hsh portfoliomanagement AöR

ANNUAL REPORT 2017

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hsh portfoliomanagement AöR

hsh portfoliomanagement AöR (hereinafter also referred to as hsh portfoliomanagement or hsh pm) was established in December 2015 as an asset resolution entity based on a State Treaty entered into by the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein, who were to be the joint sponsors of the entity.

The mandate of hsh portfoliomanagement AöR, which is an entity under German public law, is to carry out the resolution of a portfolio of non-performing loans related to ship financing transferred from HSH Nordbank AG while preserving the value of the assets as far as possible. The outstanding amount of the transferred loans was EUR 3.86 billion as of 31 December 2017. The carrying amount as of 31 December 2017 was EUR 1.64 billion.

hsh portfoliomanagement AöR enjoys outstanding ratings from international rating agencies thanks to the guarantees provided by its sponsors and arranges its own funding through the money and capital markets.

The Executive Board (Ulrike Helfer and Dr. Karl-Hermann Witte) and the 60 employees are guided by a clear mission statement: “To provide expert portfolio resolution while preserving the financial interests of the sponsors”.

/ KEY FIGURES

PORTFOLIO

in EUR million	31 Dec. 2017	31 Dec. 2016	Change
Outstanding loan amount	3,856	4,478	-622
Carrying amount	1,643	2,038	-395

- / The outstanding loan amount refers to the amounts due from customers, comprising outstanding loan principal and unsettled interest receivables. The amounts due had fallen to EUR 3,856 million as of the balance sheet date, primarily as a result of exchange rate effects, realization of collateral, loan restructuring and repayments of principal.
- / The carrying amount as of 31 December 2017 was EUR 1,643 million. The year-on-year decrease is mainly attributable to exchange rate effects and realization of collateral, as well as to changes in loan loss allowances and provisions.
- / The carrying amount as of 31 December 2016 includes the Sunrise current accounts of EUR 25 million that are reported on the balance sheet at this reporting date under loans and advances to banks. In accordance with the portfolio transfer agreement, beneficial ownership of these loans and advances was likewise transferred to hsh pm as of 30 June 2016; up until the transfer in rem (31 March 2017) these were carried by HSH Nordbank AG as overdraft facilities.

RESULTS OF OPERATIONS

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016 [1]	Change
Net interest income	870	5,732	-4,862
Net commission income	-302	-5,284	4,982
Personnel expenses	5,943	2,231	-3,712
Other administrative expenses	28,395	27,904	491
Net revaluation gain / loss	-2,444	-470,073	467,629
Result for the year	- 44,428	- 505,323	460,895

[1] Short financial year; the ship financing portfolio was transferred as of 30 June 2016

- / The decrease in net interest income is due primarily to increased funding costs resulting from higher refinancing rates.
- / Lower fees in connection with arranging the US dollar bridge financing led to significantly improved, though still negative net commission income.
- / The increase in personnel expenses is due to continued staff hiring in line with planning. In 2017, hsh pm had an average of 53 employees, compared with an average of 13 in 2016.

- While other administrative expenses in the previous year had still been dominated by start-up and initiation costs and were only incurred at operating level in the second half of 2016, other administrative expenses in 2017 were attributable in full to operations. These included further expenses in connection with setting up and expanding the entity.
- The net revaluation gain / loss (net loss on loan loss allowances and provisions) mainly include reversals and additions to specific valuation allowances. Due to a recovery of individual market segments and success in reducing the loan portfolio, these were substantially lower than in the previous year.
- Compared with the previous year, which had been dominated by start-up and initiation costs, the result for the year was substantially improved. The continued net loss for the year is mainly attributable to the operations of hsh pm. As an asset resolution entity, hsh pm manages a portfolio consisting almost entirely of non-performing loans related to ship financing. In financial year 2017, the resulting low net interest and net commission income was not sufficient to completely cover the still high administrative expenses incurred for the ongoing development of the organization.

NET ASSETS

in EUR million	31 Dec. 2017	31 Dec. 2016	Change
Loans and advances to customers	1,643,484	2,012,614	-369,130
Liabilities to banks	639,379	2,351,816	-1,712,437
Debt securities issued	1,653,564	250,013	+1,403,551
TOTAL ASSETS / EQUITY AND LIABILITIES	**2,304,560**	**2,626,230**	**-321,670**

- Loans and advances to customers match the carrying amount of the portfolio as shown above.
- The total assets / total equity and liabilities figure is largely determined by the loan portfolio and the associated funding.
- The decrease in liabilities to banks is mainly due to the repayment in full of the US dollar bridge financing in the course of 2017 through three US dollar capital market issues of an aggregate USD 1.5 billion.
- In 2017, issues totaling USD 1.5 billion and EUR 400 million were successfully placed on the capital markets and one issue of EUR 250 million was repaid, which increased debt securities issued to a total of EUR 1.7 billion.

RATING

	Short term	Long term
Moody's Investors Service	P-1	Aa1
Fitch Ratings	F1+	AAA

- The guarantees provided by the sponsors enabled hsh portfoliomanagement AöR to achieve a very good rating.

EMPLOYEES

	31 Dec. 2017	31 Dec. 2016	Change
Number of full-time equivalents	55.1	32.8	+22.3

- Since mid-2016, the team has been rapidly built up in line with planning.

FOREWORD OF THE EXECUTIVE BOARD

Ladies and Gentlemen,

We did not anticipate sustained improvement in the shipping markets in 2017. Even though conditions in the shipping markets brightened somewhat in the year now ended, we continued to assume in our planning that the difficult financial situation of borrowers would not change materially. We did not expect a sustained increase in our borrowers' debt-servicing capacity. These assumptions were confirmed for hsh portfoliomanagement.

We have been given the mandate to recover and resolve on a profit-oriented basis the risk exposures taken over from HSH Nordbank AG for the purposes of stabilization in accordance with the requirements of the German Financial Market Stabilization Fund Act. For this, hsh pm has been granted a credit authorization by the sponsors permitting it to manage the portfolio of non-performing shipping loans.

Our aim is to report as comprehensively and transparently as possible on our activities and field of business. This prompted us to expand the layout and the contents of our 2017 Annual Report compared with last year's report.

The reduction of the outstanding loan amount of our non-performing ship loan portfolio by nearly 14 percent to EUR 3,856 million and the reduction of the loans and advances to customers by almost 20 percent to EUR 1,643 million can be attributed to a variety of effects. The lion's share of this change is essentially attributable to the weaker dollar exchange rate (down by around 12 percent). In this, the first year of setting up our entity, we also took advantage of the possibilities afforded by the rise in the markets and wound down parts of the portfolio. This enabled us to reduce the carrying amount from the wind-down of the loans by EUR 193 million and trim the portfolio further by eliminating 37 vessels furnished as collateral. We thus achieved initial successes in reducing the loan portfolio even during the set-up phase!

Our employees demonstrated their expertise in taking over the portfolio, which represented a major challenge. When the portfolio was being acquired, around 250 discussions were conducted – with HSH Nordbank AG, with our borrowers, with lawyers, brokers and ship managers. Meetings were held with each of our customers to work on a solution for the benefit of the sponsors.

Ulrike Helfer and Dr. Karl-Hermann Witte

The outstanding ratings we were issued by Moody's and Fitch (Aa1 and AAA) with stable forecasts boosted our funding efforts. As in the previous year, the hsh pm's high credit rating was confirmed. The positive ratings provide a solid foundation for our entity under German public law to obtain funding through the capital markets. In 2017, we succeeded in implementing a future-oriented funding strategy by repaying our bridging facility.

The results of operations of hsh portfoliomanagement are dominated by net interest income and administrative expenses. Although interest income from the portfolio of non-performing loans at EUR 35.1 million was up around 77 percent on the 2016 short financial year, this only barely covered funding costs.

Administrative expenses of hsh portfoliomanagement rose to EUR 28.4 million in the reporting period (previous year: EUR 27.9 million). This high level of expenses was mainly attributable to the non-recurring expenses for the continued establishment of the business organization in a highly regulated environment. Our first employees started work on 1 July 2016, which meant personnel expenses were low in 2016. As the entity became established and the headcount grew, personnel expenses rose to EUR 5.9 million in 2017 (previous year: EUR 2.2 million).

Overall, a net loss for the year of EUR 44.4 million was disclosed which was considerably lower (previous year: EUR 505.3 million) due to the substantially lower loan loss allowances and provisions of EUR 2.4 million (previous year: EUR 470.1 million).

We prepared our annual financial statements for 2017 much faster than in the previous year. The auditor's opinion from our auditor is unqualified. We view this as an important validation of our team's hard work in the first full financial year. We thus achieved in 2017 what was a very important goal for us: we finished setting up the organizational structure of the entity with success!

Once again, the commitment demonstrated by all of our employees was exemplary – they faced many additional challenges. We would like to thank our employees and know that they will continue to make every effort to fulfill the mandate of hsh portfoliomanagement. They are always conscious of the importance this has for our two sponsor states.

The further course of business will depend to a large extent on the performance of the shipping markets, interest costs and EUR / USD price movements. We expect developments in the 2018 financial year to be slightly more positive than in the past year. That said, it will remain a challenge to at least break even with a portfolio comprised exclusively of non-performing loans in highly volatile markets.

We are on track and took successful steps in the right direction in 2017, but will continue to need energy and endurance to successfully fulfill our mandate for the benefit of Schleswig-Holstein and Hamburg.

Kiel, 28 March 2018

Ulrike Helfer Member of the Board of Managing Directors	Dr. Karl-Hermann Witte Member of the Board of Managing Directors

REPORT OF THE ADVISORY BOARD

The Advisory Board fulfills its responsibilities as the supervising body of hsh portfoliomanagement AöR in accordance with the rights and obligations derived from laws and the entity's Statute.

The tasks of the Advisory Board mainly include

- approving the asset resolution plan and specifying the information to be included in the asset resolution plan
- determining the mandatory content and format of the asset resolution reports
- appointing and dismissing the members of the Executive Board
- issuing Rules of Procedure for the Executive Board
- appointing the auditor of the financial statements and
- approving and formally adopting the annual financial statements.

The Advisory Board is tasked with advising the Executive Board and monitoring its management activities. The Advisory Board also advises the Executive Board on issues of particular strategic importance.

In the 2017 financial year, the Advisory Board received regular oral and written reports from the Executive Board covering the position of the entity and key management issues. The Advisory Board of hsh portfoliomanagement AöR held a total of five meetings in 2017.

The main topics covered in the deliberations of the Advisory Board in financial year 2017 were the commencement in full of the entity's business operations and the resulting termination of the transition project. In the meetings of the Advisory Board, items addressed by the members included the transfer in rem of the loan portfolio, funding, the level of liquidity, the entity's project topics and the progress on restructuring and asset resolution activities. The Advisory Board dealt with the asset resolution plan and set specific requirements for the plan.

The Advisory Board received regular information on the position of hsh portfoliomanagement AöR through the quarterly reports, asset resolution reports and other reports, especially the risk reports, submitted for its attention. The Advisory Board also addressed the appointment of the auditor of the annual financial statements. In addition, the Advisory Board used its meetings to monitor the management activities of the Executive Board and provide advice.

The Advisory Board appointed KPMG AG Wirtschaftsprüfungsgesellschaft as the auditor of the institution's statutory annual financial statements for the 2017 financial year. The auditor carried out the audit of the annual financial statements and management report of hsh portfoliomanagement AöR for the financial year ended. The audit has not led to any reservations relating to the legal compliance of the annual financial statements and of the management report. The auditor issued an unqualified auditors' opinion.

The auditor reported on the audit to the Advisory Board, explaining the result of the audit in detail. No objections were raised on completion of the examination.

The auditor reports to hsh portfoliomanagement AöR on the findings of its audit through the auditors' report contained in the annual report. Due to its issues on the regulated capital market, hsh portfoliomanagement AöR has been classified as a publicly traded entity as defined in the German Commercial Code and therefore as a public-interest entity (PIE) since the 2017 financial year. This entails much more extensive requirements with regard to the scope and content of the auditors' report. By outlining the key audit matters in the auditors' report, the entity now provides transparency over the auditors' points of focus in the course of their audit.

At its meeting on 23 April 2018, the Advisory Board formally adopted and approved the annual financial statements and management report for the 2017 financial year prepared by the Executive Board of hsh portfoliomanagement AöR.

The Advisory Board would like to take this opportunity to thank the Executive Board and all employees of hsh portfoliomanagement AöR for their work on behalf of the entity in 2017.

Kiel, 23 April 2018

Dr. Philipp Nimmermann
Chairman of the Advisory Board

“NETWORKING IS EMBODIED IN OUR CORPORATE CULTURE. WE WORK TOGETHER TO CREATE SOLUTIONS.”

/ MANAGEMENT REPORT

1. FUNDAMENTAL INFORMATION ABOUT hsh portfoliomanagement AöR

1.1 LEGAL AND ORGANIZATIONAL STRUCTURE

1.1.1 Overview

On 22 December 2015, a State Treaty between the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein came into force establishing hsh portfoliomanagement AöR (hereinafter called "hsh pm"), Kiel, as an entity under German public law with full legal capacity in accordance with section 8b of the Finanzmarktstabilisierungsfondsgesetz (FMStFG – Financial Market Stabilization Fund Act). The structure of hsh pm was specified in more detail in accordance with section 11 of the State Treaty with the issue of the institution's Statute on 19 January 2016.

hsh pm is not classified as a bank or financial services institution and is not involved in any operations that require authorization by national or international supervisory authorities. Nevertheless, certain stipulations in the Kreditwesengesetz (KWG – German Banking Act), Wertpapierhandelsgesetz (WpHG – German Securities Trading Act) and the Geldwäschegesetz (GwG – German Anti-Money Laundering Act) must be applied to hsh pm pursuant to section 8b (2) of the FMStFG.

The sponsors of hsh pm are – with equal shares – the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein. The constituent meeting of the Board of Sponsors was held on 19 January 2016. The Statute of hsh pm was issued and the members of the Advisory Board and Executive Board were appointed.

hsh pm was entered in the commercial register of the Kiel local court under reference number HRA 9377 KI on 8 June 2016.

1.1.2 Share capital, guarantor liability and institutional liability

hsh pm does not currently have any share capital. Under section 4 (1) of the State Treaty, the Board of Sponsors can decide to establish share capital but there are no plans to do so at the moment.

In accordance with section 5 (1) of the State Treaty, the sponsors are jointly and severally liable to third parties without limitation for the liabilities of hsh pm if creditors cannot be satisfied from the assets of hsh pm (guarantor liability).

The sponsors must also ensure pursuant to section 5 (2) of the State Treaty that hsh pm remains fully operational as an institution for the duration of its existence (institutional liability).

1.1.3 Registered office of hsh pm
The registered office of hsh pm is situated in Kiel. hsh pm also has offices in Hamburg.

1.1.4 Governing bodies of hsh pm
The governing bodies of hsh pm are as follows:

- the Executive Board
- the Advisory Board and
- the Board of Sponsors

The Executive Board of hsh pm has two members. The Executive Board manages the business of hsh pm and represents it in dealings with third parties, both before and outside the courts.

The Advisory Board comprises four members, who are representatives of the sponsors. The Advisory Board determines the basic principles for the management of the business and monitors the management activities of the Executive Board. It is also responsible, in particular, for

- approving the acquisition of risk exposures held by HSH Nordbank AG, Hamburg / Kiel
- approving the asset resolution plan
- appointing the members of the Executive Board
- appointing the auditor of the financial statements and
- approving and formally adopting the annual financial statements

The Board of Sponsors has two members, one representing the Free and Hanseatic City of Hamburg and the other the Federal State of Schleswig-Holstein, the members being appointed by the sponsors. The Board of Sponsors makes decisions related, in particular, to

- issuing and amending the Statute
- acquiring risk exposures held by HSH Nordbank AG
- formally approving the actions of the members of the Executive Board and the Advisory Board
- approving the asset resolution plan

1.1.5 Organizational structure of hsh pm

The organizational structure at hsh pm is broken down into two overall areas of Executive Board responsibility (Board Departments).

Board Department I is headed by Ulrike Helfer. It consists of the following units

- Restructuring Management I
- Restructuring Management II
- Loans
- Human Resources

Board Department II is led by Dr. Karl-Hermann Witte. It comprises the following units:

- Risk Controlling & Strategic Wind-down Planning
- Treasury & Finance
- Business Management

This Board Department also includes Internal Audit functions.

The Office of the Executive Board is assigned to both departments.

1.2 ECONOMIC BACKGROUND

1.2.1 Tasks of hsh pm

Pursuant to section 2 of the State Treaty and in accordance with the requirements in section 8b (1) of the FMStFG, hsh pm is responsible for taking over risk exposures from HSH Nordbank AG, its domestic and foreign subsidiaries and its legal successors for the purposes of stabilizing both these entities and the financial market, and for recovering or resolving these assets on a profit-oriented basis.

Generally, hsh pm may operate any type of banking and financial services business to fulfill its responsibilities. However, it must take into account that it is not permitted to operate any business that requires authorization under EU law. The latter includes deposit-taking business subject to authorization and activities that require authorization under

- Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, or

- Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (MiFID), or
- Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market (Payment Services Directive).

In particular, hsh pm is authorized to raise loans to enable it to meet its responsibilities, namely to fund its acquisition of risk exposures from HSH Nordbank AG, commence operations and support its ongoing business activities. The authorization limit was reduced from a maximum of EUR 6.2 billion to a maximum of EUR 4.9 billion in 2017.

1.2.2 Transferred loan portfolio

At the end of the day on 30 June 2016, hsh pm initially acquired beneficial ownership of a portfolio of almost exclusively non-performing loans related to ship financing from HSH Nordbank AG by way of a sub-interest for cash. Legal ownership of the loan portfolio was transferred from HSH Nordbank AG to hsh pm by the agreement for the spin-off of a portfolio of financing agreements dated 30 June 2016. The transfer in rem is effected through the spin-off agreement (approximately two-thirds of the loans) or by means of individual transfers (approximately one-third of the loans). The spin-off agreement took effect on its entry into the commercial register in Kiel and Hamburg on 18 May and 19 May 2017, respectively. Most of the individual transfers are still outstanding as of year-end 2017. The portfolio was taken over after the European Commission had approved state aid (Commission decision of 2 May 2016 on the state aid and measures SA.29338 (2013/C-30) and SA.44910 (2016/N) in favor of HSH Nordbank AG).

The loan receivables acquired amounted to a total of approximately EUR 4.2 billion as of 30 June 2016. The consideration paid by hsh pm for these amounted around EUR 2.4 billion. The purchase price had been specified by the European Commission as the maximum permissible purchase price under state aid rules.

