change requirements resulting from its review during the course of 2016. This may lead to a significant reduction in the relief provided by the guarantee, particularly in relation to the guarantee buffer and associated hedging effect for the Bank's capital ratio, which results from the difference between the regulatory minimum risk weight and the significantly lower calculated risk weight of the hedged portfolio. It can also not be excluded that the guarantee buffer remaining after implementing the ECB review findings in conjunction with the intended sale of the federal state portfolios to the workout institution formed by the federal states will be used up during the course of 2016. In this case, developments that result in an increase in risk-weighted assets (RWA) in the hedged portfolio (these include, for example, declining charter rates or a lower EUR/USD exchange rate), also have a direct, adverse impact on the Bank's CET1 ratio. Non-occurrence of the recovery in the shipping markets assumed in the plan may result in a significant negative impact on the capital ratios. The impact of such developments in the guaranteed portfolio on the capital ratio was offset in the past by a corresponding guarantee buffer.

Any potential deterioration in the market values determined by the Bank for the planned sale of loan portfolios in the market up to the planned date of sale at the end of 2016 or in the middle of 2017 or an increase in loan loss provisions in the hedged portfolio may, particularly in combination with the findings of the supervisory review, have a further significant adverse impact on the Bank's CET1 ratio. A potential decrease in the market values may result from the valuation uncertainty regarding the movement in the relevant market prices up to the planned date of sale. Lower market values achieved than those determined by the Bank for the transactions or changes to the composition of the portfolios to be sold to the federal states or in the market may result in higher losses, thereby adversely impacting the Bank's CET1 ratio.

It is also possible that additional individual and increased capital requirements or additional requirements in other prudential regulatory areas such as liquidity will arise from the regular SREP process carried out in the Banking Union. Additional discretionary decisions made by the supervisory authorities and sector-wide capital requirements (capital buffer for systemic risk) could adversely impact the capital ratios and significantly reduce the effectiveness of the guarantee.

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

There is also the risk that even the Pillar 1 minimum requirements pursuant to CRR (CET1 4.5%) could not be fully complied with in the planning period (e.g. on a deterioration in market and risk parameters) without taking additional measures. Non-compliance with the minimum capital requirements could have material repercussions for the operating company and, for example, require measures to be taken to strengthen capital in order to avert such a scenario.

Furthermore, there is also a risk regarding the future financial holding group subject to banking supervision in that the banking supervisory authorities could stipulate additional capital requirements over and above the Pillar 1 minimum requirements and the buffer requirements applied uniformly across institutions, particularly if the conditions stipulated by the competent banking supervisory authority in order to shield HSH Nordbank AG would not be met with regard to the future holding company. The banking supervisory authority has considerable discretionary powers in respect of the above-mentioned risks regarding non-compliance with capital requirements.

The forecast of the medium-term CET1 ratio is based on the assumption that the operation of the guarantee structure remains unchanged under the regulations currently applicable to securitisations. A tightening of the supervisory set or rules regarding securitisation due to the further development of the Basel III framework (Basel 3.5), which is likely to come into force at the latest by 2020 through its implementation in the EU could significantly reduce the RWA relieving effect and therefore the efficiency of the guarantee.

Delays in implementing the portfolio sale of € 5.0 billion to the federal states planned for 30 June 2016 or delayed settlement of the resulting losses under the guarantee could have a negative effect on the planned capital ratios.

The capital ratios may be significantly impacted in future by the intended changes to the regulatory requirements (sometimes referred to as "Basel IV"), particularly from 2019. A large number of changes in the area of market, operational and counterparty risk are consolidated in this regard under Basel IV. Stricter rules concerning counterparty risk will be of particular relevance for HSH Nordbank. HSH Nordbank extensively uses models approved by the supervisory authorities to map counterparty risk (Internal Ratings Based Approach – IRBA). The supervisory authorities are planning under Basel IV to significantly restrict the use of IRBA models by basing the capital backing more closely on the standard approach (CSA floor), by limiting the use of the IRBA to certain exposure classes as well as limiting the use of internal risk parameters (constrained IRB).

New regulatory requirements or accounting rules (such as IFRS 9 from 2018) may also adversely affect the capital ratios in the future.

Risks relating to non-compliance with the MREL ratio lie in the ongoing discussions of the European supervisory authorities regarding the qualitative requirements for eligible liabilities. Resolutions regarding tighter requirements have already been adopted for institutions which are relevant for the system on a global scale (TLAC – Total Loss Absorbency Capacity). A potential tightening of the requirements also for institutions that are not of relevance for the system on a global scale may be mitigated by means of a transitional period for complying with the MREL ratio, as the case may be.

The movement in the EUR/USD exchange rate has a marked effect on the RWA trend. A lower than planned exchange rate would lead to an increase of the RWA and immediately reduce the CET1 ratio of the Bank.

Funding forecast

The Bank expects to continue to successfully implement its diversified funding strategy in 2016. The Bank's asset business will continue to be refinanced primarily by providing bond products for the client business of the savings banks and other financial institutions and placing secured and unsecured bonds with institutional investors and the deposit business transacted with the Bank's corporate clients.

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

For the remainder of 2016, the Bank expects the regulatory liquidity ratio as defined in the Liquidity Regulation (LiqV) to be at the level prevailing at the 2015 year end. HSH Nordbank also expects that the trend of the liquidity coverage ratio (LCR) and net stable funding ratio (NSFR) will be stable compared to the 2015 year end and consequently that the corridor of 80% to 120% provided for in the catalogue of conditions and commitments will be complied with. HSH Nordbank also expects that all other supervisory requirements such as the survival period in the liquidity development report for the combined stress scenario will continue to be complied with and the key ratios are more or less at the same level as in the previous year.

Deposit business is a key component of the Bank's refinancing mix. HSH Nordbank aims to reduce the high proportion of short-term deposits, which is partly attributable to building up surplus liquidity in advance of the extensive maturities of guarantor liability bonds, and depositor concentration further. The regulatory liquidity ratios and requirements will be complied with at all times, also under stress conditions. Details regarding this can be found under Liquidity risk in the Risk report section.

Furthermore, the sales of portfolios to the federal states (€ 5 billion) and in the market (up to € 3.2 billion) planned as part of the informal agreement reached with the EU Commission and the formal decision of the EU Commission will ease the liquidity position in the future. In this regard, the Bank has assumed in its liquidity planning that the purchase price payments at the respective transaction dates and associated settlement of losses in cash for the federal state portfolios (insofar as the first loss piece of losses settled under the guarantee of € 3.2 billion is not exceeded as a result) are made immediately after the sale, and for the market portfolios six to nine months after the respective transaction is concluded. It is assumed that the federal state portfolio will be sold as at 30 June 2016 and the market portfolio as at 31 December 2016 or until 30 June 2017, respectively. Stable access also in unfavourable market conditions to refinancing sources that are not dependent for the most part on the performance of the capital markets such as the German Savings Bank Association and other financial networks as well as to collateralised refinancing sources such as Pfandbriefe and asset-based funding, which is also important for refinancing US dollar business, is paramount.

Under the catalogue of conditions and commitments, which forms the basis for the formal decision and was accordingly reflected in the Bank's planning, the proportion of USD business in the Core Bank refinanced by primary USD funding (and not by derivatives) is to be at least 55% as at the 2016 and 2017 year ends.

The two rating agencies, Moody's and Fitch, regard the conclusion of the EU proceedings as important milestones and assess the structural measures, which ought to lead to an improvement in the financial and risk profile, as positive in principle. Nevertheless, the agencies consider, in particular, the uncertainty during the divestiture period, the ambitious time frame for a change in ownership as well as the one-off payment and liquidity resources to be provided to the holding company to be a burden. An overall assessment of the EU decision will probably be made by the agencies in the summer months.

Due to the postponement of the publication of the single entity financial statements and Group financial statements as at 31 December 2015, the Bank suspended its issuing activities during the first quarter for a short period of time from the date of the ad hoc announcement regarding this (3 March 2016). This also resulted in the temporary increase in incoming cash flows from deposits and issues. The resulting effects were accordingly taken into account in the funding plan.

Opportunities and risks in the funding forecast

Opportunities

The fulfilment of the funding objectives is mainly influenced by external factors. A positive capital market environment should support the implementation of the issuing strategy in 2016. A sustained expansive monetary policy on the part of the ECB and the associated expansion of liquidity is likely to tend to have a positive impact on the refinancing options and costs.

The currently limited access to the capital markets would gradually improve by the conclusion of the ongoing EU proceedings and implementation of the planned structural measures, as these would reduce an important uncertainty factor. This is also of key importance for assessments made by the rating agencies. Like this, ratings that are continued to be confirmed as investment grade would significantly underpin the implementation of the funding targets.

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

Risks

Execution of funding measures in the market would be made more difficult by potential tensions in the financial markets. For example, a central bank monetary policy that is more restrictive than expected emanating from the USA could significantly limit the refinancing options and increase funding costs.

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

If the implementation of the formal decision and catalogue of conditions and commitments, particularly the privatisation to be completed by 28 February 2018 and the viability review of the new corporate structure required in this connection as well as approval of the acquisition by the EU Commission, is not, not fully or not successful within the specified time frame, this could have a significant adverse impact on funding and funding costs, trigger outflows of short-term funds or fundamentally restrict HSH Nordbank's funding options. In this case, additional measures will be required to strengthen the liquidity situation.

If there are delays in settling the losses and sales prices of the portfolios to be sold to the federal state owners and in the market or an agreement cannot be reached with the federal state owners on a planned specification of the process for the quick settlement of losses, this may have a negative impact – as at the respective settlement date – on the Bank's liquidity position. Furthermore, the planned liquidity relief could be delayed compared to the assumptions made in the Bank's planning in case it takes longer to settle losses, particularly in the case of the settlement of losses arising on the sale of market portfolio.