1.2.3 Strategic objective

The task of hsh pm is to recover or resolve the risk exposures acquired with the loan portfolio generating the maximum possible profit. In addition to the extent of the asset resolution process and the associated reduction in risk, the measure of a successful resolution is therefore also the net resolution income. The net resolution income is derived from the price paid for the acquired loan portfolio and takes into account the income generated and expenses incurred in connection with the asset resolution activities. In the case of individual lending exposures, this can also include the realization of losses if these are lower than the expected future losses. This definition of profit-oriented recovery developed with the sponsors (City of Hamburg and the Federal State of Schleswig-Holstein) can also be described as a loan portfolio resolution with maximum value preservation.

The acquired portfolios consists almost exclusively of non-performing loans in which the borrower is unable to service the debt or can only do so on a very limited basis. Given this background, the asset resolution plan prepared by hsh pm is largely based on individual strategies for each specific exposure. The goal is to achieve the repayment of loans while preserving as much of their value as possible, taking into account the market environment for recovering loan collateral and the debt-servicing capacity of the borrowers.

In fulfillment of the requirement in article 7 of the Statute, hsh pm prepares an asset resolution plan setting out the specific details of its business activities. The plan sets out the expected reduction in outstanding loans and advances each year by forecasting the anticipated inflows from redemptions and collateral recovery. As the portfolio administered by hsh pm is impacted by the volatile trends in the shipping markets, the asset resolution strategy is reviewed at least quarterly as part of the asset resolution planning process and adjusted if required. The asset resolution plan is updated and carried forward at least annually. The asset resolution plan from March 2017 was updated and carried forward on schedule in November 2017. Following its adoption by the Advisory Board on 18 December 2017, the asset resolution plan was approved by the Board of Sponsors on 10 January 2018.

1.3 INTERNAL MANAGEMENT

1.3.1 Financial key performance indicators used to achieve the strategic objectives

The objective of hsh pm is to recover and resolve the acquired loan portfolio. The challenge here lies in strategic management of the non-performing loan portfolio. Particularly the borrowers' limited debt-servicing capacity makes it difficult to estimate expected incoming payments of interest and repayments of liabilities as well as defaults. This uncertainty is taken into account in the asset resolution plan for the loan portfolio; the planning methodology is being developed further.

hsh pm has aligned the strategic management of its business activities with its asset resolution plan, which defines objectives and action to be taken by hsh pm for the portfolio's short- and medium-term resolution. A key measure for assessing the extent to which the objectives defined in the asset resolution plan are being achieved is the reduction in the carrying amount of the loan portfolio over time.

Changes in general and administrative expenses (personnel expenses and other administrative expenses) are used to assess the extent to which the acquired loan portfolio is being managed cost effectively. The Executive Board and the Advisory Board are informed of these changes in regular reports.

The changes in the financial key performance indicators are presented in the management report sections covering the results of operations (general and administrative expenses) and the asset resolution report (reduction of loan portfolio).

1.3.2 Non-financial key performance indicator – employees

Critical to the success of hsh pm are its highly qualified employees who stand out from the crowd with their exceptional professional, methodological and social skills. Their motivation and commitment is making a significant contribution to the success of hsh pm.

One of hsh pm's primary concerns is to ensure that it continues to nurture the individual capabilities and personality of each employee. To this end, the Executive Board and its managers together established a creative and constructive working environment from the very beginning, aimed at achieving strong identification and employee loyalty.

hsh pm maintains an appreciative corporate culture in which performance, transparency and trust are highly valued.

When selecting employees, hsh pm, as a rule, attaches great significance to specialist expertise acquired over many years. The selection of employees for the Restructuring Management and Loans units focused on the need for extensive experience in shipping, particularly in relation to the recovery and restructuring of non-performing exposures. The recruitment process for the functions in Board Department II also succeeded in attracting proven experts with comprehensive track records in their respective areas of specialist activity.

The staff hiring process continues to be well advanced overall. The headcount as of 31 December 2017 corresponded to 55.1 full-time equivalents. By the end of the second quarter of 2018, the headcount will probably have grown slightly again. Recruitment will then be essentially completed.

2. REPORT ON ECONOMIC POSITION

2.1 MACROECONOMIC ENVIRONMENT

In 2017, hsh pm continued to manage the loan portfolio it acquired in 2016 that predominantly facilitates the financing of merchant ships. The economic development of these loans is primarily impacted by the achievable charter and sales revenues generated by the ships being financed. In this respect, the following statements focus on charter and value-related developments in the shipping markets in 2017.

2.1.1 Overview of the shipping markets

The prices on the merchant shipping markets are principally determined by the relationship between the amount of available tonnage and demand for maritime transport capacity. The amount of available tonnage is calculated based on the size of the segment's fleet. It increases when new ships are delivered and decreases when ships go out of service, usually as a result of scrapping or decommissioning. Demand is impacted by various factors depending on the market segment. In general, demand for maritime transport correlates strongly with trends in international trade, more than 80% of which is seaborn.

Viewed as a whole, 2017 brought improvements for merchant shipping compared to the weak previous year, even though the markets continued to be characterized by overcapacity and fierce price-based and hostile competition. In 2017, maritime trade volumes grew by approximately 4.1%, expanding faster than global economic output (2017: approximately 3.6%) for the first time since 2012.

While some areas of the container and bulk shipping segments recorded significant improvements in average charter rates and ship prices, charter rates in the tanker shipping sector in particular were significantly below the previous year's level. The ClarkSea Index, which maps the development of charter rates in all major shipping markets, showed fluctuations in the first half of 2017 without significant outliers. It then rose considerably in the second half to end the year approximately 24% up on the value at the start of the year .

2.1.2 Container market

The total supply of container ship tonnage in terms of TEU capacity increased by 3.7% in 2017, while the number of ships remained virtually steady. This ratio illustrates the continuing trend toward larger ships. Deliveries in this sector during the reporting year primarily consisted of large container ships from Asian shipyards that made a disproportionately large contribution to tonnage growth. With 141 ships representing around 400,000 TEU capacity broken up in 2017, scrapping activity levels were lower than in 2016, with a volume roughly on a par with average scrapping activity since 2014.

Demolition volumes exceeded deliveries, particularly in smaller size classes up to approximately Panamax size that form the basis of the hsh pm portfolio, leading to a decline in transport capacity in these classes overall. In the segment from 3,000 – 5,999 TEU capacity, 57 ships were broken up with just six deliveries in the same period. Ships in this class were originally designed to fit the measurements of the old locks on the Panama Canal that have since been expanded. By today's standards, these ships have efficiency disadvantages, as the lock restrictions no longer apply and the ships were also optimized for once-customary higher sailing speeds with correspondingly high fuel consumption.

At the end of 2017, the order book comprised 384 container ships with average capacity of around 7,000 TEU, equivalent to around 13.5% of existing fleet capacity. In 2017, 108 new ships were ordered, representing almost 26% of the year-end order book by capacity.

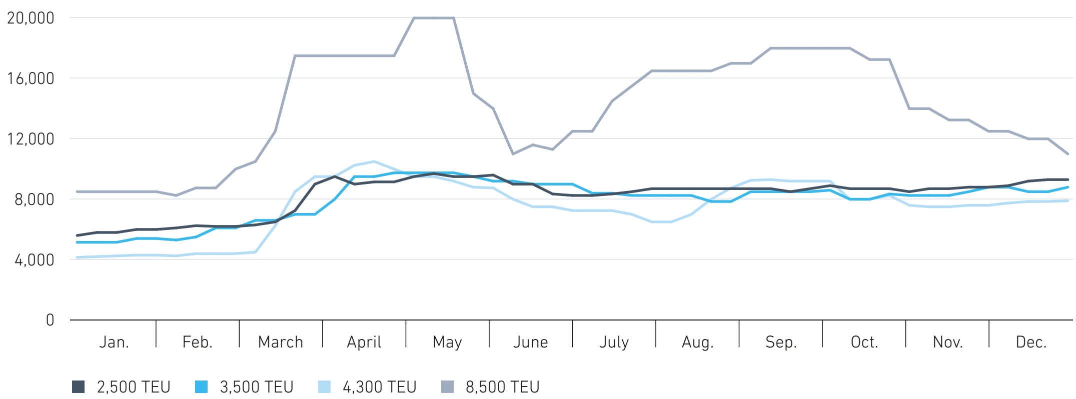
In terms of demand, the previous years' trend also confirmed in 2017 that maritime trade by container export was growing at a lower multiplier relative to the global economy than in the past. While container volumes grew at an average annual factor of around 2.3 times faster than the global economy between 1997 and 2008, the gap between these growth rates narrowed significantly between 2010 and 2017 (without taking into account the sharp decline in container trading in 2009), resulting in an average factor of around 1.4 annually over this period. Key reasons for this include the advanced state of containerization and a weakening trend toward globalization.

Specifically, global container traffic grew by around 5.0% overall year-on-year in 2017, while global GDP rose by approximately 3.6%. As a result, container trading increased around 1.4 times faster than the global economy. This growth was primarily driven by intraregional trading, where the year-on-year rise was around 5.8%. The secondary global North-South and East-West routes recorded improvement of approximately 5.5% and 3.6% respectively. Trading on the trans-Pacific route increased by around 4.6% while Far East-Europe traffic rose by approximately 4.0%.

In addition to fundamentally improved market data, the consolidation of shipping lines and alliances progressed further during the reporting year. In contrast to the previous year, there were no insolvencies of renowned charterers, thus easing the uncertainty in the charter market. While there was also further consolidation among independent tonnage providers (known as "tramp shipowners"), this did not reach the same density as on the charterer side.

Charter rates improved significantly across almost all size classes in 2017 compared to the very low level in 2016. The Howe Robinson Container Index, which tracks charter rates for common size classes from 700 TEU to 8,500 TEU, rose by 52.2% between the start of January and the end of December 2017. The Panamax segment reported the clearest improvements with an increase of around 90%, although it also posted the largest discounts in 2016. At year-end 2017, a typical Panamax ship with 4,300 TEU generated charter rates of USD 7,900 per day; at the start of the year, these rates were only around USD 4,200 per day. Generally speaking, most container ships were able to achieve charter rates that at least covered operating costs when entering into new contracts.

Howe Robinson Container Index charter rates in 2017 in US dollar per day



Prices for used container ships rose significantly year-on-year during the course of 2017. The Clarksons Container Ship Second-Hand Price Index climbed considerably and by the end of December 2017 was around 54% higher than at the start of the year. Prices for container ships in size classes around 3,200/3,600 TEU almost doubled, with prices for ten-year-old ships rising from around USD 5 million at the start of the year to approximately USD 9.8 million at the end of December 2017. The Panamax class around 4,500 TEU recorded an increase of around 82% in second-hand prices during the course of the year. At the start of January 2017, prices for ten-year-old ships were still near scrap value at around USD 5.5 million before climbing to about USD 10 million by the end of December 2017. In the 1,650/1,750 TEU size class, prices increased by approximately 64% from around USD 5.5 million to roughly USD 9.0 million. Overall, sales prices achieved in December 2017 approximated or exceeded the respective average values for the last five years after very weak figures in the previous year.

2.1.3 Tanker market

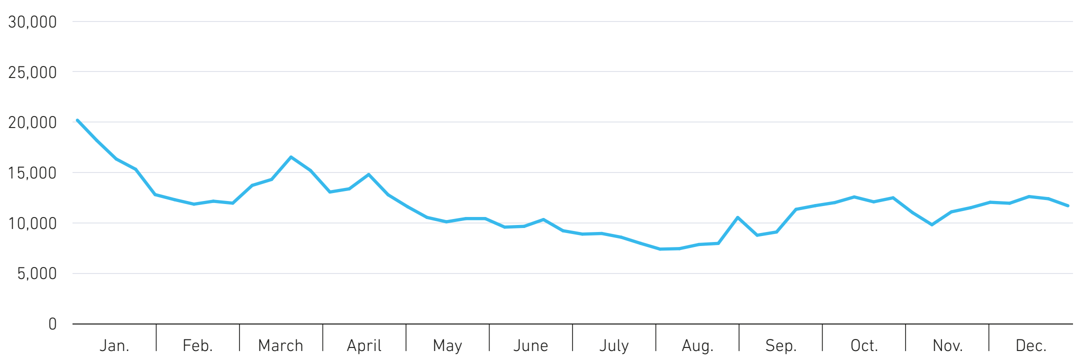
The global supply of tanker tonnage once again grew more sharply than demand during the reporting year as it did in 2016. There were approximately 329 deliveries of new vessels that were predominantly ordered in 2014 and 2015 when the market situation was more robust. While demolition activity was quite high at around 115 ships, it was unable to compensate for the increase in supply. This meant that the crude oil tanker fleet grew significantly on a net basis by around 5.7%, while the product tanker fleet increased by around 4.3%.

At the end of 2017, the order book still comprised around 563 tankers. Of these, roughly 229 vessels representing at least 46% of capacity yet to be delivered were ordered during the reporting year. Order book volume represented around 11.7% of existing fleet capacity at the year-end.

In 2017, demand for oil transport by sea rose by approximately 5.1% for crude oil and around 3.6% for oil products. The key growth drivers were the sharp rise in crude oil imports in Asia, while demand for tankers as floating storage capacity fell as it did amid lower oil prices.

As a result of disproportionate growth in supply and the resulting weakening of fleet utilization, charter rates dropped further during the reporting year after the slump in 2016. The Clarksons Average Tanker Earnings Index, which tracks the short-term revenue situation in different tanker classes, was still at around USD 20,200 at the start of January 2017 and temporarily fell to just USD 7,400 in August 2017. Revenues then recovered slightly in the last four months of the year, with the Clarksons Average Tanker Earnings Index nonetheless reaching around half of its value at the start of the year by year-end. The ten-year average for this index is approximately USD 18,800.

Clarksons Average Tanker Earnings Index 2017 in US dollar per day



Prices for used tankers practically stagnated at low levels across all size classes and ages during the year. At the end of the year, the second-hand price level was thus around 20.6% below the ten-year average.

2.1.4 Bulker market

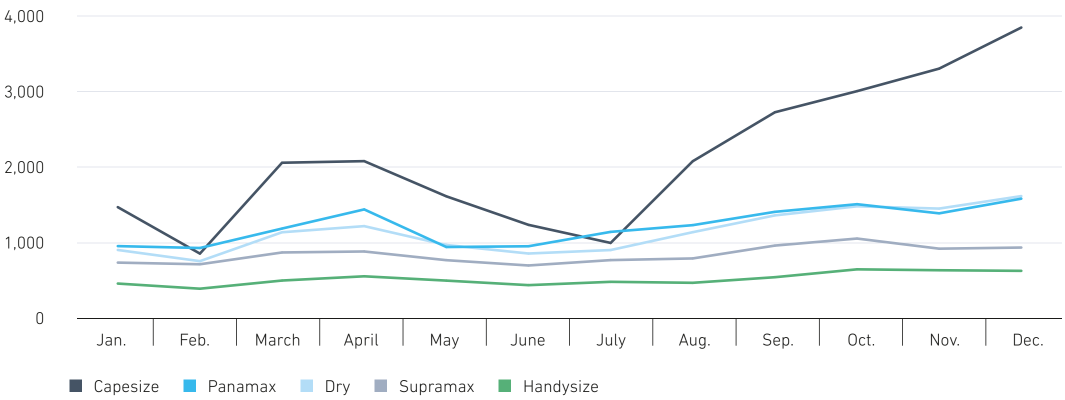
The supply of bulk tonnage grew at a lower rate compared to demand in 2017, with the market developing positively as a result. Order books show that a total of 456 ships with approximately 38 million tonnes of deadweight tonnage (dwt) were delivered. This compares to scrapping volumes of 215 ships with around 15 million dwt. The primary growth driver by deadweight tonnage was the Handymax segment with growth of approximately 4.3%, followed by the Panamax class with approximately 3.0% growth. Overall, bulker capacity increased by around 3.1% year-on-year in 2017.

At the end of 2017, the order book for bulkers comprised approximately 722 ships with an average capacity of around 76,000 dwt. Approximately 284 new ships were ordered in 2017 alone, representing the highest share of the order book by capacity at almost 43%. At the year-end, the order book was equivalent to around 9.3% of existing fleet capacity.

Demand for bulk shipments was primarily determined by the two most important bulk commodities, iron ore and coal. One key driver of this demand was the unexpectedly high Chinese steel production. While Chinese imports of iron ore therefore grew by approximately 6%, other key import regions such as India stagnated or experienced a decline in demand. In global terms, the trade of all bulk commodities grew by around 4.2%.

As the leading overarching indicator of freight rates on the bulk commodities market, the Baltic Dry Index reached 1,619 points in December 2017, its highest monthly average since the end of 2013 after its all-time low in the previous year. The Baltic Dry Index's ten-year average is around 1,900 points. Revenues improved significantly across all classes during the year. The Baltic Capesize Index saw particularly strong performance, rising by around 261% between January and December 2017.

Baltic Indices in 2017 in index points



Ship prices in the second-hand market also developed positively during the year, with the Clarksons Bulk Carrier Second-Hand Price Index finishing the year around 34% higher than at the start of January 2017. For example, sales prices for ten-year-old Capesize ships rose by approximately 37% from around USD 15 million to USD 20.5 million during the year.

2.2 COURSE OF BUSINESS

2.2.1 Overview

The business activities and result of hsh pm for the year ended 31 December 2017 continued to be shaped by the establishment of the entity's organizational structure. hsh pm is not classified as a bank. However, the main regulations for credit institutions are applicable to hsh pm. The requirements for a "proper business organization" are very stringent and involve corresponding expenditure. In financial year 2017, initial successes in reducing the loan portfolio were reflected in the decrease in the carrying amount of the portfolio and restructuring measures were completed.

For financial year 2017, hsh pm reported a negative result before loan loss allowances and provisions, and before foreign currency translation of EUR 32.9 million (previous year: EUR 29.7 million). Net interest and net commission income totaling EUR 0.6 million (previous year: EUR 0.4 million) and net other comprehensive income of EUR 0.9 million (previous year: EUR 26 thousand) were reduced by other administrative expenses of EUR 28.4 million (previous year: EUR 27.9 million) and by personnel expenses of EUR 5.9 million (previous year: EUR 2.2 million). On account of net additions to loan loss allowances and provisions of EUR 2.4 million, which were down substantially on the prior-year figure (EUR 470.1 million) and a negative result from foreign currency translation of EUR 9.1 million (previous year: EUR 5.6 million), hsh pm recorded an overall net loss for the year of EUR 44.4 million (previous year: EUR 505.3 million).

On the whole, business performance in 2017 was better than projected, mainly due to the fact that loan loss allowances and provisions were much lower than envisaged as a result of better market forecasts.

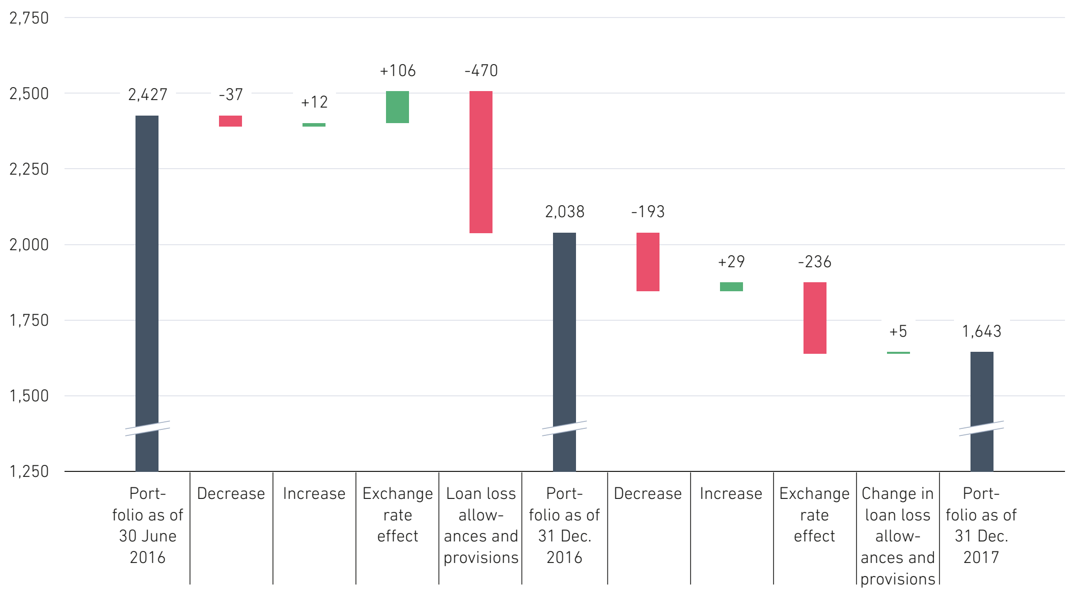
While net interest and net commission income was lower than projected and other administrative expenses were higher than anticipated, personnel expenses were only marginally above budget. Other comprehensive income was higher than expected. In the financial year now ended, net interest and net commission income was again reduced by customers' failure to make interest payments owing to the improved yet still very difficult conditions in the ship financing segment. Income from the non-performing commitments remained insufficient to cover all contractually agreed interest. In other administrative expenses, higher costs were recorded in particular for organizational consulting services in relation to the set-up of the entity and for unbudgeted costs for register corrections. Other comprehensive income comprises unplanned reversals of provisions and reimbursement of legal costs by customers.

2.2.2 Asset resolution report

An asset resolution report in which hsh pm provides information on the ongoing implementation of the asset resolution plan is submitted each quarter to the Advisory Board in accordance with article 8 of the Statute. The asset resolution report contains information on the acquired loan portfolio, the resolution activities in the reporting period and the implementation status of the asset resolution plan. The success of the asset resolution activities is measured on the basis of the extent to which the targets in the asset resolution plan have been attained, taking into account the market environment in each case.

The following overview shows changes in the carrying amount of the loan portfolio since acquisition:

Change in the portfolio's carrying amount in EUR million



In financial year 2017, the carrying amount of the portfolio before exchange rate effects and before loan loss allowances and provisions decreased by a total of EUR 164 million to EUR 1,874 million. This change can be attributed to two effects. The reduction in the value of the loan portfolio, which is defined as a key performance indicator, of EUR 193 million resulted mainly from redemptions and proceeds from the sale of ships. On the other hand, the carrying amount increased slightly by a total of EUR 29 million mainly in connection with liquidity support provided for individual borrowers and loan restructuring. Most of the loans are denominated in foreign currency and the exchange rates as of the balance sheet date were also taken into account. Due in particular to the significantly weaker US dollar compared with 31 December 2016, the carrying amount decreased by EUR 236 million as a consequence of exchange rate effects. The figure reported for loan loss allowances and provisions as of 31 December 2016 was reduced by EUR 5 million as of 31 December 2017. The total carrying amount of the portfolio as of 31 December 2017 was EUR 1,643 million.

Incoming payments from interest, redemptions and proceeds from recovery in financial year 2017 totaled EUR 208 million and before exchange rate effects were, in the aggregate, about 20% higher than the budget target for the asset resolution plan in 2017.

The outstanding loan amount in the portfolio declined by EUR 621 million to EUR 3,856 million in financial year 2017, due mainly to the weakening of the US dollar against the euro.

2.3 NET ASSETS, FINANCIAL POSITION AND RESULTS OF OPERATIONS OF hsh pm

When reading the following statements on the net assets, financial position and results of operations of hsh pm, it is important to remember that in the previous year operations were not commenced until the end of the first half of the year. This reduces the comparability of figures in the income statement in particular.

2.3.1 Net assets

The following table shows the assets and liabilities of hsh pm:

Balance sheet [1]

in EUR thousand	31 Dec. 2017	31 Dec. 2016	Change
Assets			
Cash reserve	49,993	15,520	34,474
Loans and advances to banks	57,205	92,198	-34,993
Loans and advances to customers	1,643,484	2,012,614	-369,130
Prepaid expenses	3,593	157	3,436
Deficit not covered by equity	549,751	505,323	44,428
Other items	534	418	116
TOTAL ASSETS	**2,304,560**	**2,626,230**	**-321,670**
Liabilities			
Liabilities to banks	639,379	2,351,816	-1,712,437
Liabilities to customers	17	5,005	-4,988
Debt securities issued	1,653,564	250,013	1,403,551
Other liabilities	5,535	9,289	-3,755
Deferred income	272	809	-537
Provisions	5,793	9,297	-3,504
TOTAL LIABILITIES	**2,304,560**	**2,626,230**	**-321,670**

[1] Figures taking into account rounding differences

The net assets and capital structure of hsh pm continue to be shaped by the particular nature of the business operations and the responsibilities assumed by the institution as an asset resolution entity of the City of Hamburg and Schleswig-Holstein.

The cash reserve and loans and advances to banks of EUR 107.2 million in total was comparable to the previous year's level (prior-year reporting date: EUR 107.7 million). As of 31 December 2016, loans and advances to banks had included loans and advances to HSH because the Sunrise current accounts amounting to EUR 24.9 million had not yet been transferred. The corresponding loans and advances to customers were transferred in rem with effect from 31 March 2017.

The net assets of hsh pm are dominated by the loan portfolio taken over from HSH Nordbank AG on 30 June 2016. The portfolio almost exclusively comprises non-performing loans related to ship financing. The vast majority of these loans are denominated in US dollars. The portfolio is measured at cost after making allowance for specific valuation allowances calculated as of the reporting date using the relevant collateral.

The carrying amount of loans and advances to customers decreased by EUR 369.1 million to EUR 1,643.5 million as of 31 December 2017 as a result of loan repayments received in a higher amount than projected, liquidity support for individual borrowers, low net changes in valuation allowances, and after taking into account exchange rate effects. The loan repayments received are attributable in particular to successful realization of collateral. For more information, please refer to section 2.2.2 Asset resolution report.

Prepaid expenses are mostly comprised of discounts from interest and costs for the issuance of bonds (EUR 3.2 million; previous year: EUR 0 million) plus, to a small degree, prepaid invoice amounts (EUR 0.4 million; previous year: EUR 0.2 million).

The liabilities to banks relate to the short-term funding of the loan portfolio. To minimize the currency effects from the loans, the vast majority of which are denominated in US dollars, most of the funding is also arranged in US dollars. The breakdown of the loan portfolio, together with any changes in the portfolio, are taken into account in funding arrangements so that hsh pm can respond quickly to changes. The liabilities to banks are due in up to one year. The year-on-year decrease in liabilities of EUR 1,712.4 million to EUR 639.4 million is attributable to the full repayment in the second half of 2017 of the US dollar bridge loan taken out in mid-2016. This was repaid through the placement of three US dollar capital market issues of an aggregate USD 1,500 million following publication of the 2016 Annual Report.

The debt securities issued in the amount of EUR 1,653.6 million (previous year: EUR 250.0 million) concern the US dollar issues placed on the capital markets in the second half of 2017 under the debt issuance program in addition to three euro bonds issued in the first half of 2017 amounting to an aggregate EUR 400.0 million plus accrued interest in each case. The bonds have a maturity of more than one year and their purpose is also to fund the purchase price of the portfolio. The debt securities issued in the previous year matured in 2017.

Other liabilities (EUR 5.5 million; previous year: EUR 9.3 million) are almost exclusively made up of trade payables (EUR 5.4 million; previous year: EUR 9.2 million).

Deferred income (EUR 0.3 million; previous year: EUR 0.8 million) consists of the premium on a euro bond that will be reversed over the maturity of the bond on a straight-line basis.

Provisions (EUR 5.8 million; previous year: EUR 9.3 million) have been recognized in the amount dictated by prudent business practice. The decrease of EUR 3.5 million is predominantly attributable to the reversal of loan loss provisions of EUR 5.3 million recognized in the previous year.

At the end of the financial year, hsh pm reported a deficit not covered by equity of EUR 549.7 million (previous year: EUR 505 million), mainly as a consequence of the loan loss allowances and provisions recognized in the previous year. There is no risk to the continued existence of hsh pm as a going concern because of the guarantor liability and the institutional liability assumed by the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg.

2.3.2 Financial position

The key objective of hsh pm is to ensure that it has sufficient liquidity at all times while minimizing currency risks. In view of these general conditions, the focus in 2017 was on broadening the international investor base and making use of the international capital markets. The following issuance programs were set up for this:

- Debt issuance program (DIP) for capital market funding
  Under this program, US dollar bonds that have a medium-term funding horizon will be issued initially. In the second half of 2017, the first three US dollar issues of USD 500 million each were successfully placed with diverse institutional investors on the international capital markets.
- Euro commercial paper program (euro CP) for money market funding
  Supplementing the DIP, a euro CP program was launched in the second half of 2017 for short-term funding on the international capital markets (maturity up to one year). The initial transactions under this program were effected at the beginning of 2018.

As of the reporting date, the maturity structure of the capital market issues (carrying amounts) and their currencies were as follows:

Maturities by calendar year

	31 Dec. 2017			31 Dec. 2016		
in EUR thousand	US dollar issues	Euro issues	Total issues	US dollar issues	Euro issues	Total issues
2017	0	0	0	0	250,013	250,013
2019	418,483	0	418,483	0	0	0
2020	417,228	0	417,228	0	0	0
2021	417,750	150,000	567,750	0	0	0
2022	0	100,000	100,000	0	0	0
2023	0	150,103	150,103	0	0	0
TOTAL	**1,253,461**	**400,103**	**1,653,564**	**0**	**250,013**	**250,013**

In the money market, hsh pm funded itself almost exclusively in 2017 by obtaining fixed-term deposits from banks denominated in US dollars and euros. There were also fixed-term deposits in Japanese yen and Swiss francs to a very limited extent.

Since October 2016, the ratings have been as follows:

Ratings

	Short-term ratings	Long-term ratings
Moody's Investors Service	P-1	Aa1
Fitch Ratings	F1+	AAA

In conjunction with the issuance programs, these ratings will make it easier for hsh pm to obtain funding through the international capital markets.

Please also refer to the cash flow statement for information on the financial position of hsh pm. The cash flow statement and the statement of changes in equity were prepared as components of the annual financial statements. The cash flow statement has been prepared in accordance with the classification format in Appendix 2 of GAS 21, which covers the sector-specific requirements for the cash flow statements of credit institutions and financial services institutions.

2.3.3 Results of operations

For 2017, hsh pm reported a negative result before loan loss allowances and provisions, and before foreign currency translation of EUR 32.9 million (previous year: EUR 29.7 million). The main reasons for the loss were barely break-even net interest and net commission income of EUR 0.6 million in total (previous year: EUR 0.4 million), largely attributable to the lack of interest income on the non-performing loan portfolio acquired and to higher funding costs, as well as general and administrative expenses of EUR 34.3 million (previous year: EUR 30.1 million). Personnel expenses rose in the reporting period from EUR 2.2 million to EUR 5.9 million as a result of the increase in the headcount in line with planning. The workforce expansion is expected to be completed in 2018. Other administrative expenses came to EUR 28.4 million, up slightly on the prior-year level (EUR 27.9 million). The recognition of loan loss allowances and provisions of EUR 2.4 million (previous year: EUR 470.1 million), which were necessary in respect of the acquired loan portfolio, and a negative result from foreign currency translation of EUR 9.1 million (previous year: EUR 5.6 million) together essentially led to a net loss for the year of EUR 44.4 million (previous year: EUR 505.3 million).

The following table shows the breakdown of results of operations:

Income statement [1]

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016	Change
Net interest income	870	5,732	-4,862
Net commission income	-302	-5,284	4,982
Other result [2]	948	26	923
Personnel expenses	-5,943	-2,231	-3,713
Other administrative expenses	-28,395	-27,904	-491
Depreciation, amortization and write-downs of tangible and intangible fixed assets	-62	-32	-30
Result before loan loss allowances and provisions, and before foreign currency translation	**-32,884**	**-29,693**	**-3,191**
Result from loan loss allowances and provisions	-2,444	-470,073	467,629
Result from foreign currency translation [3]	-9,099	-5,557	-3,542
Taxes (including Other taxes)	-1	0	-1
NET LOSS FOR THE YEAR	**-44,428**	**-505,323**	**460,895**
Loss brought forward from the previous year	-505,323	0	-505,323
NET ACCUMULATED LOSSES	**-549,751**	**-505,323**	**-44,428**

1 Figures taking into account rounding differences
2 Excluding result from foreign currency translation
3 Reclassified from "Other result"

Net interest income includes both interest income from lending and money market transactions and interest expenses incurred in connection with funding. The decrease in net interest income of EUR 4.9 million to EUR 0.9 million is due primarily to higher funding costs. These were mostly US dollar funding costs, impacted mainly by interest rate step-ups and higher LIBOR interest rates. The low interest income on the portfolio of non-performing loans also made it impossible to generate higher net interest income.

Net commission income was negative on the whole as a consequence of the commission expenses of EUR 1.2 million (previous year: EUR 5.4 million) payable in connection with the extension of a US dollar loan that had been taken out in the previous year. Commission income of EUR 1.1 million (previous year: EUR 0.2 million) was received.

Cost reimbursements from customers arising from the recharging of lawyer's fees paid (EUR 0.8 million; previous year: EUR 0 million) and reversals of provisions (EUR 0.5 million; previous year: EUR 0 million) were significant contributing factors to the positive other comprehensive income of EUR 0.9 million (previous year: EUR 26 thousand).

Personnel expenses were up year-on-year (EUR 5.9 million; previous year: EUR 2.2 million). It should be noted that the number of employees had been gradually built up within the 2016 short financial year, particularly in the second half of the year, in line with planning. At the reporting date of 31 December 2017, there were 55.1 full-time equivalents (prior-year reporting date: 32.8 full-time equivalents). The workforce expansion is expected to be completed in 2018.

Other administrative expenses amounted to EUR 28.4 million (previous year: EUR 27.9 million). In financial year 2017, costs for continuing the set-up of the entity were incurred together with operating costs. Costs were incurred in particular for the further development of structures and optimization of necessary processes. These relatively high expenses were primarily needed to ensure proper business organization. The main expense items in financial year 2017 were costs of significant outsourcing arrangements (EUR 10.4 million; previous year: EUR 4.1 million), organizational consulting services (EUR 6.2 million; previous year: EUR 5.0 million), legal consulting services (EUR 6.0 million; previous year: EUR 1.9 million), costs for the preparation and auditing of financial statements (EUR 1.5 million; previous year: EUR 3.0 million) and costs for register corrections (EUR 1.4 million; previous year: EUR 0 million). Of the costs for legal consulting services, an amount of EUR 0.8 million was recharged to borrowers and recorded in other comprehensive income.

Loan loss allowances and provisions in financial year 2017 were considerably lower than projected, which reduced the result from loan loss allowances and provisions to EUR -2.4 million (previous year: EUR -470.1 million).

The negative result from foreign currency translation amounted to EUR 9.1 million (previous year: EUR 5.6 million). In accordance with section 340h in conjunction with section 256a of the HGB, the loss is presented net after making allowance for temporary residual foreign currency exposure. The temporary residual foreign currency exposure mainly results from the fact that foreign currency holdings must be measured as of the reporting date. Because loan loss allowances and provisions are not determined until after the reporting date, which leads to subsequent foreign currency translation, temporary residual foreign currency exposure is a regular occurrence.

The financial year closed with a net loss for the year of EUR 44.4 million (previous year: EUR 505.3 million). Net accumulated losses for 2017 amounted to EUR 549.7 million (previous year: EUR 505.3 million).

2.3.4 Overall assessment of the net assets, financial position and results of operations of hsh pm

hsh pm does not currently have any share capital. However, in its business activities, hsh pm can rely on the guarantees, institutional liability and guarantor liability on the part of the sponsor of hsh pm, i.e. the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg. As of 31 December 2017, hsh pm reported a deficit of EUR 549.7 million not covered by equity (previous year: EUR 505.3 million). The net assets of hsh pm are well structured.

hsh pm ensured that, overall, it had sufficient liquidity at its disposal at all times during the course of the year. In the opinion of hsh pm, the existing ratings and access to the capital markets will continue to ensure that it has the necessary liquidity at all times.

Viewed as a whole, the results of operations in financial year 2017 were satisfactory in the light of hsh pm's business activities. The low net interest and net commission income from a portfolio of non-performing loans related to ship financing that is attributable to the business environment in which hsh pm operates was unable to cover the general and administrative expenses. This stands in contrast to a moderate level of loan loss allowances and provisions that was significantly better than projected. In addition, a negative result from foreign currency translation depressed the result for the year and on the whole led to a net loss for the year of EUR 44.4 million (previous year: EUR 505.3 million).

3. RISK REPORT

3.1 OVERVIEW OF RISK MANAGEMENT

In accordance with section 8b (2) sentence 1 in conjunction with section 8a (5) sentence 2 of the Finanzmarkt-stabilisierungsfondsgesetz (FMStFG – German Financial Market Stabilization Fund Act), hsh pm must comply with certain provisions of the Kreditwesengesetz (KWG – German Banking Act) and Wertpapierhandelsgesetz (WpHG – German Securities Trading Act) and in this regard is regulated by the Federal Financial Supervisory Authority (BaFin). hsh pm is considered an "obliged entity" within the meaning of section 2 (1) of the Geldwäschegesetz (GWG – German Money Laundering Act). Section 15 of the Finanzdienstleistungs-aufsichtsgesetz (FinDAG – German Act Establishing the Federal Financial Supervisory Authority) must be applied accordingly.