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

Potential rating downgrades, which cannot be excluded despite the formal decision of the EU in the EU state aid proceedings, would fundamentally restrict the refinancing options via the capital markets, trigger outflows of short-term funds and increase funding costs. A rating downgrade by both Moody's as well as by Fitch would result in a rating outside investment grade. Adverse developments in the privatisation period (for example, reduced capitalisation, elimination of the guarantee buffer, liquidity charges or an unplanned deterioration in net income) may negatively affect the rating.

Most of the assets denominated in foreign currency are refinanced via derivatives (for example, via EUR/USD basis swaps). An appreciation in the US dollar results in an increase in the cash collateral to be provided and therefore in pressure on the liquidity situation under otherwise similar conditions. In the event of an unfavourable exchange rate trend below the planned rate, the Bank would have to take additional action to ensure an adequate liquidity position.

In this case, the Bank has plans to sharply reduce the assets to be refinanced, for instance through selling loans and securities and reducing the expansion of new business. These possible measures could have a negative impact on earnings. In addition, HSH Nordbank is exposed to the risk that these measures may not be able to be implemented or not at the desired point in time.

Because of the marked influence of the EUR/USD exchange rate on the Bank's liquidity position due to the need to provide collateral for EUR/USD basis swaps the focus continues to be placed on the reduction of US dollar assets in different asset classes in the course of the winding down of portfolios in the Restructuring Unit. This may result in unscheduled losses that could not be invoiced under the guarantee. Furthermore, the restrictions on US dollar business will be maintained.

The regulatory liquidity ratio of the German Liquidity Regulation (LiqV) as well as other liquidity ratios such as the LCR, NSFR and LDR would deteriorate regardless of any conscious control measures taken such as, for example, the reduction in short-term deposits. Additional liquidity requirements could arise under the ECB's SREP process.

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

Formal decision in the EU state aid proceedings

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

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

The planned structural measures and resulting expected effect on the net assets, financial position and earnings are taken into account in the Bank's new planning for the coming years. Implementation of the individual planned measures will be driven forward over the coming months, such as the setting up of the holding structure to relieve the operating HSH Nordbank from the guarantee obligation, planned portfolio transfer as at 30 June 2016 of € 5 billion to the federal state owners and planned sale at a later date of non-performing loans of € 3.2 billion in the market.

In addition to the one-off relief recognised in the 2015 single entity and Group financial statements, long-term structural improvements to the financial and risk situation are expected on the full implementation of the agreed measures, such as the significant reduction in the base premium payable in the future by the operating company and agreed portfolio sales. The aim is a further rapid reduction in the legacy portfolios remaining at the Bank, which continue to be covered by the guarantee facility provided by the federal states. This will improve the conditions for a sustainable long-term business model for the Bank. The operating company's capital backing is to be strengthened by improved profit retention opportunities. As the assets to be sold within the framework of portfolio transactions 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 removal of loan transactions from the balance sheet. This also strengthens the Bank's liquidity situation affected by movements in the US dollar.

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

Following the successful completion of the sales process resulting in an offer that does not require state aid and an offer price that is positive (while retaining the guarantee) the intended acquisition will be subject to a viability assessment of the new corporate structure by the EU Commission prior to implementation and has to be approved by the EU Commission. Should the divestment procedure not lead to offers not requiring state aid (while maintaining the guarantee) with a positive price being offered before the expiry of the deadline or should the Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business.

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 legally permitted from the operating company to the holding company to be formed.

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

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

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

Opportunities

Following the final conclusion of the EU state aid proceedings, the successful implementation of the planned structural measures agreement would create a sound basis for establishing a sustainable long-term business model for the Bank and facilitating a successful privatisation process.

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

The expansion of business opportunities in the corporate clients sector included in the catalogue of conditions and commitments compared to the original applicable list of conditions and requirements in the previous EU decision, particularly the opportunity to finance German clients and their foreign investments as well as foreign clients, provided the latter are seeking to support transactions in Germany, could have a positive impact on new business planned for the corporate clients sector.

Acquisition of an ownership position by another strong partner as part of the planned privatisation would increase HSH Nordbank's business and refinancing opportunities and thereby contribute to the further strengthening of the business model.

If the measurement parameters improve, the measurement of the transaction portfolios to be sold in the market at the actual dates of sale could be higher than previously assumed in the planning and calculation of loan loss provisions and have a positive effect on the net assets, financial position and earnings.

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

The measurement of the portfolios to be sold in the market could be lower at the actual dates of sale than previously assumed in the planning and calculation of loan loss provisions. The federal state owners are not precluded in respect of the portfolios to be sold to HSH Portfoliomanagement AöR from setting the transfer values determined by the EU Commission under state aid aspects at a lower amount as at the date of the portfolio transfer. In addition, execution of the portfolio sales could be delayed. Subsequent changes in the composition of the portfolios to be sold to the federal states or in the market, for example, in the course of the implementation of the transactions, may also have an additional adverse impact on loan loss provisions. The above-mentioned effects may have a significant adverse impact on the earnings, net assets and financial position as well as the CET1 ratio.

Furthermore, tax risks could arise in connection with the transfer of assets, particularly to foreign jurisdictions, as part of the implementation of the portfolio transactions. These may result, on the one hand, in higher loan loss provision expense and, on the other, in changes to the portfolio selected for the transfers compared to the plan. Changes in the portfolio selected may also result in increasing loan loss provision expense in connection with the planned portfolio transactions.

There is a risk that the privatisation of HSH Nordbank is not successful or not completed on time and, as a result, HSH Nordbank would have to cease new business activities and wind down existing portfolios. The long-term survival of HSH Nordbank would not be ensured in this case. If the resolution conditions laid down in Regulation (EU) no. 806/2014 (SRMVO) are met in this case, this could result in resolution measures being ordered by the competent resolution authorities (for example, conversion of equity instruments and debt capital into core Tier 1 capital, a so-called "bail-in").

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

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

As a member of the German Savings Banks Association (DSGV) HSH Nordbank AG is a member of the guarantee scheme of the German Savings Bank Finance Group (SFG). This system is intended to secure the continued existence of the member institutions as well as their liquidity and solvency. An affiliated member institution ceases to be a member of the security scheme two years after its membership has expired. HSH Nordbank AG will remain a member of the German Savings Banks Association (DSGV) and Savings Banks Finance Group (SFG) during the divestment process. Should membership end at a date not currently foreseen, its membership of the guarantee scheme would continue to apply for a further two years in accordance with Section 94(4) of the Framework Statute.

Due to the above-described consequences of the implementation of the formal decision of the EU Commission there is the risk that HSH Nordbank AG may no longer be member of the DSGV and therefore also of the joint liability scheme of the German Savings Banks Finance Group in the event that its ownership structure is changed in favour of private owners after a two-year transition period. This could increase HSH Nordbank AG's refinancing costs and make it difficult to access funding channels.

The assumption of the Bank as a going concern for accounting and measurement purposes is based in particular on the fact that:

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

(ii) the operating company, HSH Nordbank AG, is sold at a positive sales price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure. Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline or should the EU Commission, in the course of its viability assessment, come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event of significant unexpected outflows of funds (e.g. in the scenario described above), measures must be taken to strengthen the liquidity position.

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

Overall appraisal and net income forecast

Against the backdrop of the formal decision of the EU Commission HSH Nordbank is confident that, together with its federal state owners, it can successfully drive forward and implement the planned structural measures over the coming months.

At the same time, HSH Nordbank will further expand its new business activities based on its strong presence in the markets and operating progress made over recent years. The Bank will use the expanded business opportunities in the corporate clients sector included in the catalogue of conditions and commitments compared to the original applicable catalogue of conditions and commitments in the previous EU decision to consistently implement the new business plan taking account of the strict internal risk and income requirements. Furthermore, HSH Nordbank is reviewing additional strategic and operating improvements to ensure its competitiveness in a challenging environment. The aim is a further rapid reduction in the legacy portfolios remaining at the Bank, which continue to be covered by the guarantee facility issued by the federal states, following the adjustments made in the past year and transactions planned in connection with the implementation of the formal decision of the EU Commission.

Overall, the basis for a sustainable, viable alignment of the Bank is strengthened and a business model created for the future operating company, which, as a minimum, should convince clients, employees and investors and facilitate a successful privatisation process.

There are still major challenges and uncertainties regarding future developments arising primarily from the continuing difficult situation in the shipping industry including the assessment of the long-term trend of loan loss provisions (also in the event of a sharper reduction in risk), volatility in the financial and currency markets (especially the US dollar), implementation of the formal decision of the EU Commission, changing assessments made by rating agencies as well as the further development of requirements of the European Banking Authority.

These give rise to corresponding uncertainties regarding the achievement of the forecast developments. Nevertheless, HSH Nordbank is confident that it will further develop the Bank on a forward-looking basis in line with its restructuring plan and be able to meet the challenges facing it. The implementation of the planned structural measures and operating progress made on the income and cost side will make a considerable contribution to strengthening of HSH Nordbank.

The future results of HSH Nordbank are likely to benefit noticeably over the coming years from the implementation of the planned structural measures of the EU proceedings and further implementation of the strategy. The Bank expects to record a significant reduction in net income before taxes at the Group level compared to the previous year due to the material non-recurring items recognised in the 2015 financial year relating to the reversal of guarantee premiums as a result of the informal agreement (with the exception of the one-off payment and the provision of liquidity to the holding company to be made under the formal decision of the EU Commission). Against the same backdrop, the return on equity for the Group will probably decline significantly in 2016 compared to the previous year.

For 2016, net income before taxes higher than that at the Group level is expected for the Core Bank. Compared to 2015 the positive effects arising from the structural measures that were recognised in the 2015 Group financial statements will also result in a reduction in net income before taxes and the return on equity for the Core Bank year on year. The expected net income of the Restructuring Unit will also decrease sharply due to the continued winding down of portfolios, such that net income before taxes for the Restructuring Unit for 2016 is likely to be negative.