The KWG requires hsh pm to have a "proper business organization" (section 25a (1) sentence 1 of the KWG). This also necessitates a suitable and effective risk management system. In particular, the risk management system includes establishing internal control procedures with an internal control system and an Internal Audit unit, ensuring an appropriate level of human resources and technical / organizational resources, and developing a suitable contingency plan for emergencies, especially for IT systems. In setting up a suitable business organization for risk management, hsh pm followed the Federal Financial Supervisory Authority's Circular 09/2017: Minimum Requirements for Risk Management (MaRisk BA) to the extent logically applicable to hsh pm in view of its special circumstances as an asset resolution entity.

Risk management is a key component of the overall management of hsh pm. Risk management at hsh pm is primarily tasked with providing the most effective support possible for profitably resolving the portfolio and managing the resulting risks, while minimizing risks as much as possible.

The individual risk management elements together form a system that guarantees the identification, analysis, assessment, management, ongoing monitoring and reporting of risks. Risk management responsibilities at hsh pm are clearly defined. Overall responsibility for risk management at hsh pm, including the risk measurement, management and monitoring methods and processes to be used, is assigned to the Executive Board. Each quarter, a comprehensive risk report regularly informs the Executive Board and the Advisory Board about the risk situation at hsh pm.

In order to assess the materiality of risks, hsh pm performs a general risk inventory annually and as needed as the foundation for an overall risk profile of hsh pm. The focus of this inventory is a review to determine which risks could materially affect the net assets, results of operations or liquidity position. Due to the size and complexity of the portfolio transferred, counterparty credit risk is the most important type of risk for hsh pm. Other material risks identified in the most recent risk inventory carried out in December 2017 were market risk, liquidity risk and operational risk. Responsibilities and processes, comprehensive management and monitoring measures and risk tolerances (including limits and risk classifications) have been defined in the risk strategy for these material risks.

Other risks identified as relevant but not material are strategic risks, business risks and regulatory risks.

The Risk Controlling & Strategic Wind-down Planning unit is tasked with independently monitoring and communicating hsh pm's risks and providing support to the Executive Board for all risk policy issues as well as structuring a system to limit risks. The unit is also responsible for monitoring counterparty credit, market and liquidity risk and operational risks, analyzing risk positions and limit utilization, and recommending risk-reduction measures, if required. hsh pm's risk management system is part of Internal Audit's audit planning process.

In the reporting year, Internal Audit carried out a review in the Risk Controlling & Strategic Wind-down Planning department, which was completed with a satisfactory result.

3.2 RISK MANAGEMENT GOALS

hsh pm's risk management system aims to identify at an early stage, analyze and disseminate information about hsh pm's risk position and changes that occur as well as to develop and implement suitable measures to manage the risks associated with winding down the loan portfolio. Risk management at hsh pm is based on the risk strategy determined by the Executive Board, which is reviewed at least annually and modified, if necessary.

Risk awareness and transparency about the risks assumed are enhanced by the assignment of responsibilities at hsh pm as follows:

- Independent reporting is performed by the Risk Controlling & Strategic Wind-down Planning unit (risk control function).
- Strategic wind-down planning and the asset resolution report are prepared by the Risk Controlling & Strategic Wind-up Planning unit, which is organizationally separate from the Restructuring Management and Loans units.
- Risk Controlling (risk control function) is responsible for determining the methodology for risk classification.
- External market data is obtained from recognized market data providers (e.g., Bloomberg, MSI).
- Collateral valuation is based on appraisals by third-party experts.
- The Executive Board has the power to decide on the recognition of loan loss allowances and provisions.
- Restructuring management is organizationally separate from the Loans unit.

3.3 COUNTERPARTY CREDIT RISK

3.3.1 Definition
Counterparty credit risk is the most significant risk hsh pm faces. It stems from the lending transactions in the portfolio transferred. hsh pm defines counterparty credit risk as the danger that business partners will not meet their contractual obligations, or will do so only in part. hsh pm's counterparty credit risk comprises credit, counterparty, issuer, settlement and country risks.

3.3.2 Strategic direction
hsh pm's long-term strategic goal is to resolve the loan portfolio while preserving as much of its value as possible. This effort prioritizes borrower repayment of receivables, which will be achieved through repayments of principal or through realization of collateral. Here, hsh pm will review the existing courses of action on a case-by-case basis to establish which is the most economically beneficial from an asset resolution perspective.

In the case of exposures with a positive recovery outlook, hsh pm will fall back on a range of restructuring and recovery measures. These may entail deferment of debt servicing or extension of loan maturity, subordination of priority and, where necessary, temporary liquidity support. Furthermore, in appropriate cases a change in technical or commercial management for the ships serving as collateral may take place.

In the case of exposures without a positive recovery outlook, the priority is to resolve or end the commitments and customer relationships. In these cases, the earliest possible date for ending the credit exposure and liquidating the collateral will be identified. The proceeds from the liquidation of collateral are used to reduce the loan portfolio.

In addition to the counterparty credit risk of borrowers, hsh pm's risk strategy takes into account all other transactions subject to any default risk. The risk strategy therefore covers all on- and off-balance sheet business activities of hsh pm.

3.3.3 Management and monitoring
To the extent possible for non-performing loans, counterparty credit risk is managed (and monitored) using borrower-specific limits determined in accordance with the risk classification and collateral.

Counterparty credit risk is minimized mainly through maximum credit limits set by hsh pm based on the outstanding loan amount per borrower. In cases where the temporary liquidity bottlenecks of individual borrowers are bridged in the course of portfolio resolution, this temporary granting of funds requires a loan decision. Loan decisions are made by the Credit Committee.

The Risk Controlling & Strategic Wind-down Planning unit analyzes and monitors counterparty credit risk and the appropriateness of the risk provisions and allowances to be recognized on a quarterly basis. Additionally, the unit ensures that the risk situation of the largest individual commitments is regularly reviewed.

hsh pm sets individual limits per counterparty for the investment of cash and cash equivalents in the form of overnight and fixed-term deposits as part of liquidity management. The decision on limits is made exclusively by the Executive Board upon request by the Treasury & Finance unit.

The Risk Controlling & Strategic Wind-down Planning unit issues a quarterly general risk report summarizing the current situation and changes in counterparty credit risk and all sub-risks. The general risk report is addressed to the Executive Board and the Advisory Board of hsh pm.

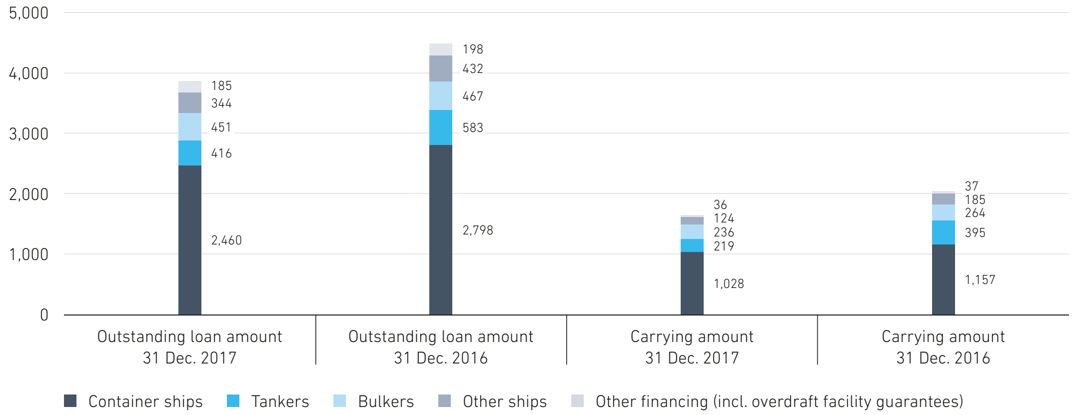
3.3.4 Credit risk

hsh pm defines credit risk as the risk of potential loan losses if borrowers are unable to meet their contractual obligations at the due date either in whole or in part.

The portfolio acquired from HSH Nordbank AG consists almost entirely of non-performing loans. The carrying amount of the portfolio as of 31 December 2017 was EUR 1,643 million, down substantially on the outstanding loan amount of EUR 3,856 million. Loans and advances were reduced by 14% in the reporting period and the carrying amount fell by 18%.

The majority of the loans in the portfolio are collateralized with ship mortgages. The cash flows expected from the ships used as collateral cover the carrying amount of the loan receivables in full. A significant share of the loans is attributable to container ships (64% of the outstanding loan amount or 63% of the carrying amount of the loan receivables). Bulk carriers, tankers and other ships, mainly multi-purpose ships, account for a much smaller share of the loan portfolio than container ships. The number of ships serving as collateral declined by 37 in the financial year to 214 as of 31 December 2017 due to restructuring and liquidation.

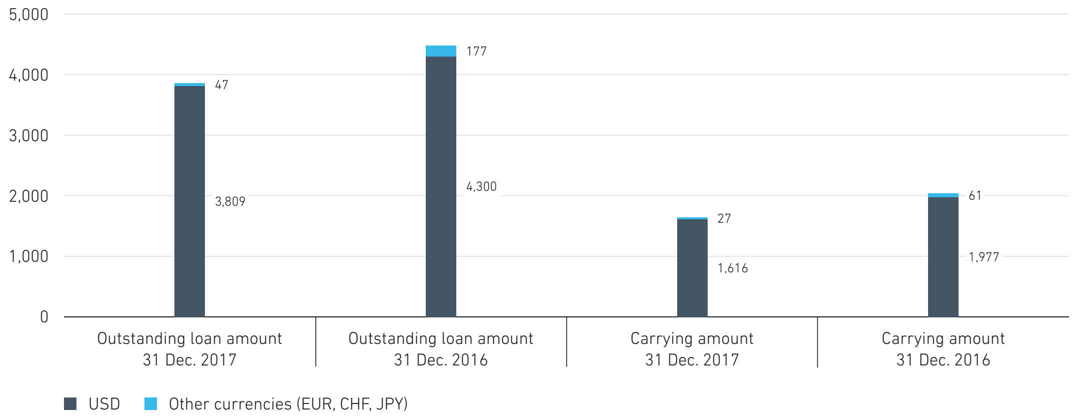
Breakdown of the loan portfolio by ship segment in EUR million



The loan portfolio is heavily concentrated on a few large borrower units. In terms of the carrying amount of the loan receivables, the ten largest borrower units account for 70% of the portfolio.

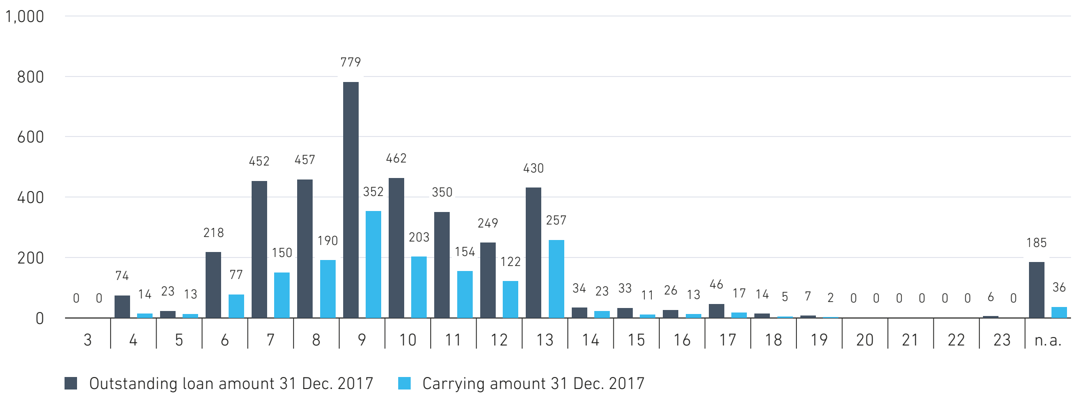
Around 99% of the loans are denominated in US dollars, with the rest in euros, yen and Swiss francs. The picture regarding the carrying amount is similar, because 98% of the carrying amount is attributable to US dollar-denominated loans.

Breakdown of the loan portfolio by currency in EUR million



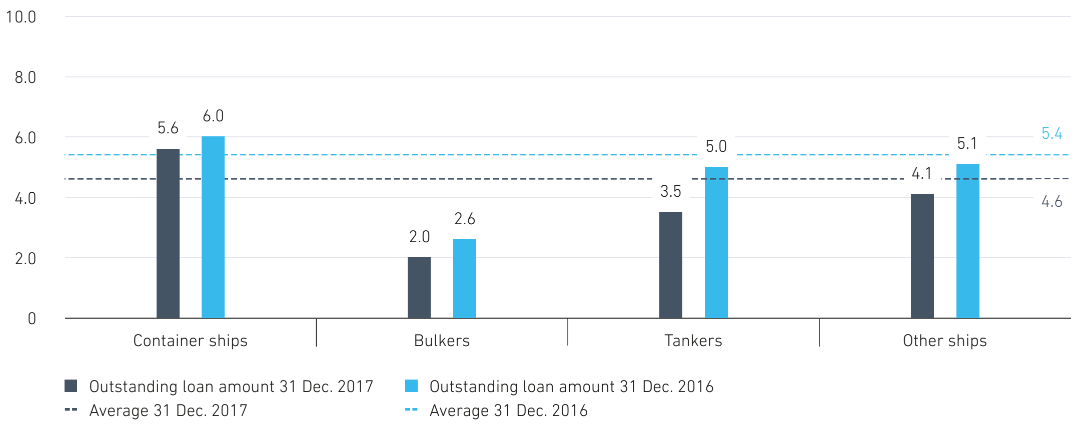
A material factor in the longer-term resolution strategy is the age of the ships serving as collateral and the remaining terms of the respective loans. In the reporting period, the average ship age weighted by outstanding loan amount increased from 8.8 to 9.7 years, reflecting the age of the ships serving as collateral.

Breakdown of outstanding loan amounts and carrying amounts by ship age in EUR million and years



The average remaining term weighted by loan receivables declined from 5.4 to 4.6 years in the reporting period.

Weighted average maturity structure of the loan portfolio in years (remaining term)

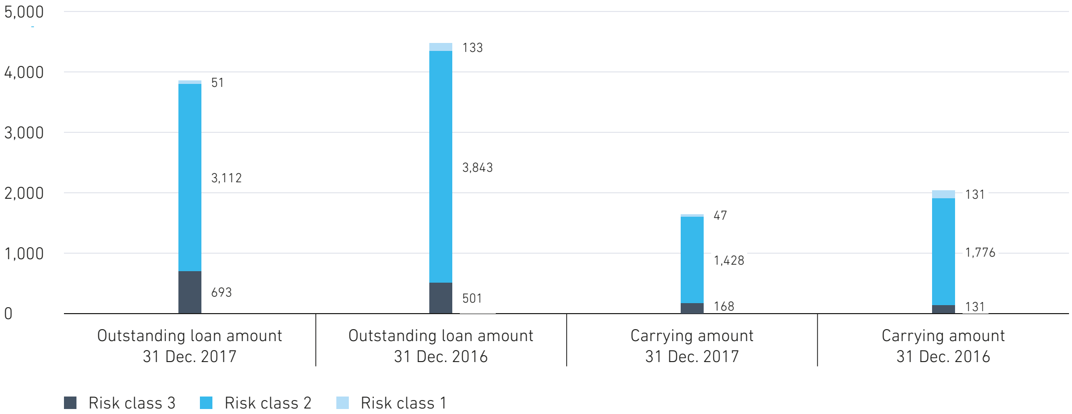


The borrowers of hsh pm are assigned to four risk classes, which differ as follows:

- Risk class 0 comprises all borrowers subject to regular monitoring
- Risk class 1 comprises borrowers subject to intensive monitoring
- Risk class 2 consists of borrowers in default [1] with a positive going concern outlook
- Risk class 3 comprises loans in default where the borrower is in liquidation because insolvency proceedings have been initiated

The outstanding loan amount and the carrying amount of the loan receivables are spread across three of the four hsh pm risk classes. A total of 82% of the outstanding loan amount or 90% of the carrying amount of the loan receivables is attributable to borrowers subject to intensive monitoring (risk class 1) or to borrowers which have a positive restructuring outlook (risk class 2). No borrower has been assigned to risk class 0 as of the 31 December 2016 and 2017 reporting dates.

Risk structure of the loan portfolio in EUR million



In addition to the aforementioned credit risk, hsh pm also takes into account the credit risk arising from the investment of liquidity in compliance with counterparty-specific limits. The funds invested amounted to EUR 112 million at 29 December 2017.

[1] Among other reasons, borrowers are deemed to be in default if they cannot service their debt in whole or in part over a period of more than 90 days.

3.3.5 Counterparty risk from derivatives

As of the reporting date, hsh pm had no derivatives in its portfolio. Derivatives are the source of counterparty risk because market-driven changes in price can occur during their term. If a counterparty defaults, there is a risk that hsh pm may only be able to replace the derivative with a new contract at a less favorable price. The counterparty risk exists during the entire term of the transactions.

3.3.6 Issuer risk

Issuer risk is the risk of a loss due to a credit rating deterioration or default of an issuer. Issuer risk becomes a material element of counterparty credit risk as soon as hsh pm acquires securities for its own portfolio. At the reporting date of 31 December 2017, hsh pm was not subject to any issuer risk.

3.3.7 Settlement risk

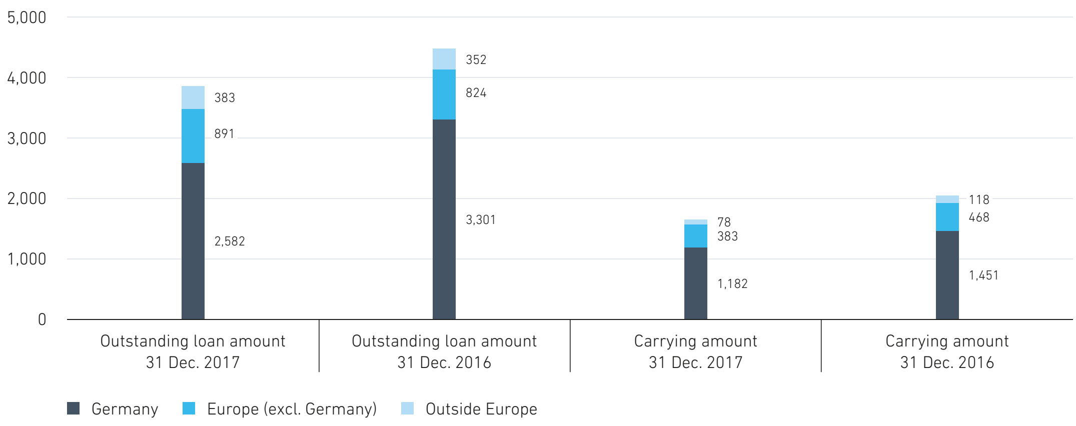
No settlement risks materialized 2017. hsh pm defines settlement risk as the risk of a potential loss in the case of default of a counterparty on the money or capital markets during the settlement period. This risk arises from transactions where there is a danger that because hsh pm's advance performance, the counterparty will fail to provide the consideration owed either in whole or in part.