The Bank will make further efforts to ensure a competitive cost-income ratio. The cost-income ratio is benefitting from further reductions in administrative expenses. The positive non-recurring items recognised in connection with the informal agreement on the income side in the 2015 Group financial statements are likely to result in a moderate increase in the cost-income ratio in the Group and slight decrease in the Core Bank in 2016.

Structurally, the Bank's results will be improved by the planned implementation of the intended measures, especially by the gradual increase in the relief provided with regard to guarantee fees and the planned optimisation of the business model. This is reflected in the increase in net income and the return on equity for the Group and Core Bank in the planning period.

At the same time, the complexity of the figures disclosed by HSH Nordbank should decrease noticeably in future, since the complex guarantee premium structure comprising additional premiums, ex ante base premiums and debt waivers (apart from the one-off payment and the liquidity backing of the holding company to be made under the formal decision of the EU Commission) was dissolved in the 2015 annual and Group financial statements on account of the informal agreement reached with the EU Commission and loan loss provisions recognised in connection with the informal agreement were determined based on the assumption of revised commitment strategies and on market values as at the planned date of sale. Accordingly, this should increase transparency and informative value regarding the Bank's operating performance.

In light of the formal EU decision, the Bank expects not to make any coupon payments on the hybrid capital instruments during the divestiture period as part of the implementation of the structural measures. Against this backdrop the Bank assumes that, on the successful conclusion of the 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.

In order to fulfil the net income forecast as well as for future distributions starting from 2020, HSH Nordbank's plan needs to be implemented as intended and the risks described in this management report do not materialise.

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

RISK REPORT

RISK MANAGEMENT SYSTEM

Principles of risk management

Active risk management represents a core component of the overall bank management at HSH Nordbank. The current version of the Minimum Requirements for Risk Management (MaRisk) laid down by the Supervisory Authorities serves as the main framework for the design of our risk management system. Since the beginning of 2016 comprehensive requirements resulting from the Supervisory Review and Evaluation Process (SREP) have to be observed.

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

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

Risk management objectives and the measures used to achieve these objectives are defined in the risk strategy and sub-risk strategies on the basis of the planned development of the main business activities. The main focus is on ensuring the risk-bearing capacity and liquidity of the Bank. Specifically, this involves the allocation of scarce resources such as risk coverage potential and long-term liquidity taking into account risk tolerance, strategic business goals, the market environment and the existing portfolio. The risk strategy is supplemented by guidelines for granting loans (Credit Standards) and Investment Guidelines which contain detailed rules and regulations concerning the individual business areas of HSH Nordbank.

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

The risk management system is designed to identify, make transparent and manage risks arising from future developments. An opportunity management system comparable to the risk management system does not exist at HSH Nordbank. Instead, the Bank's management system is generally aimed at optimising the risk-reward profile of the Bank.

Organisation of risk management

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

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

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

The division Group Risk Management develops the methods and tools for identifying, measuring, managing and monitoring risks and is responsible for a significant number of tasks of operative portfolio management.

Amongst the tasks of Credit Risk Management are the preparation of the credit risk analysis, including the determination of the internal rating and the drawing up of the credit application for normal and intensified loan management cases of the Core Bank as well as the structuring of the processes and regulations for the lending business of HSH Nordbank. Loan and Collateral Management is responsible for the settlement and administration of the lending business as well as for obtaining and ongoing valuation of loan collateral.

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

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

As an internal winding down unit of HSH Nordbank, the Restructuring Unit (RU) existing since 2009 is fully integrated into the Group's risk management process. The risk methods and processes of the Core Bank apply to the Restructuring Unit accordingly. The Restructuring Unit (RU), which is established as a back office department in terms of organisational and operational structure, is responsible for the positions of business areas no longer of strategic importance and all recovery activities of HSH Nordbank. It is in charge of preparing the credit risk analysis, including determining the internal rating and drawing up the credit application for the business assigned to it as well as for designing and documenting the processes for the securities, restructuring and workout business assigned to the Restructuring Unit. With regard to restructuring cases of the Core Bank the Core Bank remains responsible for taking the relevant decisions.

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

The CRO and the chief representative (Generalbevollmächtiger, GBV) of the Restructuring Unit (RU) make decisions independently of the members of the Management Board responsible for the market or trading divisions. In this way the separation of functions required under the regulatory rules between the market and trading divisions on the one hand and risk controlling, settlement and control as well as back office on the other is taken into account at all levels of the Bank from an organisational perspective.

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

HSH Nordbank has stipulated rules according to the specifications of MaRisk under which formalised audit processes are gone through prior to entering into transactions in new products or new markets (NMNP processes). This should ensure that the products are properly considered under risk aspects in the relevant systems and reflected in the relevant processes and that transactions involving new products or on new markets are only entered into with the approval of the Management Board.

HSH Nordbank uses an economic scope of consolidation as the basis for the Group-wide risk management. This scope of consolidation combines the entities required to be consolidated under regulatory and IFRS rules as well as additional entities, as the case may be, that make a contribution to risk that is identified as relevant by HSH Nordbank. Those companies that are to be specifically monitored at the Group level due to material risks are selected from this population that comprises all relevant risk positions. The risks of other companies not included in the "economic scope of consolidation" are fully taken into account at the aggregate level (for instance in the form of equity holding risks in the default risk management process).

Risk management by a central committee structure

The Management Board has established committees that support it in monitoring and managing all material risks. Besides the members of the Management Board the committees are composed of the heads of the risk and other departments in order to ensure that information regarding questions on risk is regularly exchanged. Insofar as internal or external regulations do not permit delegation of decisions to the committees, such decisions are prepared by these committees for approval by the Overall Management Board.

The Asset Liability Committee (ALCO) under the chairmanship of the Chief Financial Officer (CFO) is the central committee responsible for managing capital and liquidity resources. Its tasks include the management of capital, including limit management, as well as making decisions regarding measures for managing the short- and medium-term liquidity position and the strategic liquidity maturity transformation, among other things. This also includes the specification of internal liquidity transfer prices.

The Transaction Committee (TC) is a body composed of division heads taking decision independently at the level of material individual loan transactions. The use of the resources liquidity, economic and regulatory capital is managed by the TC, based on the requirements concerning resource management of the Group defined by ALCO. Furthermore, the TC plays an active portfolio management role.

The Business Review Meeting (BRM), chaired by the Chairman of the Management Board and with the involvement of the other Board members as well as members of selected division heads, regularly monitors the achievement of targets by the divisions with regard to new business, income and costs and discusses other general topics of strategic importance. The analysis is used as a basis for identifying any plan variances and initiating any possible measures at an early stage, such as the reallocation of income or cost targets.

The objective of the Group Risk Committee (GRC) is the monitoring and management of all significant risks to HSH Nordbank, in order to secure the risk-bearing capacity at all times, on the basis of the risk tolerance of the Bank. To implement this objective, the GRC under the chair of the CRO in particular deals with reports and analyses on the individual risk types, the results of the stress tests and methodical further development of the risk steering models.

The MaSan Committee monitors the trend in recovery and early warning indicators defined in HSH Nordbank's recovery plan in accordance with MaSan (Minimum Requirements for the Design of Recovery Plans), performs an assessment of the overall financial situation and reports on this to the Overall Management Board. The objective is to enable the Management Board to take appropriate action if HSH Nordbank's situation deteriorates in order to ensure its financial stability.

The other key committees mainly include the Provisioning Meeting that deals with the loan loss provision trend and material loan loss provision cases (members: CRO, the chief representative (Generalbevollmächtigter, GBV) of the RU, heads of the relevant divisions), the NPNM decision-making committee (members: heads of the relevant divisions), the Project Portfolio Board (members: CFO, GBV of the COO division, heads of the relevant divisions), the OpRisk Committee (members: CRO, GBV of the COO division, heads of the relevant divisions), the Concentration Management Meeting (members: CRO as well as Management Board members/GBV and heads of the relevant divisions) and other committees of foreign branches.

Risk reporting and measurement systems

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

The following key reports are prepared for the overall risk:

- The MaRisk Risk Report constitutes the core element of risk reporting to the Management Board and the Risk Committee. It is prepared quarterly and shows HSH Nordbank's overall risk position together with detailed information on the material risk types.
- Furthermore, the Management Board is informed monthly of HSH Nordbank's overall situation with respect to the key value drivers, especially income, costs, liquidity and risk in the Finance and Risk Report.
- The MaSan Committee and the Overall Management Board are informed of the development of the recovery and early warning indicators by way of regular MaSan reporting.

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

Internal control system

Bank-wide internal control system

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

The ICS of HSH Nordbank is based on a bank-wide main and subprocess structure (process map), which also includes the domestic and foreign branches. A person responsible for the process is designated for all main processes.

Furthermore, a so-called ICS cycle is implemented, which is to be run regularly with the following steps:

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

The top priority of this ICS assessment is the structured and systematic examination of potential or known weaknesses in processes together with the definition of and the decision on measures to be taken to eliminate them. Furthermore, the ICS makes a significant contribution to the effectiveness of the processes by specifying uniform rules. The ICS cycle also ensures that the ICS is continuously enhanced with respect to its correctness and functionality. Central responsibility for the management and monitoring of the ICS as well as the enhancement of the methodology lies with the ICS Office of the Process Management & Organisation division.

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

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

The Bank determines the processes for running the control cycle are defined annually based on the risk established and the last cycle run for each process. Approximately 65 % of the processes were scheduled for a run of the control cycle in 2015. It was possible to remedy all control weaknesses identified for these processes. The management of the outsourcing of material functions by the ICS is reported to the Management Board on an annual basis.

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

Internal control system with regard to the accounting process

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

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

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

Regulatory requirements

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

Regulatory figures are set out in the section Net assets and financial position. The requirements that resulted from the further implementation of the Basel III rules in 2015 were implemented within the framework of projects. For example, the implementation of new liquidity ratios (LCR based on Commission Delegated Regulation (EU) 2015/61 and the net stable funding ratio (NSFR)) was driven forward in the reporting year.

In accordance with the requirements of Part 8 CRR in conjunction with Section 26a (1) Sentence 1 KWG HSH Nordbank publishes material qualitative and quantitative information on equity capital and risks incurred in a separate Disclosure Report. As an institution that uses the IRB Advanced Approach for nearly the whole portfolio, particular requirements apply to HSH Nordbank in this context. The document provides more information than statements made in this Annual Report on the basis of the accounting principles applied, as it provides a comprehensive insight into the regulatory framework and the current risk situation of the Bank based on regulatory figures. The Disclosure Report as at 31 December 2015 is available on our website, www.hsh-nordbank.de, about one month following publication of this Annual Report. With its publication HSH Nordbank complies with the third pillar of the Basel Accord (market discipline). The requirements regarding the disclosure of risk management objectives and policies in accordance with Article 435 (1) CRR and (2)(e) CRR are implemented in this Risk Report.

Risk-bearing capacity

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

As part of the monitoring of its risk-bearing capacity HSH Nordbank regularly compares the total economic capital required to cover all major quantifiable types of risk (overall risk) to the available amount of economic risk coverage potential and reports is to the supervisory authorities of the Bank. HSH Nordbank analyses its risk-bearing capacity comprehensively on a quarterly basis as well as within the framework of its annual planning process.

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

As at 31 December 2015, the risk coverage potential amounted to € 10.2 billion (31 December 2014: € 7.7 billion). The increase is mainly attributable to a reduction in the present value of the second loss guarantee costs deducted from the risk coverage potential as a result of the reduction in guarantee fees provided for under the informal agreement reached with, and formal decision of, the EU Commission and to an increase in the economically adjusted regulatory capital.

The overall risk takes into account default risk, market risk, operational risk as well as the liquidity maturity transformation risk as an element of liquidity risk. Economic capital required as an expression of unexpected losses is determined monthly for default, liquidity and market risks in a methodical consistent manner with a confidence level of 99.9 % and a risk horizon of one year. The economic capital requirements for the individual risk types are aggregated to an overall economic risk. In doing so, no risk-reducing correlations are utilised.

Overall economic risk decreased by € 0.3 billion compared to the end of 2014 and amounted to € 2.5 billion as at the reporting date (31 December 2014: € 2.8 billion). This decrease is mainly attributable to a decrease of default risk thanks to a lower exposure at default (EaD) in the reporting year.

The utilisation of risk coverage potential amounted to 25 % as at the reporting date (31 December 2014: 36 %). The risk-bearing capacity was secured at all times during the period under review.

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

RISK-BEARING CAPACITY OF THE GROUP

(€ bn)	**31.12.2015**	31.12.2014
Economic risk coverage potential[1]	**10.2**	**7.7**
Economic capital required	**2.5**	**2.8**
of which for default risks[2]	1.3	1.5
for market risks	0.8	0.8
for liquidity risks	0.2	0.3
for operational risks	0.2	0.2
Risk coverage potential buffer	**7.6**	**4.9**
Utilisation of risk coverage potential (in %)	**25**	**36**

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

The risk tolerance of HSH Nordbank is determined as part of the annual preparation of the risk strategy and the Bank planning process. Amongst other things this includes the level of the buffer between the risk coverage potential and the maximum accepted overall risk (global buffer). The buffer serves to cover any potential increase in the capital required in the event of adverse developments for HSH Nordbank as well as any non-quantified risks. In the course of the reporting year, a global buffer was reported that ensured adherence to the risk tolerance determined in the risk strategy at all times.

Stress tests

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

The framework linked to HSH Nordbank's recovery plan under MaSan has a comparable objective. It serves both the purpose of the early identification of any resource bottlenecks using appropriate indicators and their elimination in crisis situations by means of pre-defined options. The effectiveness of the options identified, the selected recovery and early warning indicators and related processes are reviewed in the recovery plan by means of specific stress scenarios.

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

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

DEFAULT RISK

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

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

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

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

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

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

Organisation of default risk management

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

Credit Risk Management is responsible for the risk analysis for the lending business of the Core Bank including the preparation and setting of the internal rating and drafting of the credit applications. Furthermore, the organisation of the bodies of rules for the lending business, including the related processes, is the responsibility of Credit Risk Management. The Loan Collateral Management division is responsible for the settlement of new lending business, the administration of the existing portfolio as well as the valuation and monitoring of collateral. The trading lines for counterparty and issuer risk are managed by the Group Risk Management division. As part of the trading line monitoring the potential future exposure on currency, interest rate and commodities derivatives is recalculated daily for each client on the basis of a 95% quantile and compared to the respective trading limit.

Lending decisions in the Core Bank are made jointly by the respective market department and back office. A decision cannot be made without back office approval. A separate department within Credit Risk Management (Core Bank) is responsible for decisions on and management of restructuring cases of the Core Bank, while operative restructuring activities are carried out in the Restructuring Unit. The Restructuring Unit independently takes all decisions necessary in respect of the positions transferred to it. As a matter of principle, the competence levels are based on nominal amounts and the internal rating category in line with the Core Bank.

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

The Group Risk Management division is responsible for the independent analysis and monitoring of risks at the portfolio level, independent reporting and the management of country risk for both the Core Bank and the Restructuring Unit. The Portfolio Management unit ensures portfolio transparency and is responsible for the independent business area analysis (including scenario simulations) and the operation of an early warning system for identifying loan exposures on a timely basis that are beginning to show signs of increased risk.

The principles and regulations contained in the Credit Manual of HSH Nordbank, in particular on lending competencies, the determination of the rating, the treatment of collateral and loan monitoring, form the basis for the operating activities within the lending business. Thereby, credit risks, recognised based on the definition of a loan under Article 389 of the Capital Requirements Regulation (CRR), are considered and treated differently based on collateral, loan type, rating category and type of credit risk. The basis is HSH Nordbank Group's aggregate exposure per group of connected clients (GCC) in accordance with Article 4 (39) CRR, whereby the bearer of the economic risk is always to be regarded as the relevant borrower.

The Bank has defined valuable collateral in order to differentiate between collateralised and non-collateralised loans. The focus is placed on meeting the requirements of the CRR (e.g. availability of a market value, ability to realise the collateral, no correlation to the collateralised loan, legal enforceability, and maturity match). The range of approved collateral can be expanded following an assessment carried out by a team independent of the market divisions consisting of specialists from the Credit Risk Management, Group Risk Management and Legal divisions.

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

Default risk management

Default risks account for the major part of the risk potential of HSH Nordbank. The Bank has developed an advanced range of instruments for their analysis, assessment and proactive management.

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

As a result of portfolio reduction implemented in the year under review, economic capital required for default risk decreased slightly to € 1.3 billion as at the reporting date after taking account of the second loss guarantee made available by the federal states of Hamburg and Schleswig-Holstein.

Non-performing exposure (NPE, total of all risk positions of borrowers in default) will be implemented in the future as an important management indicator in order to take account of the importance assigned to this key indicator by the banking supervisor and market participants.

In addition information on the non-performing portfolio will also continue to be disclosed in the IFRS reports (Note 57). Under the informal agreement with the EU Commission, which in principle was confirmed and set out in more detail in the formal decision, HSH Nordbank AG is to be relieved of a substantial portion of its troubled legacy portfolios. According to the formal decision it is intended that non-performing loans in the amount of € 5 billion be initially transferred at market prices to the federal state owners and an additional portfolio volume of up to € 3.2 billion be sold in the market. The volume of non-performing loans will decrease clearly thanks to these measures, which in turn will lead to a significant improvement of HSH Nordbank's non-performing exposure (NPE) ratio.

Rating procedures, LGD and CCF

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

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

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

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

As part of the annual validation process the predictive accuracy of the rating modules was reviewed in the reporting year with regard to the predicted probabilities of default using anonymous, aggregated data. In addition, the LGD and CCF processes were also validated and are being continually refined. All reviews have confirmed the full applicability of the models.

Risk concentrations

Within the framework of regular business segment analyses potential counterparty default risk concentrations, for example with regard to groups of connected clients (GcC), regions or industrial sectors in a broader sense, are identified and their trend is monitored. At the end of 2015 the material risk concentrations of HSH Nordbank were in the shipping portfolios of the Core Bank and Restructuring Unit, which accounted for 24% of the overall portfolio as well as in the US dollar business, which accounted for 30%. The shipping loan portfolios denominated in US dollars are included in both key figures.

An internal process, which reflects the regulatory requirements, was set up to monitor large exposure limits in accordance with Article 395 CRR. As a supplementary measure, the material counterparty concentrations in the portfolio are identified and reported quarterly to the Management Board and Risk Committee using risk-oriented parameters. Net rating-based upper limits are applied to new business to prevent future counterparty concentrations. Overdrafts of cases under both procedures are discussed in the regular Concentration Management Meetings where risk-reducing measures are discussed and their implementation is monitored.

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

Equity holding risk

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

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

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

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

Management of default risk in pricing and actual costing

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

Default risk exposure

The figures in the following tables showing default risk exposure are based on the EaD. The EaD corresponds to the volume of loan receivables, securities, equity holdings, derivative financial instruments (positive market values after netting) and off-balance-sheet transactions (taking credit conversion factors into account). The total EaD amount outstanding was € 98,037 million as at 31 December 2015.

The EaD broken down by internal rating categories is presented in the following table. The EaD with an investment grade rating (rating category 1 to 5) at Group level accounts for € 53,927 million or 55% of the total exposure (previous year: € 60,738 million or 55%). The loan amount outstanding for investment grade exposures amounts to € 44,670 million or 63% (previous year: € 46,690 million or 64%) for the Core Bank and € 9,257 million or 34% (previous year: € 14,048 million or 38%) for the Restructuring Unit. 42% of the Overall Bank portfolio is covered by the second loss guarantee (previous year: 48%). For the Core Bank a share of 26% is guaranteed (previous year: 29%) and for the Restructuring Unit 85% (previous year: 85%). At 92% (previous year: 92%) the share of the guaranteed portfolio is particularly high in the default categories 16 to 18.