3.3.8 Country risk

Country risk describes the danger associated with lending to borrowers domiciled abroad that agreed upon payments will not be made either in whole or in part due to governmental restrictions on cross-border payments. The rating of the relevant country of domicile and any rating changes occurring over time are key indicators of country risk. Additionally, the "outlook" published by rating agencies provides information on whether a particular country requires more intensive monitoring.

In terms of their place of business, the regional focus is on borrowers in Europe, particularly Germany. Some 67% (74% at the end of 2016) of the outstanding loan amount is attributable to borrowers with their place of business in Germany, as is 72% (71% at the end of 2016) of the carrying amount of the loan receivables. Clients with their place of business outside of Europe make up a relatively small share of the loan portfolio at 10% (8% at the end of 2016) of the outstanding loan amount and 5% (6% at the end of 2016) of the carrying amount of the loan receivables.

Country structure of the loan portfolio in EUR million



3.4 MARKET RISK

3.4.1 Definition

hsh pm defines market risk as the risk of potential losses in on- and off-balance sheet items as a result of changes in interest rates and exchange rates. Due to the structure of the transferred portfolio, market risk at hsh pm comprises interest rate risk and foreign currency risk.

3.4.2 Strategic direction

hsh pm's long-term asset resolution strategy aims to resolve the transferred portfolio while maximizing its value and does not make short-term changes in capital market value the foundation for its management. In order to minimize the risk of potential losses from resolving the transferred portfolio, market risk is reduced wherever financially feasible and appropriate.

The strategy to mitigate foreign currency risk laid down in the business strategy is executed by the Treasury & Finance unit by entering into hedges and obtaining funding at matching currencies, taking into account cost-benefit considerations. The uncertain cash flows of the positions acquired (e.g. due to delays or the failure to make interest and principal payments) may also require hsh pm to take action, because changes in the expected cash flows must be addressed quickly by modifying and adjusting currency hedging.

3.4.3 Management and monitoring

Various interest rate developments influence both the net interest income from operations as well as the net assets of hsh pm. Interest rate risk comprises the danger that interest income may be lower or interest expense may be higher than expected because of changes in market interest rates. Using a present value approach (interest rate sensitivities), the change in the market value of the interest exposure book, and therefore the corresponding economic capital, is calculated by discounting the future cash flows by the current or changed market rate. The sensitivity indicator for measuring the absolute market value change of the portfolio as a result of interest rate changes is Basis Point Value (BPV). BPV indicates the effect of a shift in the interest rate curve by one basis point (0.01%).

In terms of hsh pm's current method for managing interest rate risk, the primary aim is to identify the negative effects of interest rate changes on net interest income and, if necessary, take steps to manage these risks.

In addition, hsh pm can be subject to funding risk when interest rates rise. In this case, funding costs increase, while principal and interest payments by mostly non-performing borrowers stay the same or even decrease. An increased interest expense would therefore be detrimental to the income statement, because borrowers would be unable to fully absorb an increase in interest liability if shipping markets were to continue to be in crisis.

Foreign currency risk is also analyzed using sensitivities determined on a net present value basis. At hsh pm, foreign currency risk arises from possible changes in the value of open foreign currency positions as a result of fluctuating exchange rates. An exchange rate movement directly affects the market value of financial instruments. The foreign currency sensitivity is calculated using exchange rate fluctuations of 1% each in US dollars, Swiss francs and Japanese yen. Open positions and loans payable on demand are included in this calculation. The most significant driver of foreign currency risk is the US dollar, because the largest share of the loan portfolio (around 99%) is denominated in this currency.

Due to specific valuation allowances recognized in euros, there are differences at the reporting date between the composition of loans denominated in foreign currencies (assets) and the foreign currency structure on the liabilities side. The resulting increased foreign currency risk is temporary and is eliminated through corresponding foreign exchange transactions following presentation of the relevant information about the specific valuation allowance recognized.

The management of interest rate risk is challenging for hsh pm, since receiving contractually agreed cash flows depends on the creditworthiness of borrowers in the non-performing loan portfolio and therefore future developments in highly volatile shipping markets. Smoothly functioning asset / liability management in the medium to long term is therefore determined by the quality of the estimate regarding cash flows at borrower level. Short-term management focuses mainly on the different bases for calculating interest rates on the asset and liabilities sides.

A majority of the loans related to ship financing managed by hsh pm feature variable-rate interest agreements. This means that if interest rates rise, borrower payment obligations would also increase. As enforcing these contractual claims will not be completely possible owing to the non-performing loan portfolio, this gives rise to an additional counterparty credit risk.

Interest rate risk is analyzed weekly. The result of the risk calculations is the reporting in euro equivalents of the change in value of the entire portfolio and individual maturity ranges. As of the measurement date of 31 December 2017, hsh pm's interest rate risk in view of a shift in yield curves by one basis point is EUR 60.1 thousand. Interest rate risks are relatively low in relation to the total volume of assets and liabilities and were insignificant in the full financial year.

Interest rate risk is limited using a total sensitivity figure across all maturity ranges and for all currencies. Further sub-limits will be determined as needed for individual maturity ranges and currencies by the Risk Controlling & Strategic Wind-down Planning unit.

The purpose of foreign currency risk management is to hedge assets and the expected cash inflows and outflows denominated in foreign currencies against exchange rate fluctuations. There is considerable uncertainty associated with the asset-side cash flows, so they require continual monitoring and, if necessary, timely use of currency swaps to ensure that balance sheet items are mostly in matching currencies. If the exchange rate were to change by 1%, hsh pm's foreign currency risk would be EUR 1.3 million at the reporting date. Given that most funding is obtained in US dollars, the currency risk as of the reporting date of 31 December 2017 is comparatively low.

The Risk Controlling & Strategic Wind-down Planning unit monitors compliance with and utilization of interest rate and foreign currency limits, whose utilization is presented in the quarterly risk report to the Executive Board and Advisory Board.

There were no indications that any limits were exceeded in 2017.

3.5 LIQUIDITY RISK

3.5.1 Definition

hsh pm defines liquidity risk as the risk of failure to fulfill payment obligations due either in full or on time, or the ability to obtain funding only at higher market rates.

3.5.2 Strategic direction

The key objective of hsh pm's liquidity strategy is to always be able to meet payment obligations, i.e. to be able to cover outgoing payments at any time with incoming payments and possible measures to obtain liquidity. In this regard, liquidity management must ensure a suitable liquidity buffer.

Due to the guarantor liability, hsh pm's liquidity risk primarily arises from systemic liquidity bottlenecks in the market and, less commonly, from a lack of funding options for hsh pm. When the market as a whole is in crisis, hsh pm must also temporarily count on incurring higher costs for funding to cover liquidity requirements. In addition, there is a danger that the unexpected failure to make payments (e.g. if settlement risk materializes) or execution of subsidiary agreements (e.g. cash sweep agreements) could adversely affect the liquidity situation of hsh pm for a short period.

hsh pm strives to avoid cost-intensive liquidity building, because its credit rating ensures ample opportunities for obtaining liquid funds. Standard market funding transactions are conducted in ordinary business activities to cover liquidity needs. In addition, hsh pm can rapidly access short-term liquidity assistance from the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein from 2017 onward. In order to ensure that liquidity is obtained at favorable terms, hsh pm maintains relationships with banks and investors (e.g. establishing an issuing program, establishing contact with banks with strong placement records) and maintains a presence on international financial markets. This enables hsh pm to quickly and flexibly react to changes in the market situation depending on capital market parameters.

To the greatest extent possible, hsh pm pursues a strategy of obtaining funding with maturities matching the expected maturity profile of the loan portfolio. Surplus liquidity generated during asset resolution activities is either invested at standard market terms or, if possible and appropriate, used to repay hsh pm's funding transactions.

The feasibility of this liquidity strategy is regularly analyzed in stress scenarios in view of insolvency and funding risks by calculating the days of available liquidity assuming the elimination of expected cash inflows and a reduction in existing liquidity potential.

3.5.3 Management and monitoring

Operational liquidity risk management comprises short-term and medium-term liquidity planning so that liquidity needs can be identified well in advance and covered by implementing suitable measures. Operational management handles both short-term liquidity management of maturities of up to one year as well as structural liquidity management involving funding activities to ensure the long-term success of the portfolio resolution. Mismatched currencies and concentration risks are avoided as much as possible, as long as this is economically feasible.

hsh pm conducts detailed analyses of asset-side risk positions (including the planned liquidity reserve) and funding requirements to assess the liquidity situation. A liquidity gap analysis reflecting expected cash inflows and outflows is also prepared.

Contractually agreed cash flows from funding and the cash flows from principal and interest repayments in the loan portfolio estimated in a model are used to calculate the flow of liquidity. Comparing expected incoming and outgoing cash flows therefore provides information about possible future liquidity bottlenecks.

The liquidity positions are additionally analyzed and limited in the context of stress assumptions. The aim of the liquidity stress test is to show whether hsh pm's liquidity is sufficient even when general conditions are less favorable than expected.

As of 31 December 2017, hsh pm has sufficient liquidity. In addition to liquidity received from debt service by borrowers, hsh pm obtains short-term funding from fixed-term deposits and medium-term funding from standard market instruments for procuring liquidity. If necessary, hsh pm can also draw down short-term loans from the Free and Hanseatic City of Hamburg totaling up to EUR 100 million, or more if available in the context of the total liquidity assistance available for equity investments, as well as obtain short-term liquidity assistance from the Federal State of Schleswig-Holstein in the amount of EUR 1 billion (maximum term of 6 months).

Liquidity coverage of EUR 87 million existed at the reporting date of 31 December 2017 in the period of up to three weeks. Taking into account the liquidity assistance from the Free and Hanseatic City of Hamburg and the state of Schleswig-Holstein that is available at short notice, there is a positive liquidity balance in a range of EUR 547 million to EUR 1,112 million in the entire limited period of up to twelve months.

By the end of 2017, the bridging facility had been repaid completely. At the beginning of 2018, to supplement the debt issuance program (DIP) currently being implemented, commercial paper in both euros and US dollars was also employed as a liquid money market product used for short-term financing in maturities of up to one year.

The Risk Controlling & Strategic Wind-down Planning unit on a weekly basis monitors compliance with the requirements for securing liquidity. The results are presented in the quarterly risk report to the Executive Board and Advisory Board.

3.6 OPERATIONAL RISKS

3.6.1 Definition

hsh pm defines operational risk as the danger of incurring losses as a result of the inadequacy or failure of internal processes and systems or people, or due to external events. Operational risks arise in the form of potential loss events in the course of the business activities of hsh pm that could lead to deterioration in the net assets, financial position or results of operations of hsh pm. The definition of operational risks also extends to outsourcing, compliance, IT, legal, model, reputation and personnel risks, but not strategic or regulatory risks.

3.6.2 Strategic direction

hsh pm primarily follows a strategy of avoiding operational risks while using the fewest resources possible. The objective of the risk management process in place is to proactively identify risks to avoid loss events from occurring or to mitigate their effects. Suitable risk management and risk control processes were set up in the specialist departments as part of a qualitative measurement approach for purposes of assessing and analyzing operational risks.

3.6.3 Management and monitoring

A system for documenting and measuring operational risks appropriately scaled for hsh pm was established to monitor and manage operational risks. This ensures that the Executive Board can be provided at any time with an overview of all material operational risks at hsh pm.

Senior managers are directly responsible for management in their units to prevent, minimize and transfer operational risks in general as well as individual operational risks. They can also delegate operational implementation to risk owners in their departments. The primary measures for preventing operational risks involve setting up effective internal control processes and procedures, establishing a stable IT infrastructure and ensuring adequate numbers of personnel. Risk owners are responsible for reviewing their processes and systems for possible risks on an ongoing basis and documenting any losses that occur. The Risk Controlling & Strategic Wind-down Planning unit bears ultimate responsibility for risk management and risk control processes for operational risks.

Management of operational risks is based on the risks identified in the annual OpRisk risk inventory conducted at hsh pm and on the losses documented in the loss database.

The OpRisk risk inventory serves to identify changes in the risk profile of hsh pm. In the event of negative changes, this allows hsh pm to take preventive measures to manage risk at an early stage. The objective of the OpRisk risk inventory is to identify and analyze risks. It is also a tool to communicate relevant risks across units as well as raise employee awareness of risk and therefore limit potential losses from the very start. The individual specialist departments identify and assess their operational risks in terms of severity and likelihood of occurrence to fulfill the criteria of suitability and materiality.

Ensuring systematic documentation of operational risks requires loss events to be recorded after they occur and processed in a loss database. Both direct and indirect gross losses (recognized and not recognized in the income statement) are documented. Significant internal and external losses are analyzed to determine their cause and effects on the risk profile in order to develop preventive strategies for action to minimize losses, to prevent similar losses in the event the risk occurs again, and to therefore adequately manage operational risk.

A loss of approximately EUR 4.7 million was incurred in the 2017 calendar year in connection with currency translation. There were no other losses directly influencing the income statement for the period ended 31 December 2017.

Based on the results of the ex-ante risk inventory and ex-post analysis of the loss database, activities are developed to manage material operational risks. To this end, measures are designed to minimize specific losses, and weak points and potential areas for improvement are continually identified. The management of operational risks is thus not primarily concerned with managing loss events but with proactively measuring and managing operational risks.

IT and outsourcing risks, among others, have been identified in the OpRisk risk inventory and analyzed. Both are elements of the risk reporting. The data submitted by Business Management / IT to the central risk controlling function quantifies the IT risks based on observed infringements of service-level agreements (SLAs) and contains the information security reporting. The following three areas are distinguished:

- Processes supported by the IT department
- Systems supported by the IT department
- Individual data processing supported by the specialist departments

These risks arise when services are delegated to third parties, and the services are not performed as agreed, or at all. Mitigating the risks associated with outsourcing involves developing measures to ensure a high level of service quality and continual performance by service providers as well as operational stability.

3.6.4 Outsourcing

For purposes of resolving the loan portfolio transferred, hsh pm outsourced some administrative functions for operational and cost reasons, particularly to HSH Nordbank AG, Dataport AöR, Revisions- und Treuhand-Kommanditgesellschaft (RuT), CASIS Heimann Buchholz Espinoza Partnerschaft Wirtschaftsprüfungsgesellschaft and Rhenus Archiv Services GmbH.

HSH Nordbank AG provides support to hsh pm under an outsourcing contract by providing certain services in the areas of credit support, loan and collateral management and IT. The compensation for these services in the set-up phase included both cost reimbursement and a margin. From the time regular servicing began in March 2017, the work of HSH Nordbank AG was remunerated based on the schedule of services. In 2017, an extension of the contract until the end of June 2019 was agreed because a new call for tenders will be issued from March 2018 for the scope of the outsourcing portfolio of HSH Nordbank AG in connection with the “Award of New Servicing HSH Nordbank” project.

With the support of central outsourcing management, hsh pm conducts control and monitoring processes to monitor its outsourcing risk with respect to service quality and compliance with internal and statutory requirements. Responsibility for the technically correct performance of services by the service provider lies with each individual unit at hsh pm. The objective of these measures is to continually improve existing processes, structures and service definitions.

Based on risk analyses, hsh pm independently determines which outsourced activities and processes are material in view of risk (material outsourcing activities). The risk analysis is conducted on the basis of uniform standards both regularly and as necessary by the relevant specialist department. It takes into account all aspects of outsourcing relevant to hsh pm (e.g. the material risks of outsourcing, including possible risk concentrations, risks arising from further subcontracting and the suitability of the company to which the services are outsourced). In the event of full or partial outsourcing of control units and core units of the institution, hsh pm reviews whether and how it can ensure that the outsourced activities and processes will be integrated into risk management.

Central outsourcing management has been set up to manage and control outsourcing activities stipulating the following management components:

- Strategic management: Monitoring and alignment of the service provider’s services to the requirements of the service recipient (e.g. hsh pm specialist departments)
- Business management: Implementation of contractually agreed financial measures to ensure the provision of services in the required quantity and quality
- Technical / operational management: Monitoring of the content of the operational provision of services, including clarifying and following up on technical questions or problems (in conjunction with the specialist departments) relating to the provision of services or interfaces to other specialist departments
- Risk management: Outsourcing risks are managed by the specialist departments outsourcing the services themselves

In cases where termination of the outsourcing agreement for material outsourcing activities is planned or expected, hsh pm has taken steps to guarantee the continuity and quality of the outsourced activities and processes even after termination. For the event of unplanned or unexpected termination of these outsourcing activities, which could significantly impair business activities, hsh pm reviews the corresponding courses of action for feasibility at least once a year. When appropriate and possible, this also includes determining exit strategies.

3.7 OTHER RELEVANT BUT NOT MATERIAL RISKS

The last general risk inventory carried out in December 2017 showed that hsh pm is exposed to strategic risk, business risk and regulatory risk, as well as other relevant but not material risks.

Strategic risk is the risk of unfavorable business performance occurring as the result of (erroneous) basic business decisions. hsh pm's strategic goal is to resolve the transferred portfolio while preserving as much of its value as possible. Due to the particular focus of hsh pm as an asset resolution entity, no proactive strategic decisions are generally made that would have a significant effect on the net assets, results of operations or liquidity position. The risk of strategic mistakes is considered to be low due to the prevalence of case-by-case decisions.

Business risk refers to the general danger of unexpected volatility in earnings attributable to changes in general business conditions (e.g. business environment) that cannot be balanced out by reducing costs. Against this backdrop, hsh pm's business risk is low because the effects on earnings caused by changes in general business conditions are addressed in other risk types (particularly counterparty credit risk).

Regulatory risk is the risk arising from the fact that new or amended regulatory requirements are generally unforeseeable. The regulatory risk to which hsh pm is subject as an asset resolution entity is low despite the high likelihood of occurrence.