DEFAULT RISK STRUCTURE BY RATING CATEGORY[1)]

(€ m)	**2015**				2014			
	Core Bank	Restructuring Unit	**Total**	of which guaranteed (in %)	Core Bank	Restructuring Unit	Total	of which guaranteed (in %)
1(AAAA) to 1 (AA+)	18,285	4,784	23,069	19	20,296	6,829	27,125	24
1(AA) to 1 (A-)	8,075	2,060	10,135	29	10,721	2,738	13,459	27
2 to 5	18,310	2,413	20,723	23	15,673	4,481	20,154	38
6 to 9	14,922	2,202	17,124	38	15,521	4,002	19,523	47
10 to 12	2,219	1,192	3,411	66	2,210	1,423	3,633	83
13 to 15	1,883	2,956	4,839	75	2,149	3,435	5,584	81
16 to 18 (default category)	6,770	11,638	18,408	92	6,303	13,522	19,825	92
Other[2)]	208	120	328	–	395	105	500	–
Total	**70,672**	**27,365**	**98,037**	**42**	**73,268**	**36,535**	**109,803**	**48**

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

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

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

DEFAULT RISK STRUCTURE BY SECTOR

(€ m)	2015			2014		
	Core Bank	Restructuring Unit	Total	Core Bank	Restructuring Unit	Total
Industry	8,507	1,379	9,886	8,095	1,597	9,692
Shipping	15,392	7,427	22,819	15,791	8,378	24,169
Trade and transportation	3,352	1,159	4,511	3,867	2,076	5,943
Credit institutions	8,262	850	9,112	8,993	1,397	10,390
Other financial institutions	2,929	3,461	6,390	2,884	5,988	8,872
Land and buildings	10,211	4,881	15,092	9,469	6,633	16,102
Other services	6,331	1,534	7,865	6,312	2,588	8,900
Public sector	15,192	6,101	21,293	16,963	7,196	24,159
Private households	496	573	1,069	894	682	1,576
Other	–	–	–	–	–	–
Total	**70,672**	**27,365**	**98,037**	**73,268**	**36,535**	**109,803**

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

DEFAULT RISK STRUCTURE BY RESIDUAL MATURITIES

(€ m)	2015			2014		
	Core Bank	Restructuring Unit	Total	Core Bank	Restructuring Unit	Total
Up to 3 months	8,776	3,959	12,735	11,872	3,373	15,245
> 3 months to 6 months	2,062	729	2,791	2,333	1,516	3,849
> 6 months to 1 year	3,919	823	4,742	3,882	3,240	7,122
> 1 year to 5 years	35,395	9,041	44,436	32,241	12,834	45,075
> 5 years to 10 years	15,613	6,794	22,407	17,529	7,104	24,633
> 10 years	4,907	6,019	10,926	5,411	8,468	13,879
Total	**70,672**	**27,365**	**98,037**	**73,268**	**36,535**	**109,803**

The following table provides an overview of the foreign exposure by region, which reached € 39,650 million as at 31 December 2015 (previous year: € 50,827 million).

FOREIGN EXPOSURE BY REGION

EaD (€ m)	2015			2014		
	Core Bank	Restructuring Unit	**Total**	Core Bank	Restructuring Unit	Total
Western Europe	14,916	9,991	24,907	15,229	13,772	29,001
of which eurozone countries	9,810	6,035	15,845	10,191	8,195	18,386
Central and Eastern Europe	1,034	337	1,371	1,083	465	1,548
of which eurozone countries	52	42	94	55	126	181
Africa	939	276	1,215	852	307	1,159
North America	1,939	2,656	4,595	5,636	5,083	10,719
Latin America	633	453	1,086	684	546	1,230
Middle East	48	808	856	56	949	1,005
Asia-Pacific region	3,318	1,459	4,777	3,178	2,046	5,224
International organisations	815	28	843	911	30	941
Total	**23,642**	**16,008**	**39,650**	**27,629**	**23,198**	**50,827**

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

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

The following table shows the EaD of the exposures in the European countries stated. HSH Nordbank's total exposure to these countries has decreased by 16% compared to the previous year and amounted to € 6,180 million in total as at 31 December 2015 (previous year: € 7,341 million).

EXPOSURE AT DEFAULT IN SELECTED EUROPEAN COUNTRIES

(€ m)	Country		Banks		Corporates/Other		Total	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014
Greece	–	6	–	–	1,163	1,224	1,163	1,230
Italy	445	691	–	1	639	683	1,084	1,375
Croatia	–	–	–	–	106	117	106	117
Portugal	223	270	4	3	29	51	256	324
Russia	–	–	4	6	135	128	139	134
Spain	156	211	58	134	1,328	1,592	1,542	1,937
Turkey	–	–	22	44	473	476	495	520
Cyprus	–	–	–	21	1,395	1,683	1,395	1,704
Total	**824**	**1,178**	**88**	**209**	**5,268**	**5,954**	**6,180**	**7,341**

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

Note 55 includes more information on the selected European countries.

Loan loss provisions

Within the framework of risk management, HSH Nordbank pays the most attention to default risk. Impairments of a loan commitment are shielded through the creation of individual valuation allowances for loans and advances and provisions for contingent liabilities in the amount of the potential loss in accordance with Group-wide standards. HSH Nordbank also recognises portfolio valuation allowances for latent default risks, which have already occurred but are not yet known to the Bank as at the balance sheet date.

All restructuring and workout commitments are subject to a comprehensive two-step review process every quarter. In a first step, a review is carried out on the basis of objective criteria (so-called trigger events) to determine whether the receivable could be impaired (impairment identification). If this is the case, the loans identified are reviewed in a second step to determine whether a loan loss provision is actually required and the amount thereof (impairment measurement). The amount of the loan loss provision is calculated by deducting the present value of all expected future incoming payments from the IFRS carrying amount of the receivable. The expected incoming payments comprise in particular all expected interest and redemption payments, as well as payments from the liquidation of collateral.

The overall trend in loan loss provisions, significant loan loss provision cases and potential changes to the loan loss provisions and the creation of new loan loss provisions are addressed in the monthly Provisioning Meeting, in which the CRO, the authorised chief representative (Generalbevollmächtigter) responsible for the Restructuring Unit and the heads of the relevant departments participate.

The following tables show the loan loss provision trend by segment:

CHANGES IN LOAN LOSS PROVISIONS

(€ m)	01.01. – 31.12.2015							
	Individual valuation allowances/ provisions	Portfolio valuation allowances	**Loan loss provisions before currency translation and compen-sation**	Net income from foreign currency from loan loss provisions	Compensation item	**Total**	Hedging effect of credit derivative second loss guarantee	**LLP incl. hedging effect credit derivative**
Shipping, Project & Real Estate Financing	– 1,546	35	– 1,511	0	0	– 1,511	0	– 1,511
Corporates & Markets	– 29	80	51	0	0	51	0	51
Corporate Center	0	– 440	– 440	37	0	– 403	0	– 403
Consolidation Core Bank	– 2	1	– 1	– 192	1,839	1,646	282	1,928
Total Core Bank	**– 1,577**	**– 324**	**– 1,901**	**– 155**	**1,839**	**– 217**	**282**	**65**
Restructuring Unit	– 1,192	73	– 1,119	0	0	– 1,119	0	– 1,119
Consolidation Restructuring Unit	0	0	–	-256	1,238	982	376	1,358
Total Restructuring Unit	**– 1,192**	**73**	**– 1,119**	**– 256**	**1,238**	**– 137**	**376**	**239**
Group	**– 2,769**	**– 251**	**– 3,020**	**– 411**	**3,077**	**– 354**	**658**	**304**

CHANGES IN LOAN LOSS PROVISIONS[1)]

(€ m)	01.01. – 31.12.2014							
	Individual valuation allowances/ provisions	Portfolio valuation allowances	**Loan loss provisions before currency translation and compen-sation**	Net income from foreign currency from loan loss provisions	Compensation item	**Total**	Hedging effect of credit derivative second loss guarantee	**LLP incl. hedging effect credit derivative**
Shipping, Project & Real Estate Financing	– 411	8	– 403	–	–	– 403	–	– 403
Corporates & Markets	– 44	– 12	– 56	–	–	– 56	–	– 56
Corporate Center	–	–	–	63	–	63	–	63
Consolidation Core Bank	– 3	1	– 2	– 164	497	331	1	332
Total Core Bank	**– 458**	**– 3**	**– 461**	**– 101**	**497**	**– 65**	**1**	**– 64**
Restructuring Unit	– 69	44	– 25	–	–	– 25	–	– 25
Consolidation Restructuring Unit	–	–	–	– 238	904	666	–	666
Total Restructuring Unit	**– 69**	**44**	**– 25**	**– 238**	**904**	**641**	**–**	**641**
Group	**– 527**	**41**	**– 486**	**– 339**	**1,401**	**576**	**1**	**577**

1) The way in which loan loss provisions are presented has changed compared to the previous year. The previous year figures have been adjusted for purposes of comparability.

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, 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 into account.

Net loan loss provision expense amounted to € -3,020 million before taking the compensation effects under the guarantee into account.

This includes additional net loan loss provisions of € 1,584 million due to the effects of the changed commitment strategies taking 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) into account.

Furthermore, loan loss provisions had to be increased 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 which were recognised in total in the corporate loan portfolio.

Individual valuation allowances and direct write-downs excluding the transaction portfolios amounted in total to € – 1,436 million. In addition, HSH Nordbank had to recognise extensive portfolio valuation allowances in order to reflect the risks arising from the very challenging environment in the shipping markets, and take account of new standards to be observed in shipping.

Loan loss provisions recognised in particular for the legacy shipping portfolios and the additional loan loss provisions recognised for the transaction portfolios due to the changed commitment strategies that take account of market values as at the planned date of sale were largely compensated for by the guarantee.

The relief regarding guarantee fees, agreed under the informal agreement and set out in more detail in the formal decision, had a positive effect on loan loss provisions and comprised the reversal of guarantee premiums, except for the payments still to be expected after 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 and recognition of the debt waiver as an expense (€ 781 million).

In total, HSH Nordbank disclosed loan loss provisions of € –354 million including the hedging effect of the financial guarantee contract as at the 2015 year end (previous year: € 576 million). Including the hedging effect of the credit derivative loan loss provisions would have been a positive amount of € 304 million (previous year: € 577 million).

Detailed information on the development of loan loss provisions in the individual divisions is set out in the Segment reporting section.

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

TOTAL LOAN LOSS PROVISIONS

(€ m)	**2015**	2014
Loans and advances to customers	56,575	67,336
Loans and advances to banks	5,595	6,915
Volume of impaired loans	15,766	13,303
Non-current assets held for sale and discontinued operations (IFRS 5)	5,082	
Individual valuation allowances for loans and advances to customers	–7,601	–5,777
Portfolio valuation allowances for loans and advances to customers	–611	–343
Individual valuation allowances for loans and advances to banks	–14	–14
Portfolio valuation allowances for loans and advances to banks	–1	–1
Total loan loss provisions for balance sheet items	**–8,227**	**–6,135**
Provisions for individual risks in the lending business	–57	–47
Provisions for portfolio risks in the lending business	–50	–51
Total loan loss provisions for off-balance sheet items	**–107**	**–98**
Total loan loss provisions (before compensation item)	**–8,334**	**–6,233**
Compensation item	7,162	4,074
Total loan loss provisions (including compensation item)	**–1,172**	**–2,159**

The loss rate in the Group amounted to 1.35 % in the reporting year (previous year: 1.00 %). The loss rate is calculated based on the actually realised defaults as a ratio of the credit risk exposure. The total amount of actually realised defaults in 2015 was € 1,316 million (previous year: € 1,136 million) and the credit risk exposure € 97,554 million (previous year: € 113,255 million). The credit risk exposure includes all balance sheet and off-balance sheet assets, taking account of the individual and portfolio valuation allowances for loans and advances to customers and banks that are subject to default risk. Total loan loss provisions (including compensation items) for the Group amounted to € –1,172 million as at 31 December 2015 (previous year: € –2,159 million).

Total individual valuation allowances amounted to € –7,672 million (previous year: € –5,838 million), comprising individual valuation allowances of € –7,615 million (previous year: € –5,791 million) for loans and advances to banks and customers, € –55 million (previous year: € –38 million) for contingent liabilities and irrevocable loan commitments and € –2 million (previous year: € –9 million) for other off-balance sheet transactions.

The portfolio valuation allowances totalled € –662 million (previous year: € –395 million) and were composed of portfolio valuation allowances of € –612 million (previous year: € –344 million) for loans and advances to banks and customers and € –50 million (previous year:
€ –51 million) for contingent liabilities and irrevocable loan commitments.

Details regarding the total loan loss provisions are presented in Notes 14, 26 and 42.

Planning for loan loss provisions and losses

Loan loss provisions are planned as part of the annual Bank plan under the plan assumptions specified therein. The planning includes the annual changes in the amounts of the individual and portfolio valuation allowances, broken down by the amounts covered by and not covered by the second loss guarantee and including new business. Other components of the plan are the change in the utilisation of the second loss guarantee as well as the actual losses invoiced and the total loss to be expected from the second loss guarantee.

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

The effects arising from the transfer of a portfolio of initially € 5 billion to the federal state owners and a sale of up to € 3.2 billion have been taken into account in the years 2016 and 2017 charging the resulting losses against the guarantee. Further information on the EU state aid proceedings is set out in the Forecast, opportunities and risks report section.

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

The payment defaults expected in the portfolio covered by the second loss guarantee will probably exceed the amount retained by the Bank of € 3.2 billion starting from 2016 and will result in actual payments under the second loss guarantee. Further details on the second loss guarantee can be found in Note 2.

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

Reports on default risk

The Management Board and Risk Committee are regularly informed regarding the risk content and the trend in the individual asset classes and/or sub-portfolios as well as recommended measures by means of the portfolio batch reports. In this context, particular importance is attached to risk concentrations.

Other regular reports on default risk include the tied-up capital and funding requirement limit utilisation report, problem loan report, new business and pipeline report, profit centre accounting, report on the rating validation results, rating migration report and the report under CoRep (Common Solvency Ratio Reporting). These reports are supplemented with information on the monitoring and management of country risk.

MARKET RISK

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

Organisation of market risk management

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

Market risk was actively managed in the Capital Markets division in the year under review. The Asset Liability Management (ALM) department in the Finance division (former Strategic Treasury division) performs the central management function for interest and foreign exchange risks in the banking book. The Asset Liability Committee is responsible for selected strategic positions exposed to market risk.

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

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

Market risk management

Market risk measurement and limitation

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

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

The main market risks at HSH Nordbank are interest rate risk (including credit spread risk) and foreign exchange risk. In addition to these risk types, the VaR of HSH Nordbank also covers equity and commodity risk for both the trading book and the banking book. The basis risk is also taken into account in determining the VaR.

The basis risk constitutes the risk of a potential loss or profit resulting from changes in the proportion of prices or interest rates on similar financial products within a portfolio. The individual market risk types are not restricted by separate limits. Limitation is applied within the VaR limit for the overall market risk of the Bank. Limits are set for the VaR for the different reporting units for the purposes of managing market risk, whereas losses incurred are restricted through stop loss limits. There are clearly defined processes for limit adjustments and breaches.

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

Further information on this and the type and categories of the hedging instruments and hedging relationships entered into by HSH Nordbank as well as the type of risks hedged is presented in the Notes. In particular we refer to Section I. F) of Note 7 Accounting policies, Note 10 Result from hedging, Note 27 Positive fair values of hedging derivatives, Note 40 Negative fair values of hedging derivatives and Note 60 Report on business in derivatives.

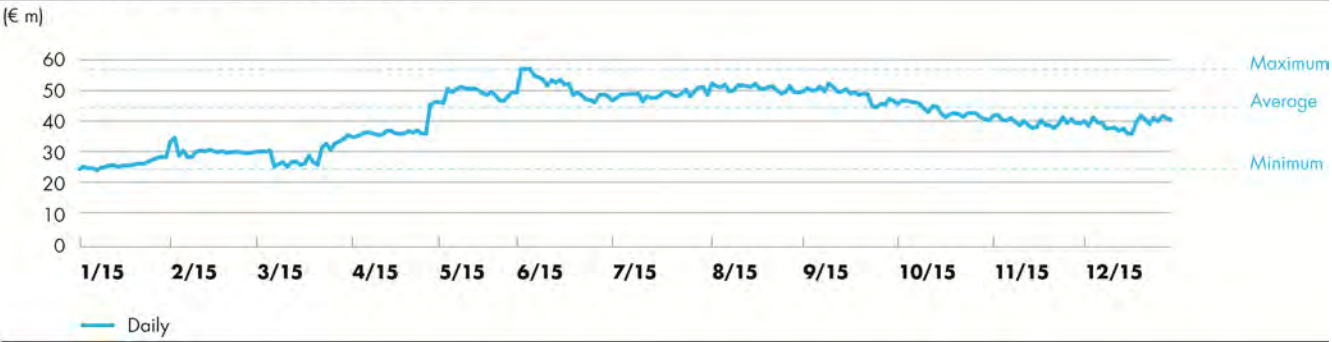
Market risks arising from the lending business and liabilities of the Bank are transferred to the trading divisions and taken into account in the corresponding risk positions. There they are managed as part of a proactive portfolio management process and hedged through external transactions.

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

Daily value-at-risk during the year under review

The following chart illustrates the movement in the daily VaR for the total trading and banking book positions of HSH Nordbank over the course of 2015.

DAILY VALUE-AT-RISK IN THE COURSE OF 2015



Market risk fluctuated between € 25 million and € 57 million. The key driver behind the increase in the overall VaR in the first six months was temporary market volatility.

The VaR of the trading book positions amounted to € 2 million as at 31 December 2015, while that of the banking book transactions amounted to € 40 million. The overall VaR, which cannot be derived from the total VaR of the trading and banking book positions due to risk-mitigating correlation effects, amounted to € 41 million as at the reporting date. This resulted in a limit utilisation of 58 % based on a VaR limit of € 70 million.

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

DAILY VALUE-AT-RISK OF THE GROUP

(€ m)	Interest rate risk[1]		Credit spread risk[1]		Foreign exchange risk		Equity risk		Commodity risk		Total[2]	
	2015	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014	**2015**	2014
Average	18.3	9.1	23.0	18.4	19.5	11.3	2.9	2.3	–	0.2	41.6	22.7
Maximum	24.9	13.7	28.0	25.3	25.4	16.1	6.2	5.7	0.2	0.5	57.3	28.4
Minimum	11.4	6.2	17.7	15.3	10.3	8.0	1.1	0.8	–	–	24.7	16.2
Period end amount	19.4	12.1	24.0	18.4	21.3	9.9	4.1	1.1	–	0.1	40.9	26.0

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

Overall VaR increased by € 15 million to € 41 million compared to the previous year. With regard to the risk types there mainly was an increase in interest rate and foreign exchange risk. This is attributable to the temporary increase in market volatility, which is reflected in new increased risk scenarios during the period of historical simulation.

The market risk of the Core Bank is primarily characterised by interest rate and foreign exchange risk arising from the lending business, funding and the trading book, which predominantly contains positions resulting from trading in interest rate and currency derivatives with customers and bond trading. Furthermore, market risk includes, to a lesser extent, credit risk spread risk on securities positions. Equity and commodity risks are marginal.