3.8 SUMMARY OF THE RISK SITUATION AS OF 31 DECEMBER 2017

hsh pm was established to acquire the risk positions of HSH Nordbank AG and to resolve this portfolio in accordance with a long-term asset resolution plan while preserving as much of the portfolio's value as possible.

The portfolio mainly includes loans collateralized by a total of 214 ships from various segments of the shipping industry. Counterparty credit risk is therefore materially influenced by developments in shipping markets because their performance determines the ability of borrowers to service debt and the opportunities available to hsh pm to liquidate collateral for these loans. The focus of hsh pm's credit portfolio is on the container ship segment, which accounts for 63% of the carrying amount.

In addition to a concentration in the shipping market segment, the portfolio also features a strong concentration of a limited number of borrower units. The ten largest borrower units account for around 70% of the carrying amount. Both in terms of the outstanding loan amount (90%) and the carrying amount (95%), most of the borrowers have their place of business in Europe. hsh pm's country risk is therefore fairly low.

The further performance and wind-down of the portfolio are affected primarily by changes in market parameters and macroeconomic conditions. These are reflected in the continued existence and increase in overcapacity on shipping markets. For this reason, the timing and scope of market recovery could impact the restructuring of individual credit exposures. Developments in the market environment are taken into consideration in the asset resolution plan. The asset resolution plan is prepared or updated at least annually, and its implementation and degree of success are monitored quarterly.

Market risk at hsh pm is low with a BPV of EUR 60.1 thousand in relation to the total volume of assets and liabilities. As of the reporting date of 31 December 2017, the interest rate risk is therefore insignificant from a risk perspective.

Around 99% of the loans in the portfolio are denominated in US dollars. As a result, most funding is obtained in US dollars. The foreign currency risk as of the 31 December 2017 reporting date amounted to EUR 1.3 million and is fairly low from a risk perspective.

As of the reporting date, hsh pm has sufficient liquidity. In addition to liquidity derived from standard market instruments for procuring liquidity, hsh pm can access extensive liquidity assistance from the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg, if necessary.

A loss of approximately EUR 4.7 million was incurred in the 2017 calendar year. There were no other losses directly influencing the income statement for the period ended 31 December 2017.

In the risk inventory for operational risks, outsourcing, IT, model and personnel risks were identified as relevant, analyzed and assessed to determine their likelihood of occurrence and total potential loss. A central loss database in which losses are documented on an ad hoc basis and managed was established to assess and manage operational risks.

4. REPORT ON OPPORTUNITIES

In the previous year, continuing overcapacity reduction helped charter rates and second-hand prices to recover significantly in some areas across most size classes in the container and bulk shipping segments. By contrast, there was still no improvement in the tanker markets. This overall positive performance was also driven by the fact that new build activity remains at a low level, raising confidence of a more stable future in the medium term among market players.

Although a substantial number of contracts for new vessels were signed in the second half of 2017, order books relative to the fleet in service remained at a level below the long-term average. In the container shipping segment, capacity in the order book is concentrated on very large container ships that are not in direct competition with the container ships represented in the hsh pm portfolio.

Overall, a very low increase in capacity utilization in shipping markets with high fleet capacity utilization may lead to a significant rise in charter rates. This particularly applies if there are no longer any ships available in a shipping area within the charter market at a given time. At the end of 2017, the utilization rate was already very high in most size classes within the container and bulk shipping segments. There were hardly any ships that were laid up in the longer term. It is possible that demand will develop slightly better in 2018 and / or supply will grow at a lower rate than previously forecast. These developments would lead to a further improvement in fleet capacity utilization and enhanced performance in charter rates and thus second-hand prices than indicated in the report on expected developments. The tanker shipping segment has not yet reached a utilization rate that would lead us to anticipate a significant rise in charter rates even in the event of slight improvements in 2018. Nevertheless, a more rapid reduction in overcapacity would also lead to more robust charter markets in this area.

The factors described above would have various positive effects for hsh pm. If charter rates can sustain a higher level, this would improve the prospects of outstanding loans being properly serviced. Secondly, prices for second-hand tonnage could also rise. This could enable borrowers to redeem loans by generating more proceeds from the disposal of ships than previously planned. Both effects would tend to accelerate the reduction in the loan portfolio in accordance with asset resolution planning.

5. REPORT ON EXPECTED DEVELOPMENTS

Global economic growth of 3.7% is expected in 2018 after 3.6% in the previous year. Total maritime trade is expected to grow by around 3.6% in 2018, which would be the second-highest increase since 2012 (2017: 4.1%). However, this fundamentally positive outlook assumes that there will be no shocks triggered by the escalation of various simmering international crises.

Some areas of the individual container and bulk shipping segments recorded clear improvements in the charter and second-hand markets in the previous year, and further increases are likely in 2018 due to the excess demand expected. However, there are different expectations within these segments depending on ship size. No significant improvement is expected in the tanker market in 2018, even though demand growth is likely to exceed the increase in supply.

5.1 CONTAINER SHIPPING

In the container shipping segment, total transport capacity (TEU) growth of approximately 4.0% and demand growth (TEU) of around 5.0% is expected for 2018, and it is anticipated that this will lead to a further reduction in overcapacity.

More than 80% of tonnage growth in 2018 will be driven by deliveries of additional large container ships with slot capacity between 9,400 TEU and 21,400 TEU. Overall, approximately 223 container vessels are expected to be delivered, including 76 ships with a capacity of more than 9,400 TEU. In 2017, 150 ships were delivered, including 62 vessels with a capacity of more than 9,400 TEU. In view of the anticipated improvement in the market situation, it can be assumed that less capacity will be taken out of service in 2018 than in previous years; scrappage volumes of around 300,000 to 400,000 TEU are forecast after approximately 420,000 TEU was decommissioned in 2017. It is very likely that the market share of smaller size classes will shrink further, as the ships in this segment are comparatively old and thus offer greater potential for scrappage. The share of container ships in the hsh pm portfolio consists exclusively of small and medium-sized classes ranging from 300 TEU to 8,800 TEU.

Intraregional trading is expected to record the strongest growth in trade in 2018 at 5.9%, followed by the global secondary North-South route with an anticipated increase of 5.2%. The planned expansion of punitive tariffs on US imports poses another simmering risk to the development of demand. Such trade barriers would have a particularly negative impact on container transport between the affected regions.

While fundamental market data generally indicates another slight improvement in the market situation in 2018, the outlook is adversely affected by increasing economic and political uncertainty.

5.2 TANKER SHIPPING

Demand in the overall oil market is expected to grow by 1.2% year-on-year in 2018, while output is likely to rise by around 2%. Non-OECD states in Asia are viewed as the primary drivers of demand. Demand growth will be restricted by the persistently high oil prices anticipated. OPEC will play an important role on the supply side as it wants to continue restricting output in 2018. According to forecasts, the share of US oil exports in the overall market will rise in 2018, while US consumption will increasingly be covered by domestic production.

When looking exclusively at tanker shipping, a reduction in existing overcapacity is expected in 2018, but not to such an extent that significant improvements in charter rates and second-hand prices can be anticipated. On the supply side, there is still a large number of imminent deliveries that are expected to increase crude oil tanker capacity by approximately 3.9% and product tanker capacity by 2.2%. The predicted growth in demand is around 5.0% for crude oil tankers and approximately 3.7% for product tankers.

This means that charter rates and second-hand prices will remain under pressure in 2018. The fundamental data indicates a comparatively improved performance in the product tanker markets. The hsh pm tanker portfolio predominantly consists of product tankers.

Due to the existing overcapacity, charter rates and second-hand prices are not expected to improve significantly in 2018, even though demand is likely to exceed supply.

5.3 BULK SHIPPING

Demand for bulk shipments is expected to grow by 2.8% in 2018, with the bulker fleet likely to expand by 1.4% over the same period.

Fleet growth in 2018 will predominantly be driven by large size classes such as Capesize bulkers. The new orders placed in the previous year will not yet be ready for delivery in 2018. A total of 373 bulkers with a total tonnage of approximately 35 million DWT are expected to be delivered in 2018, with an average capacity per ship of around 94,000 DWT.

On the demand side, growth will primarily be driven by Asia, with China alone representing more than 73% of demand for the most important bulk cargo, iron ore. A further increase in demand of approximately 4.0% is forecast in this market in 2018. However, the shift from fewer investments to more private consumption and services as envisaged and introduced by the Chinese leadership could weaken Chinese imports in future and thus have a marked impact on the equilibrium of the market. As a result, some analyses are also forecasting a weakening of Chinese iron ore demand. The “minor bulks” (e.g. steel products, forestry products, fertilizers) are less dependent on individual economies; demand in this segment is expected to grow by approximately 3.0% in 2018.

In summary, another slight increase in charter rates and second-hand prices is expected in the bulker segment in 2018, as overcapacities in this area are likely to reduce further as a result of scrapping and rising demand.

5.4 IMPACT ON hsh pm

It is difficult to quantify the effects of macroeconomic forecasts on the net assets, financial position and results of operations of hsh pm. As a result, the following statements are subject to uncertainty and meaningful only to a limited extent.

For the full-year 2018, hsh pm expects slight improvement in the shipping markets due to the positive trends observed since the second half of 2017. hsh pm therefore anticipates that the strained financial position of borrowers will generally develop more positively than in previous years. As a result, hsh pm expects debt servicing by its borrowers to increase for the full-year 2018. Further measures to wind down the portfolio such as restructuring and the liquidation of loan collateral will continue in 2018. If the shipping markets continue to improve, hsh pm expects to reduce the loan portfolio further in 2018 than in the previous year, although this will primarily be determined by how the market develops.

The financial position for 2018 will be characterized by increased money market activities as part of the ECP program as well as further improvements to the funding cost base.

The interest income received is expected to be at a higher level in 2018 than in the previous year, as borrowers are likely to make higher interest payments in light of continuing positive developments in the markets. hsh pm plans to incur slightly lower interest expenses in 2018 compared to the previous year. However, there is the risk of a further increase in variable refinancing rates (Libor) that could lead to higher-than-planned interest expenses.

Personnel expenses will rise further, primarily due to the successive increases in the number of staff carried out in 2017. The increase in headcount will largely be completed in 2018. On the other hand, other administrative expenses are expected to decrease significantly as a result of the largely completed expansion of hsh pm and thus more than offset the rise in personnel expenses. General and administrative expenses are therefore expected to fall significantly compared to the previous year.

The development of loan loss allowances and provisions primarily depends on expectations for the development of shipping markets still considered to be volatile. The slight improvement in the outlook for the shipping markets and the corresponding general improvement in borrowers' situations is contrasted by an aging collateral portfolio. Overall, the recognition of additional loan loss allowances and provisions is to be expected. This could result in a net loss for the year slightly above that of the previous year in 2018.

6. INTERNAL CONTROL SYSTEM AND RISK MANAGEMENT SYSTEM RELEVANT FOR THE FINANCIAL REPORTING PROCESS

The internal control system (ICS) comprises the basic principles, techniques and measures taken to ensure that the financial reporting process is efficient and effective. It focuses on limiting operational risk. The ICS is used to guarantee that financial reporting is in order, that hsh pm complies with the relevant statutory and regulatory requirements and that, with a reasonable degree of assurance, breaches of financial reporting standards are avoided. The aim of the implemented ICS is also to provide appropriate information in a timely manner for the users of reports.

The processes necessary to prepare data relevant for the financial statements were and are documented in all departments and units and are reinforced by prevention and detection checks in line with the overarching control objectives in order to mitigate risk. The processes and associated controls have been extensively updated and enhanced in 2017.

The strict application of the ICS provides reasonable assurance that potential errors in financial statements will be avoided, although this cannot be guaranteed with absolute certainty.

6.1 RISKS RELATED TO THE FINANCIAL REPORTING PROCESS

The risks in the financial reporting process are that financial statements may not provide a true and fair view of the net assets, financial position and results of operations as a result of unintended errors or deliberate action (fraud) and / or that their publication may be delayed and / or that the accounting may not comply with the German accepted accounting principles. These risks could adversely impact confidence in hsh pm (reputational damage) and could result in the imposition of sanctions by supervisory authorities.

Financial reporting does not provide a true and fair view of net assets, financial position and results of operations if the figures in the financial statements or disclosures in the notes to the financial statements differ materially from the correct details. Differences are deemed material if, individually or collectively, they could influence the economic decisions made by the users of the financial statements on the basis of the financial statements.

6.2 MATERIAL OUTSOURCING IN RELATION TO THE FINANCIAL REPORTING PROCESS

hsh pm has outsourced material aspects of its financial reporting:

- The loan accounting for the credit portfolio acquired in mid-2016 is carried out by HSH Nordbank AG using the integrated FusionBanking Midas core banking system produced by Finastra (formerly Mysis).
- The following tasks have been outsourced to Revisions- und Treuhand-Kommanditgesellschaft (RuT), Wirtschaftsprüfungsgesellschaft, Steuerberatungsgesellschaft, Kiel, Germany:
  - general ledger management,
  - ongoing financial accounting,
  - accounts receivable and accounts payable,
  - asset accounting,
  - preparation of the tax accounts and tax return, and
  - payroll.

  The Kanzlei Rechnungswesen pro and Lodas software applications produced by DATEV eG, Nuremberg, Germany, are used for the outsourcing. RuT is also involved in preparing the quarterly reports and annual financial statements of hsh pm and, on request, provides an opinion on individual financial reporting issues.

The outsourcing arrangements have a significant degree of relevance for the financial reporting process and the ICS related to financial reporting.

During the course of the financial year and / or during the preparation of the 2017 annual financial statements, hsh pm implemented additional measures to mitigate the risks in the financial reporting process related to the outsourcing of activities:

Please refer to the details in the “Operational risk – outsourcing” section of the risk report.

6.3 ORGANIZATION OF THE INTERNAL CONTROL SYSTEM

The Executive Board is responsible for the propriety of the financial reporting process. For this purpose, hsh pm set up an ICS authority in 2017 based in the Organization team in the Business Management department. It began work on 1 July 2017 and ensures that the accounting-related ICS at hsh pm is established and developed further on a regular basis. This also entails continuous monitoring of hsh pm's compliance with financial reporting regulations (in accordance with the HGB).

The new-product process (NPP), for which the Risk Controlling & Strategic Wind-down Planning unit is responsible, is conducted with the involvement of the Treasury & Finance unit to ensure that the risks related to financial reporting are appropriately taken into account in accordance with the Mindestanforderungen an das Risikomanagement (MaRisk – German Minimum Requirements for Risk Management) when new products are launched (making sure that the products can be properly presented in the financial reporting system).

The basic structure of the regulations set down in writing including the process maps of the individual departments was completed with the release and implementation of hsh pm's organizational manual in July 2017. Pursuant to these written regulations, the management of the individual departments is responsible for determining the risks, identifying the control requirements and carrying out the controls. A process owner specified in writing is responsible for drawing up descriptions of the controls and then implementing the controls.

The ICS framework of hsh pm sets out that the ICS control cycle must be gone through once per year in line with the specifications of the Executive Board. Large section of this were implemented and completed in the fourth quarter of 2017. In 2018, the untested departments will go through the ICS control cycle.

In the ICS control cycle, the business-critical processes, key risks and key controls were identified and further measures for the ICS control cycle were derived as needed.

Once the 2017 ICS control cycle was completed, an action plan was developed for each specialist department and approved by the Executive Board. Among other things, this stipulates that additional processes must be implemented and existing processes and ICS controls improved. Moreover, focal areas to be tested in the 2018 ICS control cycle were defined with the process owners.

6.4 CONTROLS TO MINIMIZE THE RISK OF ERRORS IN FINANCIAL REPORTING

The ICS at hsh pm relevant to the financial reporting process had an appropriate number of internal controls. The controls are item-based and risk-oriented. The dual control principle is applied in this regard.

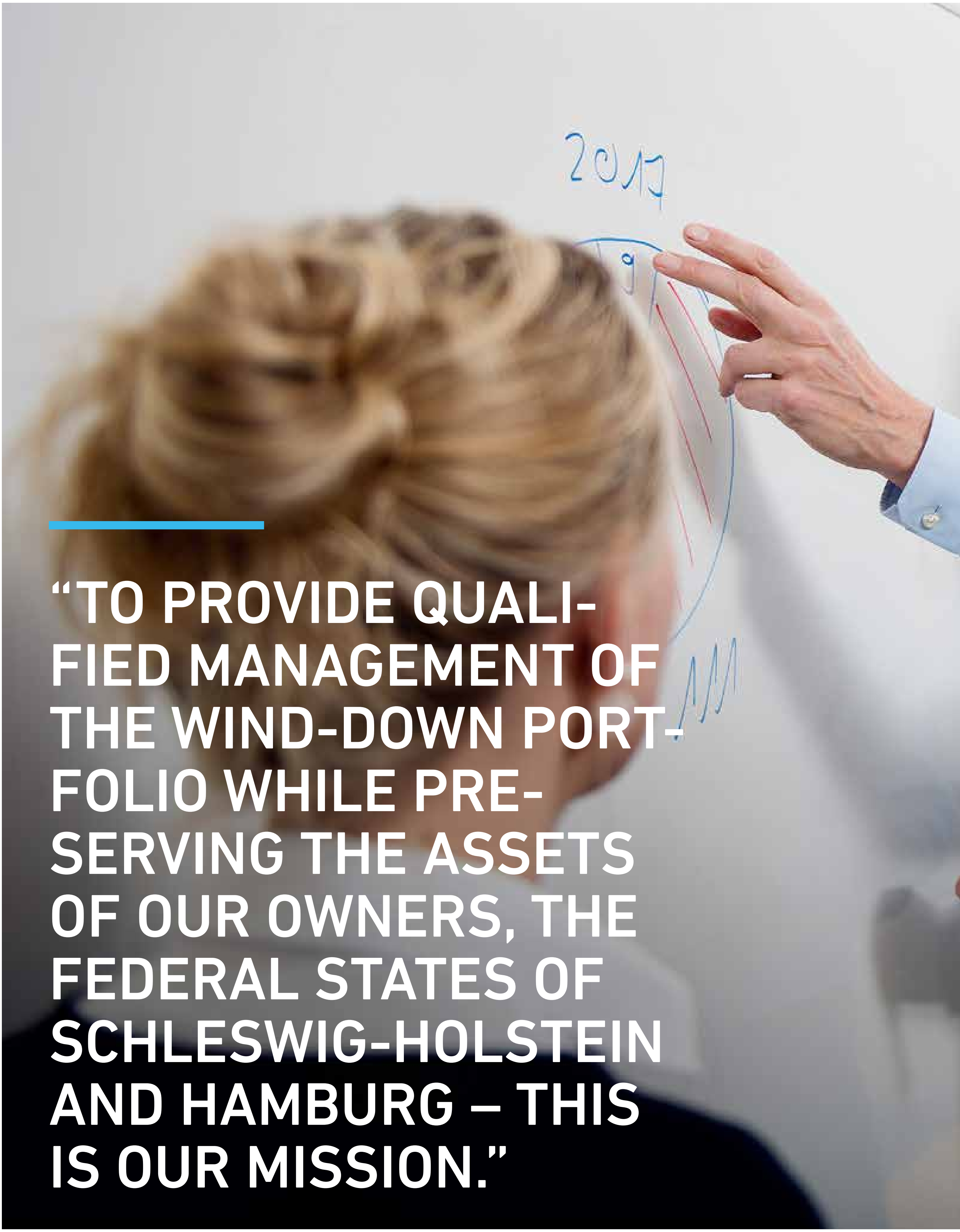
The appropriateness and effectiveness of the accounting-related ICS at HSH Nordbank AG in relation to matters relevant to outsourcing was audited by KPMG Aktiengesellschaft Wirtschaftsprüfungsgesellschaft in accordance with ISAE 3000 as part of an engagement issued by hsh pm. The service provider HSH Nordbank AG has also implemented a suitable ICS relevant to the financial reporting system and hsh pm has satisfied itself of the effectiveness of this system by inspecting the documentation and information supplied to it by HSH Nordbank AG.