The market risk of the Restructuring Unit arises predominantly from the credit investment business or the credit investment portfolio in the banking book. Accordingly, credit spread risk is the dominant factor.

Backtesting

HSH Nordbank performs regular backtests to verify the appropriateness of its VaR forecasts. On the assumption of unchanged positions, the daily profit and loss achieved in theory due to the market developments observed are compared with the VaR values of the previous day, which were forecast using historical simulation. Based on the assumption of the confidence level of 99 % applied by HSH Nordbank, up to four outliers indicate that the forecasting quality for market risks is satisfactory. In 2015 five outliers were recorded both in the month of June and December at the HSH Nordbank Group level. Nevertheless, the outliers identified do not indicate any fundamental weakness in the model. The reason for this is more the increased market volatility, to which the Bank's market risk model gradually adapts. Appropriate surcharges were added to total VaR in the following month to take account of the increasing volatility and reduce the number of outliers.

Stress tests

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

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

Reports on market risk

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

LIQUIDITY RISK

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

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

Another component of insolvency risk is the refinancing risk, i.e. the danger, of not being able to obtain liquidity or not at the expected conditions if required. The refinancing risk is determined by the refinancing structure. Information on the refinancing structure can be found in Note 52 Residual maturity breakdown of financial instruments to the consolidated financial statements.

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

Organisation of liquidity risk management

Strategic liquidity management is the responsibility of the ALM department in the Finance division (former Strategic Treasury division). The objective of liquidity management is to ensure the solvency of HSH Nordbank at all times, at all locations and in all currencies, to adhere to the regulatory liquidity ratios, to manage the marketability of the liquid assets of the liquidity buffer and to avoid concentration risks in the refinancing structure. The Capital Markets division is responsible for funding and marketing.

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

The ALCO is the central committee responsible for managing the resource liquidity and is assisted by the Transaction Committee in this task by means of an active portfolio management at the level of material individual transactions.

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

Liquidity risk management

Measurement and limitation of liquidity risk

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

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

The liquidity potential available to close gaps is composed of a securities portfolio held as a crisis precaution measure (liquidity buffer), further highly liquid and liquid securities, according to how liquid they are, unsecured funding options, secured funding potential from the issue of Pfandbriefe and industrial loans eligible for refinancing with central banks. In addition, the long-term funding potential from illiquid assets used as collateral is also taken into account. Most of the portfolio of securities and promissory notes is invested in liquid markets and can be liquidated via the refinancing channels, namely central banks, Eurex repo market, bilateral repo market or the cash market.

The components of the liquidity potential – such as the liquidity buffer required under MaRisk for example – are monitored continuously and validated in accordance with internal and external minimum requirements. Safety buffers and risk discounts are incorporated into the limits in order to keep the probability of full utilisation or overdrawing the limits as low as possible. These discounts are, for example, haircuts or other safety margins that reflect the uncertainty about the future development of the respective component of liquidity potential. Permanent market access to the funding sources relevant for HSH Nordbank is also monitored on a regular basis. This is achieved firstly through the ongoing market observation of all funding sources by the Bank's divisions. Secondly, Group Risk Management daily reviews the funding potential based on the expected prolongation ratios for short-term deposits. ALM also prepares actual/plan analyses regarding long-term funding.

The liquidity-value-at-risk (LVaR) as a reflection of liquidity maturity transformation risk is calculated monthly through historical simulation (confidence level 99.9 %) of the liquidity spread and their present value effects on transactions, which would be necessary theoretically in order to immediately close the current maturity transformation position. In doing so, it is assumed that these hypothetical close-out transactions could actually be effected in the market and that full funding is therefore possible. LVaR limits are set at Group level and are a part of the risk-bearing capacity concept.

Liquidity management

The short-term liquidity base and the regulatory liquidity ratios are operationally managed by the Capital Markets division based on general parameters specified by the ALM department. In addition to the regulatory requirements the liquidity development reports are relevant amongst other things to determine these general parameters. Any setting of or change to the individual parameters or the framework requirements is decided by the ALCO. This places HSH Nordbank in the position to react flexibly to market developments.

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

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

Stress tests

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

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

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

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

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

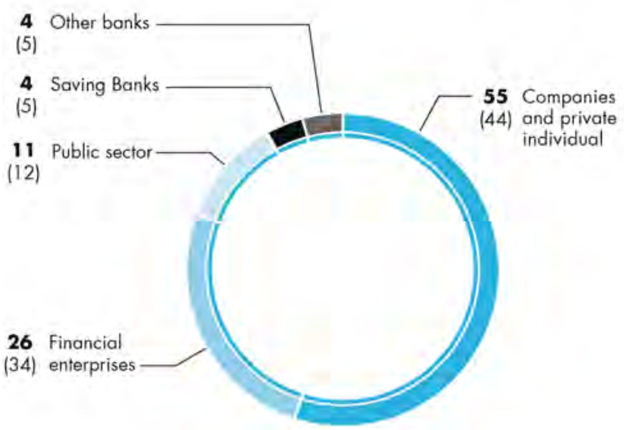
Risk concentrations

HSH Nordbank has established a monitoring system for managing concentrations of both asset and liability instruments. Special emphasis is placed on deposits that are analysed and reported on with regard to the depositor structure (investor, sectors), maturities (original and residual maturities) and deposit drain risk.

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

DEPOSITOR STRUCTURE AS AT 31 DECEMBER 2015[1]

in % (previous year figures)



[1] In addition to call an term deposits this illustration also includes demand deposits for the first time.

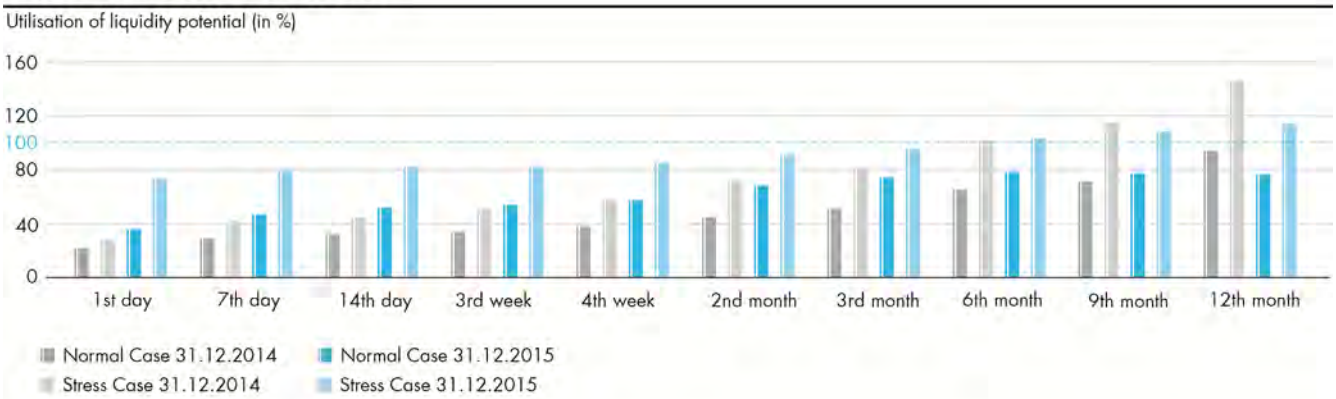
Quantitative measures are calculated for the purposes of analysing existing risk concentrations. Furthermore, an analysis is performed not only on the structure but especially on the risk content, in order to be able to derive according control impulses from the quantitative measures in combination with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

In addition to the analysis of the depositor structure with regard to existing depositor concentrations, risk concentrations are examined with regard to the US dollar asset/liability position. This shows a dependency of the liquidity situation on the movement in the US dollar, which is still to be regarded as high. This is due to the large amount of US dollar assets that are refinanced through EUR/USD basis swaps amongst other things. A decrease in the EUR/USD exchange rate will increase the cash collateral to be provided on foreign currency derivatives, representing a burden on liquidity. For the purposes of analysing the dependency on the US dollar, a US dollar liquidity development report is prepared and sensitivity analyses are performed regularly for cash collateral. In addition a US dollar stress test of the liquidity development report is performed. The depositor structure is characterised by a large proportion of short-term deposits resulting from the build-up of excess liquidity in advance of the extensive maturities of bonds covered by the guarantor liability in 2015 and the current concentration on few depositors.

Quantification of liquidity risk

The following illustration shows the relative utilisation levels of the liquidity potential for individual cumulative liquidity gaps in the normal case and stress case as at 31 December 2015 as well as at the end of 2014. Utilisation represents the share of the cumulative gap in total liquidity potential, which also includes the liquidity buffer required under supervisory law.

LIMIT ON CUMULATIVE LIQUIDITY GAPS



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

In the normal case assessment that is based on the assumption of business development in an ordinary market environment, the liquidity potential had a peak utilisation of 78 % in the sixth month as at the reporting date. All limits within the minimum survival period of twelve months defined by the Bank were thereby adhered to. The stress case liquidity development report (combined scenario-economic downturn and rating downgrade - based on the assumption of a gradual increase in the US dollar, amongst other things) shows that the liquidity potential was also not exceeded within the minimum survival period of one month established taking Minimum Requirements for Risk Management (MaRisk) into account. In fact, the limits as at the end of 2015 are even adhered to for a period of four months. Compared to the 2014 year end, utilisation levels have mainly increased in the normal case and stress case liquidity development report. The increase in utilisation is attributable in particular to the shortening of maturities and maturities of liabilities covered by the guarantor liability. Critical limit utilisation levels were recorded neither in the normal case nor in the stress case liquidity development report in the course of the period under review.

The results of the market-specific and Bank-specific stress scenarios determined in addition to the stress case liquidity development report show that as at December 2015 the liquidity requirement of HSH Nordbank was covered for four months up to twelve months despite the worst case assumptions for each scenario. A minimum survival period of one month is thereby maintained in all scenarios. The results show that HSH Nordbank is prepared accordingly for the crisis scenarios assessed.

In the year under review, the LVaR as an expression of the liquidity maturity transformation risk decreased to € 0.2 billion (31 December 2014: € 0.3 billion). The decrease is attributable to the reduction of long-term financing requirements as well as the elimination of historical scenarios during the period of historical simulation.

Regulatory liquidity ratios

The regulatory management parameter for liquidity risks is the liquidity ratio defined by the German Liquidity Regulation (LiqV). With values between 1.47 and 2.13, HSH Nordbank's liquidity ratio remained above the regulatory minimum value at all times throughout the reporting year. The average value for 2015 was 1.89 (previous year: 1.96), and 1.89 as the reporting date (31 December 2014: 1.99).

Under Basel III the Liquidity Coverage Ratio (LCR) was specified as an additional ratio to ensure liquidity in an acute stress phase of 30 days. When calculating the LCR the amount of highly liquid assets is compared to the net outflows over the next 30 days. The ratio is to be complied with since the Delegated Regulation (EU) 2015/61 entered into force on 1 October 2015, whereby the compliance rate increases from an initial 60% to 90% in 2018. As at the reporting date, the LCR was 115% within the framework of the provisional data capture sheet of the Delegated Regulation (EU) 2015/61 (previous year: 147%) which means that it was above the future minimum threshold.

The Net Stable Funding Ratio (NSFR), which must be adhered to from 2018 at the earliest, is calculated as the ratio of available funding resources across all maturities to the funding required and also must be at least 100% after full implementation. As at the end of the last quarter of 2015 the NSFR amounted to 95% (previous year: 96%) within the framework of the QIS (regulatory framework under Basel).

Refinancing situation

The implementation of the funding strategy was successfully driven forward during the course of the financial year thereby strengthening the liquidity profile of the Bank. Besides the issuing activities a stable level of deposits contributed to the refinancing of the business. The regulatory requirements concerning the liquidity ratios 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. However, there is no unrestricted access to the capital markets. Future funding and HSH Nordbank's rating continue to be key challenges despite this positive development. In the reporting year HSH Nordbank accelerated the winding down of legacy portfolios, particularly in the US dollar area, to reduce the effect of changes in exchange rates on, inter alia, the Bank's liquidity and strengthen the liquidity position against the backdrop of liabilities covered by the guarantor liability maturing in December 2015. Restrictions were also placed on new US dollar business. In the event of a sustained appreciation in the US dollar HSH Nordbank has prepared measures that aim at further reducing the asset volume to be refinanced. Furthermore, the sales of portfolios totalling € 8.2 billion to the federal states and in the market planned as part of the informal agreement reached with the EU Commission will significantly ease funding requirements and the liquidity position in the future.

Further information on HSH Nordbank's refinancing situation is set out in the Earnings, net assets and financial position and Forecast, opportunities and risks report sections.

Reports on liquidity risk

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

OPERATIONAL RISK

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

Operational risks are determined in accordance with the modified regulatory standardised approach for the purposes of managing the risk-bearing capacity. The corresponding economic capital required amounted to € 0.2 billion as at 31 December 2015 (31 December 2014: € 0.2 billion).

Organisation of operational risk management

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

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

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

Operational risk management

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

Loss event database

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

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

In the reporting year 49 % (previous year: 41 %) of the operational loss events reported were incurred in the Employee risk category. This risk category includes, for example, processing errors or unauthorised actions. The proportion of operational loss events reported under the Internal processes risk category amounted to 24 % (previous year: 29 %). These include, for example, deficient or missing processes. The proportion of operational loss events reported under the External influences category (e.g. criminal acts, regulatory and statutory requirements) amounted to 23 % (previous year: 24 %). The proportion of loss events reported under the Internal infrastructure category (e.g. system failures, functionality or security) amounted to 4 % (previous year: 6 %).

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

Risk inventory

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

Control of measures

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

Risk indicators

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

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

Management of personnel risks

Personnel risk refers to the risk of losses that may occur as a result of the unplanned departure of key personnel of HSH Nordbank, shortage of skilled employees or poor motivation of employees. This risk could materialise particularly in light of the current reduction in staff. The Human Resources division is therefore focusing increasingly on measures to reduce personnel risk. A large number of personnel management tools for employee retention are used to prevent the unscheduled departure of key personnel. In addition, headcount requirements are planned for a period of several years based on future operational needs to avoid bottlenecks by timely recruitment.

IT risk management

The IT division is responsible for IT risk management. In the IT strategy the division has defined as the primary objective of IT risk management to identify IT risks at an early stage, in order to be able to avert or reduce losses that may result e.g. from an inadequate IT infrastructure on the basis of clear responsibilities. IT-specific risk tools are used by means of which risks are actively managed in projects and in the line functions and reduced by a monitored implementation of measures.

The IT risk management methodology was adapted to current requirements and fundamentally revised at this occasion in 2015. In addition it was possible to reduce IT risks further in the year under review by intensive project work.

Business continuity management

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

Internal control system

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

Management of legal risk

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

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

HSH Nordbank recognised provisions of € 37 million (previous year: € 50 million) for litigation risks and costs as at the reporting date. In addition, contingent liabilities of € 40 million (previous year: € 41 million) arising from legal disputes are disclosed. A major portion of the provisions for litigation risks relates to the three legal proceedings mentioned below.

Since 2005 HSH Nordbank AG has been involved in legal proceedings with a Turkish shipping group and up to now had to pay a total amount of € 54 million US dollar in the year 2013 due to decisions of Turkish courts. The plaintiffs have filed new claims under which damages are asserted based on the same facts. Appropriate provisions were recognised for this in the previous years.

In addition, HSH Nordbank AG is being sued for damages in the amount of € 34 million by a service provider and is making a counterclaim thus far of approximately € 39 million in a cross-action.

Contingent liabilities relating to legal disputes result from several individual cases involving claims of up to € 7 million.

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

HSH Nordbank AG recognised other provisions relating to legal risks in the amount of € 3 million on the basis of current German case law of the Federal Court of Justice (BGH) regarding the reimbursement of loan processing fees.

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

HSH Nordbank recognised provisions (including interest) totalling € 56 million (previous year: € 159 million) for tax risks as at the reporting date. A major portion of this relates to tax risks with respect to the tax audits (in connection with internal cost allocations to foreign entities, structured transactions, reimbursement of value-added tax on inputs, and risks resulting from the tax treatment of investment income).

Management of compliance risk

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

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

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

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

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

Reports on operational risk

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

Material risk events are also reported on an ad hoc basis to the relevant Management Board member.

OTHER MATERIAL RISKS

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

Transformation risk

Transformation risk is the risk of a financial loss being incurred as a result of long-term decisions which are erroneous or based on incorrect assumptions, particularly with respect to decisions that could place the whole ongoing restructuring process at risk, or related to the performance of individual areas of business or the banking sector as a whole. Should HSH Nordbank not be successful in identifying changes in markets relevant for it on a timely basis, this could have a negative impact on its competitiveness. Changes to laws and regulations or new regulatory requirements for instance could also jeopardise the implementation of HSH Nordbank's business model.

Strategic risk is managed via the periodic review and updating of the business strategy. The responsibility for the strategy of HSH Nordbank rests with the Overall Management Board, while the Strategy division is responsible for the process. An action-oriented management dialogue, including on the strategic business objectives, is conducted during the year in the BRM that are held at least quarterly.

The second loss guarantee was replenished to the original amount of € 10 billion as at 30 June 2013 following a partial cancellation in 2011 in order to comply with the increasingly strict regulatory conditions and the requirements of the capital markets concerning capital ratios in a sustainable manner. As the replenishment of the guarantee constitutes a case relevant under state aid law, the European Commission instituted new state aid proceedings. With the formal decision of the EU Commission regarding the approval of the replenishment of the guarantee facility and changes to the guarantee agreement HSH Nordbank's federal state owners and the EU Commission agreed on a series of measures to relieve the Bank of its legacy portfolios. Further information on the EU state aid proceedings is set out in the Business developments - Significant developments and events in the 2015 reporting year and in the Forecast, opportunities and risks report, particularly in the Formal decision in the EU state aid proceedings section.

Reputation risk

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

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

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

SUMMARY OF RISK ASSESSMENT AND OUTLOOK

The 2015 financial year was characterised by the continuing winding down of high-risk, non-strategic lending and capital markets transactions held in the Restructuring Unit portfolio as well as by the progress made in implementing the business model.

The risk-bearing capacity of HSH Nordbank was maintained at all times during the year under review with a maximum utilisation of the risk coverage potential of 37 %. The guarantee facility of € 10 billion as well as the ongoing winding down of risk positions made a positive contribution in this regard.

There are still some challenges facing the Bank in particular with regard to risk concentrations in the shipping loan portfolios and the US dollar business of HSH Nordbank. The ongoing difficult conditions on the shipping markets had a particular negative impact in this regard.

On the other hand, the transfer agreed under the informal agreement reached with the EU Commission and confirmed by the formal decision of the EU Commission of non-performing loans in the amount of initially € 5 billion to the federal state owners at market prices, together with the sale of a portfolio of up to € 3.2 billion in the market, will provide relief in the future.

The implementation of the new supervisory requirements will continue to be a focus of our activities in 2016. The Basel Standard 239 (BCBS 239) gives rise, for example, to comprehensive future requirements regarding the capacity to aggregate risk data including the IT architecture and risk reporting by banks. In addition, the requirements of the EBA/ ECB resulting from the supervisory review and evaluation process (SREP) have to be met. The requirements mentioned above will be implemented within projects.

The risk and bank management systems described in this report are aligned to take account of risk on a systematic basis. This also applies to our expectations regarding future market and business developments. We believe that we have appropriately presented the overall risk profile of HSH Nordbank Group as well as the opportunities and risks inherent in the future development of our business activities in the Forecast, opportunities and risks report section and in this Risk report in an appropriate and comprehensive manner.

Hamburg/Kiel, 31 May 2016

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