The contractual regulations with RuT and its internal organization likewise ensure a functioning ICS here. hsh pm satisfied itself of this on the basis of the long-form audit report prepared by PKF FASSELT SCHLAGE, Partnerschaft mbB Wirtschaftsprüfungsgesellschaft in accordance with IDW AuS 951 (new version) and various discussions.

The controls guarantee an appropriate, effective ICS in relation to completeness, accuracy and authorization, including access to financial reporting-related data.

6.5 INTERNAL AUDIT UNIT

The Internal Audit unit was set up as a dedicated, independent unit in the second half of 2016. It commenced auditing activities immediately. Its task is to carry out systematic, regular audits to verify that hsh pm is complying with statutory and regulatory requirements, that risk management and the ICS are fully operational and effective, and that processing is carried out properly; it also monitors action taken to ensure that problems identified in audit findings are rectified.



“TO PROVIDE QUALIFIED MANAGEMENT OF THE WIND-DOWN PORTFOLIO WHILE PRESERVING THE ASSETS OF OUR OWNERS, THE FEDERAL STATES OF SCHLESWIG-HOLSTEIN AND HAMBURG – THIS IS OUR MISSION.”

/ ANNUAL FINANCIAL STATEMENTS

of hsh portfoliomanagement AöR

BALANCE SHEET

as of 31 December 2017

ASSETS

in EUR		31 Dec. 2017	31 Dec. 2016
1. Cash reserve			
Balances with central banks		49,993,263.13	15,519,568.73
Thereof with Deutsche Bundesbank EUR 49,993,263.13 (previous year: EUR 15,519,568.73)			
2. Loans and advances to banks			
a) Payable on demand	57,204,816.39		66,725,898.78
b) Other loans and advances	0.00		25,471,874.52
		57,204,816.39	92,197,773.30
3. Loans and advances to customers		1,643,483,428.98	2,012,613,781.96
4. Intangible fixed assets			
Purchased concessions, industrial and similar rights and assets, and licenses in such rights and assets		100,974.00	161,972.00
5. Tangible fixed assets		94,072.00	86,475.00
6. Other assets		339,245.96	170,012.74
7. Prepaid expenses		3,593,133.39	156,829.73
8. Deficit not covered by equity		549,750,974.03	505,323,128.41
TOTAL ASSETS		**2,304,559,907.88**	**2,626,229,541.87**

EQUITY AND LIABILITIES

in EUR		31 Dec. 2017	31 Dec. 2016
1. Liabilities to banks			
a) Payable on demand	210,175.35		5,007,719.16
b) With agreed maturity or notice period	639,169,377.70		2,346,808,743.98
		639,379,553.05	2,351,816,463.14
2. Liabilities to customers			
Other liabilities			
a) Payable on demand	0.00		0.00
b) With agreed maturity or notice period	17,228.22		5,005,348.36
		17,228.22	5,005,348.36
3. Debt securities issued			
Bonds issued		1,653,564,020.91	250,012,986.11
4. Other liabilities		5,534,514.47	9,289,016.44
5. Deferred income		272,008.21	808,943.54
6. Provisions			
Other provisions		5,792,583.02	9,296,784.28
7. Equity			
a) Net loss for the year	-549,750,974.03		-505,323,128.41
b) Deficit not covered by equity	549,750,974.03		505,323,128.41
		0.00	0.00
TOTAL EQUITY AND LIABILITIES		**2,304,559,907.88**	**2,626,229,541.87**

Other obligations			
Irrevocable loan commitments		5,907,612.77	5,379,535.49

INCOME STATEMENT

for the period from 1 January 2017 to 31 December 2017

in EUR			1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
1. Interest income from lending and money market transactions Thereof negative interest income deducted EUR 120,913.76 (previous year: EUR 294,877.12)		35,075,457.18		19,850,230.01
2. Interest expenses Thereof negative interest expenses deducted EUR 346,711.36 (previous year: EUR 82,703.14)		-34,205,621.87		-14,118,497.28
			869,835.31	5,731,732.73
3. Commission income		1,092,411.79		207,918.77
4. Commission expenses		-1,394,184.06		-5,491,655.90
			-301,772.27	-5,283,737.13
5. Other operating income			1,794,133.26	25,612.00
6. General and administrative expenses				
a) Personnel expenses				
aa) Wages and salaries	-5,065,629.00			-1,948,145.66
ab) Social security, post-employment and other employee benefit costs thereof in respect of post-employment benefits EUR 223,361.53 (previous year: EUR 67,949.28)	-877,642.49			-282,496.26
		-5,943,271.49		-2,230,641.92
b) Other administrative expenses		-28,394,719.61		-27,903,752.77
			-34,337,991.10	-30,134,394.69
7. Depreciation, amortization and write-downs of tangible and intangible fixed assets			-61,850.97	-31,682.94
8. Other operating expenses			-9,944,925.89	-5,556,816.91
9. Write-downs of and valuation allowances on loans, advances, receivables and certain securities, and additions to loan loss provisions			-2,444,126.65	-470,073,444.67
10. Result from ordinary activities			-44,426,698.31	-505,322,731.61
11. Other taxes not included in item 8			-1,147.31	-396.80
12. NET LOSS FOR THE YEAR			**-44,427,845.62**	**-505,323,128.41**
13. Loss brought forward from the previous year			-505,323,128.41	0.00
14. NET ACCUMULATED LOSSES			**-549,750,974.03**	**-505,323,128.41**

“FOR US, TRANSPARENCY STARTS WITH OPEN DIALOGUE – WHICH WE SEEK TO ENGAGE IN WITH OUR COLLEAGUES, SPONSOR STATES, PARTNERS AND THE GENERAL PUBLIC.”

NOTES

GENERAL DISCLOSURES AND EXPLANATIONS

hsh pm and its sponsors

On 22 December 2015, a State Treaty between the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein came into force establishing hsh portfoliomanagement AöR (hsh pm), Kiel, as an entity under German public law (AöR) with full legal capacity in accordance with section 8b of the Finanzmarktstabilisierungsfondsgesetz (FMStFG – Financial Market Stabilization Fund Act).

hsh pm is not classified as a bank or financial services institution and is not involved in any operations that require authorization by national or international supervisory authorities.

The sponsors of hsh pm are – with equal shares – the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein. The constituent meeting of the Board of Sponsors was held on 19 January 2016.

hsh pm was entered in the commercial register of the Kiel local court under reference number HRA 9377 KI on 8 June 2016.

GENERAL FINANCIAL REPORTING DISCLOSURES

hsh pm prepares annual financial statements and a management report within three months of the end of a financial year in accordance with section 2 (7) of the State Treaty and article 18 (2) of the Statute.

hsh pm is not subject to any obligation to carry out consolidated financial reporting. The Publizitätsgesetz (PublG – German Act Governing Financial Reporting of Certain Enterprises and Corporate Groups) does not apply.

In accordance with article 18 (2) of the Statute, the annual financial statements of hsh pm were prepared pursuant to the provisions of section 242 ff. of the HGB for large corporations, the supplementary provisions for banks pursuant to section 340 ff. of the HGB and the Verordnung über die Rechnungslegung der Kreditinstitute und Finanzdienstleistungsinstitute (RechKredV – German Accounting Directive for Banks and Financial Services Providers).

The annual financial statements for the period ended 31 December 2017 consist of a balance sheet as of 31 December 2017, an income statement for the period from 1 January to 31 December 2017 and notes to the financial statements. The annual financial statements were also expanded to include a cash flow statement and a statement of changes in equity in accordance with section 264d of the HGB. hsh pm is classified as a publicly traded entity, as in financial year 2017 it was admitted to the regulated market and in the second half of 2017 issued bearer bonds that are listed on the regulated market of the Luxembourg Stock Exchange.

A management report has also been prepared.

The amounts as of 31 December 2016 were used as comparative amounts for the balance sheet. The prior-year comparative period comprising the short financial year (19 January to 31 December 2016) was used for the income statement.

The income statement amounts are not fully comparable, as hsh pm did not commence operating activities until 30 June 2016 when it acquired the portfolio.

Pursuant to section 2 (1) of the RechKredV, hsh pm has used Form 1 to structure the balance sheet and Form 3 (vertical presentation format) for the income statement.

Rounding differences of ± one unit (euros) may occur in the tables contained in the notes.

ACCOUNTING POLICIES

Assets, liabilities as well as prepaid expenses and deferred income are recognized in accordance with sections 246 ff. and 340 ff. of the HGB. Assets, liabilities and executory contracts are measured based on the principles in section 252 ff. of the HGB in conjunction with section 340e ff. of the HGB.

On initial recognition, the loan portfolio was assigned in full to current assets and is reported under the “Loans and advances to customers” item. In the 2016 annual financial statements, acquired overdraft balances were included in the “Loans and advances to banks” item. The overdraft facilities called in by HSH Nordbank AG, Hamburg / Kiel were transferred in rem on 31 March 2017 and as of that reporting date have been presented as loans and advances to customers (previously under “Loans and advances to banks”). The acquired loans were allocated to current assets regardless of their remaining maturities because these loans were acquired for resale purposes and were not intended to form part of operating activities on a long-term basis.

Loans and advances are recognized at the lower of their principal amounts and cost and are reduced by the recognition of specific or general valuation allowances where appropriate. The proportionate recoverable interest calculated at the reporting date is recognized together with the underlying loan or advance.

Cost calculation for the acquired ship financing

The cost for each individual loan in the portfolio of predominantly non-performing loans acquired on 30 June 2016 was calculated on the basis of the consideration of approximately EUR 2.4 billion paid for the acquisition of the portfolio. As the value of the transferred loans depends for the most part on the ability of the borrowers to generate the amount required to service the debt from the operation of the ships furnished as collateral for the loans, hsh pm carried out its own investigations to establish whether the operation of the ships could continue to be viable within the existing financing arrangements. It also used estimates from a recognized third-party provider of forecasts of trends in shipping markets for certain classes of ships (benchmark ships) as of the portfolio transfer date. These estimates took into account individual features of the ships pledged as collateral by adjusting the forecast values available for the benchmark ships. The adjustment factors were derived from historical data relating to the operation of the ships.

In those cases in which the continued operation of the ships pledged as collateral within the existing financing periods could be assumed to be viable, the expected discounted future net cash inflows from the operation of the ships pledged as collateral were used to determine the cost at borrower level. In those cases in which the continued operation of the ships used as collateral could not be assumed to be viable, the anticipated proceeds from the recovery of the collateral (market value) less a discount covering the expected costs of disposal were used to arrive at the cost at borrower level. Senior loan tranches and any proportions attributable to other banks in syndicated loans were also deducted in the calculation of the costs at borrower level. To determine the expected future net cash inflows generated by ship operating activities, charter rate forecasts were obtained from a market data provider. The market values furnished as collateral were based on individual expert valuation reports from recognized marine surveyors or on market price indications from a market data provider, depending on availability.

The shares in the overall value of the portfolio calculated based on the values for each borrower determined as described above were weighted according to the ratio of present value and market value and then multiplied by the total purchase price. Loans without recoverable collateral were assigned a cost of zero. The cost for all loans to one borrower calculated in this way were then used to determine the cost for each loan. Where several loans to a borrower were secured by the same collateral, the ranking of the debt servicing (cash waterfall) was taken into account in the calculation of the costs.

Cost calculation for acquired structured financing (Nautilus structures)

As the financing for a borrower in an arrangement known as a Nautilus structure is provided in several variously secured tranches, some of which are also held by third-party banks, senior loans and advances provided by the third-party banks were taken into account in the calculation of the costs. Senior rights to a return on equity capital and third-party rights to interest in relation to individual tranches were also taken into account.

Identifiable risks in the lending business were appropriately taken into account by the recognition of specific valuation allowances, which were determined individually for each customer on the basis of the measurement of the collateral furnished by the borrowers.

Measurement of ship financing as of the balance sheet date

Ship financing was measured as of the balance sheet date for the most part using the same method that had been used to determine the costs for the individual ship financing from the total purchase price, although any loan increases, debt waivers and repayments in the meantime were also taken into account. The assessments regarding the viability of continuing to operate the ships within the existing financing arrangement and regarding the useful lives of the assets, together with the estimates of net cash inflows achievable going forward from the operation of the ships, were updated on the basis of analyses as of the balance sheet date (continuing viability / useful life) and / or as of the fourth quarter of 2017 based on forecasts of future trends in the achievable net cash inflows from ship operations for benchmark ships published by a recognized market data provider. Ships that were not forecast to continue as a going concern at 31 December 2017 were measured at their market value less a discount to cover the expected costs of disposal. The Nautilus structures were each derived on the basis of individual calculations using a method similar to that used to determine their cost.

In both the calculation of cost and the measurement as of the reporting date, any net cash inflows forecast from ship operations were discounted to the relevant reference date using a risk- and maturity-specific discount rate. Depending on the useful life of the ship, the relevant discount rate is determined from the three-month US dollar LIBOR rate plus a risk premium appropriate to the market.

The estimates and assumptions required in connection with the measurement of the loans are in some cases based on subjective assessments and the forecasts are thus unavoidably subject to uncertainty. Actual future events may therefore differ from the estimates. This can have a considerable impact on the net assets, financial position and results of operations.

Uncollectible receivables are written off.

Loans and advances to banks are carried at their principal amount.

Purchased intangible fixed assets are amortized in accordance with their estimated useful lives; tangible fixed assets are depreciated on a straight-line basis in line with their estimated useful lives.

The other liabilities take into account all identifiable risks and contingent liabilities based on the necessary settlement amount as dictated by prudent business practice. Provisions with a remaining maturity of more than one year are discounted using the discount rates published each month by Deutsche Bundesbank.

Liabilities are measured at their settlement amount. The proportionate interest calculated at the reporting date is recognized together with the underlying liability.

Asset and liability items quoted in foreign currency were translated into the reporting currency (euros) using the ECB reference rate of 29 December 2017 in accordance with section 256a in conjunction with section 340h of the HGB. Assets and liabilities denominated in foreign currency are classified for each currency as “specially covered” (“besonders gedeckt”) in accordance with section 340h of the HGB. If the “special coverage” criterion is satisfied, all income and expenses arising from foreign currency translation are netted and reported under other operating income or other operating expenses in accordance with section 340h of the HGB in conjunction with IDW Accounting Principle IDW AcP BFA 4 covering the special features of foreign currency translation in the HGB financial statements of banks. Income and expenses denominated in foreign currency are translated at the relevant spot rate.

hsh pm manages general interest rate risk in the banking book centrally as part of its asset / liability management. To this end, the existing interest-based financial instruments in the banking book (“Refinanzierungsverbund”) are viewed together as a whole in terms of the interest component and are not designated as hedges within the meaning of section 254 of the HGB. The requirements in IDW Accounting Principle IDW AcP BFA 3 relating to the loss-free measurement of the banking book are observed, taking into account the existing maintenance obligation and public guarantee.

Negative interest on assets is offset against interest income; negative interest on liabilities is offset against interest expenses. Uncollectible interest income has not been recognized in the income statement.

hsh pm has not made any use of the option to recognize deferred tax assets in the annual financial statements for the period ended 31 December 2017.

hsh pm makes use of the option under section 340f (3) of the HGB in conjunction with section 32 (2) of the RechKredV (cross-offsetting option).

The cash flow statement has been prepared in accordance with the classification format in Appendix 2 of GAS 21, which covers the sector-specific requirements for the cash flow statements of credit institutions and financial services institutions.

The statement of changes in equity has been prepared taking into account the requirements of GAS 22.

BALANCE SHEET DISCLOSURES

1. Cash reserve

The "Cash reserve" item consists solely of credit balances at Deutsche Bundesbank amounting to EUR 50.0 million (31 December 2016: EUR 15.5 million).

2. Loans and advances to banks

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Payable on demand	57,205	66,726
Other loans and advances	0	25,472
	57,205	**92,198**
Pro rata interest	0	0
TOTAL	**57,205**	**92,198**
Of which subordinated loans and advances	0	0
Due within		
3 months	0	25,472
More than 3 months up to 1 year	0	0
More than 1 year up to 5 years	0	0
More than 5 years	0	0

The loans and advances to customers and contractual partners of HSH Nordbank AG arising from drawdowns on certain overdraft facilities and included in this item in the amount of EUR 24.9 million at the prior year-end were presented as loans and advances to customers as of 31 December 2017. This is because the overdraft facilities called in by HSH Nordbank AG were transferred in rem on 31 March 2017 in accordance with the portfolio transfer agreement.

3. Loans and advances to customers

in EUR thousand	31 Dec. 2017	31 Dec. 2016
TOTAL	**1,643,483**	**2,012,614**
Of which:		
Pro rata interest	304	34
Loans and advances with indefinite maturity	0	0
Subordinated loans and advances	0	0
Payable on demand	357,612	439,382
Due within		
3 months	49,920	16,180
More than 3 months up to 1 year	44,291	69,922
More than 1 year up to 5 years	493,385	431,355
More than 5 years	697,971	1,055,775

The due dates were determined on the basis of the legal maturity dates of the nominal loans and advances relative to their carrying amounts.

4. Fixed assets

Changes in fixed assets

in EUR thousand	Intangible fixed assets	Tangible fixed assets
Cost 1 Jan. 2017	174	106
Additions	10	36
Disposals	47	0
31 Dec. 2017	137	142
Accumulated depreciation/amortization 1 Jan. 2017	12	20
Additions	34	28
Disposals	10	0
31 Dec. 2017	36	48
Depreciation / amortization during the financial year	34	28
CARRYING AMOUNT, 31 DEC. 2017	**101**	**94**
Carrying amount 31 Dec. 2016	162	86

The intangible assets consist solely of purchased standard software. Intangible assets are amortized on a straight-line basis over a normal operating useful life of five years.

Tangible fixed assets comprise individual assets as well as an aggregate item for low-value assets with a cost of EUR 150.00 to EUR 1,000.00 and consist exclusively of operating and office equipment. Tangible fixed assets are depreciated on a straight-line basis over a period of three to five years.

5. Other assets

Other assets comprise the following items:

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Receivables from the tax office	313	167
Creditors with debit balances	2	3
Other	24	0
TOTAL	**339**	**170**

6. Prepaid expenses

Prepaid expenses consist of the following items:

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Discount from the issuing business	3,242	0
prepaid invoice amounts	351	157
TOTAL	**3,593**	**157**

The discount from issuing business is attributable to issued bonds. This amount also includes issuing costs, which are allocated over the same term.

7. Deficit not covered by equity

For information on the deficit not covered by equity, please refer to the details on the guarantor liability and institutional liability of the Federal States of Hamburg and Schleswig-Holstein.

The deficit of EUR 549.7 million (previous year: EUR 505.3 million) comprises the loss brought forward from financial year 2016 (EUR 505.3 million) and the net loss for 2017 (EUR 44.4 million).

8. Liabilities to banks

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Payable on demand	210	5,008
With agreed maturity or notice period	638,296	2,346,466
	638,506	**2,351,474**
Pro rata interest	873	343
TOTAL	**639,379**	**2,351,817**
Due within		
3 months	588,301	197,535
More than 3 months up to 1 year	49,995	2,148,931
More than 1 year up to 5 years	0	0
More than 5 years	0	0

The purpose of the liabilities with an agreed maturity or period of notice is to fund the acquired loan portfolio.

9. Liabilities to customers

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Other liabilities with agreed maturity or notice period	17	5,000
Pro rata interest	0	5
TOTAL	**17**	**5,005**
Due within		
3 months	17	0
More than 3 months up to 1 year	0	5,000
More than 1 year up to 5 years	0	0
More than 5 years	0	0

10. Debt securities issued

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Bonds issued	1,653,564	250,013
TOTAL	**1,653,564**	**250,013**
Of which:		
Amounts due in the following year	0	250,013

This item comprises bearer bonds in the amount of EUR 400 million and USD 1,500 million (equivalent value in euros: EUR 1,253 million). It includes pro rata interest of EUR 2.8 million.

11. Other liabilities

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Trade payables	5,413	9,189
Taxes and social security expenses	120	98
Credit card invoices	1	2
TOTAL	**5,534**	**9,289**

Trade payables mainly relate to outsourcing costs (EUR 2.7 million; previous year: EUR 4.8 million), legal and consulting costs (EUR 2.3 million; previous year: EUR 3.7 million), and costs for the preparation and auditing of financial statements (EUR 0.3 million; previous year: EUR 0.6 million).

Taxes and social security expenses are attributable to amounts not yet paid for December 2017.

12. Deferred income

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Premium from the issuing business	272	809
TOTAL	**272**	**809**

This item contains premiums on issued bearer bonds, which are reversed over the same term.

13. Other provisions

in EUR thousand	Balance 31 Dec. 2016	Addition	Reversal	Use	Balance 31 Dec. 2017
Lending business	5,251	2,066	5,251	0	2,066
Register corrections	0	1,326	0	0	1,326
Invoices outstanding	727	786	74	653	786
Auditing costs	2,237	580	188	2,049	580
Personnel	434	552	108	326	552
Preparation of annual financial statements	351	367	0	324	394
BaFin levy	20	20	0	0	40
Preparation / publication of annual report	32	30	0	32	30
Archiving	9	10	0	0	19
MII / MAP ship portfolio insurance	236	0	140	96	0
TOTAL	**9,297**	**5,737**	**5,761**	**3,480**	**5,793**

Loan loss provisions relate to obligations to pass on interest received. Provisions for corrections to registers were recognized for corrections required to ship registers following the transfer in rem of the loan portfolio. Provisions for outstanding invoices relate predominantly to outstanding invoices for ongoing legal advice and outsourced services. Provisions for auditing costs relate to expenses in connection with the audit of the 2017 annual financial statements. Personnel provisions are attributable, among other things, to performance-related remuneration for the Executive Board and residual leave entitlements. The costs of preparing the annual financial statements are split between the internal expenses and the costs of outsourcing some of the work to an external service provider.

Provisions for archiving costs have a term of more than twelve months and were recognized to cover the storage of business documents for the statutory retention periods. The provisions are discounted in accordance with statutory provisions.

14. Other obligations

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Irrevocable loan commitments	5,908	5,380
TOTAL	**5,908**	**5,380**

Irrevocable loan commitments are commitments for funding that has been approved but not yet drawn down.

Based on current forecasts, hsh pm estimates the credit risk arising from drawdowns on irrevocable loan commitments to be mostly low.

15. Total amount of assets and liabilities denominated in foreign currency

in EUR thousand	31 Dec. 2017	31 Dec. 2016
Assets		
Loans and advances to banks	52,320	77,376
Loans and advances to customers	1,659,106	1,990,884
	1,711,426	2,068,260
Liabilities		
Liabilities to banks	412,396	2,157,552
Liabilities to customers	17	0
Debt securities issued	1,253,461	0
Other liabilities	41	11
Other obligations	5,908	1,607
	1,671,823	2,159,170

INCOME STATEMENT DISCLOSURES

1. Net interest income

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Interest income	**35,076**	**19,850**
Of which:		
Lending and money market transactions	35,197	20,145
Negative interest income	-121	-295
Interest expenses	**34,206**	**14,118**
Of which:		
Lending and money market transactions	30,272	14,195
Negative interest cost	-347	-83
Debt securities issued	4,281	-148
Other	0	154
NET INTEREST INCOME, TOTAL	**870**	**5,732**

Interest income from lending transactions is attributable predominantly to amounts of interest received and to a small extent to recoverable interest receivables. Most contractually agreed amounts of interest from lending transactions have not been recognized in the income statement because they are not expected to be collectible.

2. Net commission income

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Commission income	**1,092**	**208**
Of which:		
Lending business	1,092	208
Commission expenses	**1,394**	**5,492**
Of which:		
Lending business	1,216	5,448
Securities and issuing business	142	5
Other	36	39
NET COMMISSION INCOME, TOTAL	**-302**	**-5,284**

Of the commission expenses in the lending business, EUR 1,207 thousand is attributable to the extension of the bridge financing in June 2017. Issuing costs arising from the securities business are recognized on an accrual basis and allocated over the same term.

3. Other operating income

The following items were recognized as other operating income in the reporting period:

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Third-party cost reimbursements	836	0
Income from the reversal of provisions	510	0
Other income	448	26
TOTAL	**1,794**	**26**

Application of section 340h of the HGB in conjunction with section 256a of the HGB resulted in a net foreign currency translation loss (previous year: net foreign currency translation loss). This is reported in other operating expenses.

Cost reimbursements from third parties relate to legal costs paid.

Income from the reversal of provisions is attributable to auditing costs, the MII / MAP insurance in connection with the shipping portfolio and personnel costs.

4. General and administrative expenses

The breakdown of general and administrative expenses is as follows:

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Personnel expenses	5,943	2,231
Other administrative expenses	28,395	27,904
TOTAL	**34,338**	**30,135**

The **personnel expenses** were incurred for an average of 53 employees (previous year: 13) of hsh pm.

The breakdown of other administrative expenses is as follows:

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Material outsourcing costs	10,359	4,135
Organizational consulting services	6,214	4,980
Legal consulting services	6,018	1,930
Preparation and auditing of financial statements	1,541	3,030
Register corrections	1,400	0
Lending business costs	838	469
Office space rent	328	108
HR and IT consulting services	325	502
Rating	251	127
Market data communication	163	82
Initiation costs	0	7,561
Establishment costs	0	4,755
Other	958	225
TOTAL	**28,395**	**27,904**

Expenses for material outsourced activities were accounted for almost exclusively by the servicing of the acquired loan portfolio and services in connection with the provision of the IT infrastructure. Expenses for organizational, HR and IT consulting were incurred in connection with expanding hsh pm. Legal consulting costs were incurred mainly in setting up hsh pm and for consulting services in connection with the portfolio transferred. Some of the legal consulting costs were charged on to customers; the related income was recognized in the "Other operating income" item in the income statement. Expenses for the preparation and auditing of financial statements arise from the pro rata costs for the preparation and auditing of the 2017 annual financial statements. Expenses for corrections to registers arise from corrections required to ship registers following the transfer in rem of the loan portfolio. Costs in lending business are attributable to consulting services in connection with restructuring, valuer appraisals and expenses incurred in liquidating collateral.

5. Depreciation, amortization and write-downs of tangible and intangible fixed assets

The breakdown of amortization and depreciation expenses in the reporting period is as follows:

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Tangible fixed assets	28	20
Intangible fixed assets	34	12
TOTAL	**62**	**32**

6. Other operating expenses

The other operating expenses break down as follows:

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Net foreign currency translation income / expenses	9,099	5,557
Other	846	0
TOTAL	**9,945**	**5,557**

Application of section 340h of the HGB in conjunction with section 256a of the HGB resulted in a net foreign currency translation loss (previous year: net foreign currency translation loss).

7. Write-downs of and valuation allowances on loans, advances, receivables and certain securities, and additions to loan loss provisions

This item shows the net loan loss allowances and provisions. It amounts to EUR -2.4 million (previous year: EUR -470.1 million).

OTHER DISCLOSURES

1. Other financial obligations

Other financial obligations significant to an assessment of the financial position arise from the following rental and service agreements:

Type of obligation / contractual terms

in EUR thousand	Payments in 2018	Total payments over the fixed term
Leases for office space		
2018	16	16
2021	333	1,221
	349	1,237
Service contracts related to outsourcing		
2018	839	839
2019	6,783	9,419
2021	236	945
	7,858	11,203
TOTAL	8,207	12,440

2. Auditor's fee

Activities performed by the auditor

KPMG AG Wirtschaftsprüfungsgesellschaft, Berlin audited hsh pm's annual financial statements for the period ended 31 December 2017. In addition, assurance services related to hsh pm's annual financial statements and included in the audit were performed at an outsourcing company.

Auditor's fees as defined in IDW AcP HFA 36 new version (HGB)

The auditor's fee amounted to EUR 0.6 million in the reporting period and was incurred for the following services:

in EUR thousand	1 Jan. – 31 Dec. 2017	19 Jan. – 31 Dec. 2016
Auditing services	606	4,018
TOTAL	**606**	**4,018**

KPMG's audit fees in financial year 2017 were incurred for the audit of the 2017 annual financial statements (EUR 0.4 million) and for audit procedures performed at an external service provider (EUR 0.2 million). Of the audit services performed by PricewaterhouseCoopers GmbH (PwC) in the previous year, EUR 2.1 million was attributable to assurance services in connection with the measurement of the acquired loan portfolio and EUR 1.9 million to the auditing of the half-year and annual financial statements for 2016.

3. Number of employees

The average number of employees at hsh pm was as follows:

	1 Jan. – 31 Dec. 2017		19 Jan. – 31 Dec. 2016	
Headcount	Full-time employees	Part-time employees	Full-time employees	Part-time employees
Men	25	4	8	0
Women	15	9	4	1
	40	13	12	1
	53		13	

4. Governing bodies of hsh pm

EXECUTIVE BOARD
Ulrike Helfer, Executive Director
Dr. Karl-Hermann Witte, Executive Director

ADVISORY BOARD
Dr. Philipp Nimmermann (Chairperson until 31 December 2017, Deputy Chairperson from 1 January 2018), State Secretary, Ministry of Finance of the State of Schleswig-Holstein
Jens Lattmann (Deputy Chairperson until 31 December 2017, Chairman from 1 January 2018 up to and including 9 January 2018), State Councillor, Ministry of Finance of the Free and Hanseatic City of Hamburg
Dr. Sibylle Roggencamp (permanent representative of the Free and Hanseatic City of Hamburg until 9 January 2018, member of the Advisory Board and Chairperson from 10 January 2018), Senate Director, Ministry of Finance of the Free and Hanseatic City of Hamburg
Christian Fischer (from 15 May 2017), Counsel, Ministry of Finance of the Free and Hanseatic City of Hamburg
Meike Johannsen (until 14 May 2017), Executive Senior Director, Ministry of Finance of the Free and Hanseatic City of Hamburg
Agnes Witte, Advisor, Ministry of Finance of the Federal State of Schleswig-Holstein

BOARD OF SPONSORS
Dr. Peter Tschentscher (Chairperson until 31 December 2017), Finance Senator of the Free and Hanseatic City of Hamburg
Monika Heinold (Chairperson from 1 January 2018), Minister of Finance of the State of Schleswig-Holstein

In accordance with article 14 (2) of the Statute, the positions of chair and deputy chair of the Advisory Board rotate between the sponsors on an annual basis.

In accordance with article 16 (2) of the Statute, the position of chair of the Board of Sponsors likewise rotates between the sponsors on an annual basis.

5. Other posts held by the members of the Executive Board and by employees

As of the balance sheet date, the members of the Executive Board and employees held no other posts on statutory supervisory bodies of major corporations.

6. Loans to members of the governing bodies

There were no loans to members of the governing bodies as of the balance sheet date.

7. Benefits paid to the governing bodies

The following summary shows the benefits paid to the members of the Executive Board for the 2017 financial year:

	Dr. Karl-Hermann Witte	Ulrike Helfer	Total
Composition in EUR thousand	1 Jan. – 31 Dec. 2017	1 Jan. – 31 Dec. 2017	1 Jan. – 31 Dec. 2017
Non-performance-related remuneration	211	319	530
Non-monetary benefits	7	11	18
Performance-related remuneration	40	40	80
Long-term incentive components	0	0	0
TOTAL	**258**	**370**	**628**

The members of the Executive Board receive an employer-funded defined contribution pension plan in addition to a fixed salary. The defined contribution plan equates to 10% of the annual fixed salary and has been outsourced to a third-party pension provider. Both components are reported as non-performance-related remuneration. The non-monetary benefits result from the use of company cars. The members of the Executive Board are also granted a performance-related remuneration component that depends on the Executive Board's attainment of targets. The final amount of this remuneration had not been determined at the time of preparing these annual financial statements and will be set by the Advisory Board. The amounts listed above refer to the amounts for which a provision has been recognized in financial year 2017. Components involving long-term incentives do not form part of the contracts.

Events of particular significance after the balance sheet date

There were no events of particular significance after the balance sheet date.

Kiel, 27 March 2018

Ulrike Helfer Dr. Karl-Hermann Witte

CASH FLOW STATEMENT

for financial year 2017

in EUR thousand			1 Jan. – 31 Dec. 2017 [1]	19 Jan. – 31 Dec. 2016 [1]
1.		Profit / loss for the period	-44,428	-505,323
2.	+ / –	Depreciation, amortization and write-downs on items of fixed assets / reversals of such write-downs	62	32
3.	+ / –	Valuation allowances on loans, advances and receivables / reversals of such valuation allowances	16,136	464,822
4.	+ / –	Increase / decrease in provisions	-3,504	9,297
5.	+ / –	Foreign currency translation expenses / income	9,099	5,557
6.	+ / –	Other non-cash expenses / income	424	152
7.	– / +	Increase / decrease in loans and advances to banks	18,979	-77,036
8.	– / +	Increase / decrease in loans and advances to customers	118,114	-2,372,390
9.	– / +	Increase / decrease in other assets relating to operating activities	-3,605	-327
10.	+ / –	Increase / decrease in liabilities to banks	-1,490,611	2,225,900
11.	+ / –	Increase / decrease in liabilities to customers	-4,988	5,005
12.	+ / –	Increase / decrease in debt securities issued	1,423,096	250,013
13.	+ / –	Increase / decrease in other liabilities relating to operating activities	-4,291	10,098
14.	+ / –	Interest expense / interest income	-870	-5,732
15.	+	Interest and dividend payments received	35,075	19,850
16.	–	Interest paid	-34,206	-14,118
17.	**=**	**Cash flows from operating activities (total of lines 1. to 16.)**	34,482	15,800
18.	–	Payments to acquire tangible fixed assets	-36	-106
19.	+	Proceeds from disposal of intangible assets	37	0
20.	-	Payments to acquire intangible fixed assets	-10	-174
21.	**=**	**Cash flows from investing activities (total of lines 18. to 20.)**	-9	-280
22.		Net change in cash funds (total of lines 17.+21.)	34,473	15,520
23.	+	Cash funds at beginning of period	15,520	0
24.	**=**	**CASH FUNDS AT END OF PERIOD (TOTAL OF LINES 22. TO 23.)**	**49,993**	**15,520**

	COMPOSITION OF CASH FUNDS	31 Dec. 2017 [1]	31 Dec. 2016 [1]
	Balances with central banks	49,993	15,520
=	**CASH FUNDS**	**49,993**	**15,520**

[1] Figures taking into account rounding differences

STATEMENT OF CHANGES IN EQUITY

as of 31 December 2017

in EUR thousand	Loss brought forward	Net loss for the year	Net accumulated losses / deficit not covered by equity
Equity as at 19 Jan. 2016	0	0	0
Net loss for the year 2016	0	-505,323	-505,323
EQUITY AS AT 31 DEC. 2016	**0**	**-505,323**	**-505,323**
Equity as at 1 Jan. 2017	0	-505,323	-505,323
Appropriation of profit / loss 2016	-505,323	505,323	0
Net loss for the year 2017	0	-44,428	-44,428
EQUITY AS AT 31 DEC. 2017	**-505,323**	**-44,428**	**-549,751**

RESPONSIBILITY STATEMENT IN ACCORDANCE WITH SECTIONS 264 (2) SENTENCE 3 AND 289 (1) SENTENCE 5 OF THE HGB

To the best of our knowledge, and in accordance with the applicable reporting standards, the annual financial statements give a true and fair view of the assets, liabilities, financial position and profit or loss of hsh pm, and the management report includes a fair review of the development and performance of the business and the position of the entity, together with a description of the material opportunities and risks associated with the expected development of hsh pm.

Kiel, 27 March 2018

Ulrike Helfer

Dr. Karl-Hermann Witte

Independent Auditor's Report

To hsh portfoliomanagement AöR, Kiel

Report on the Audit of the Annual Financial Statements and of the Management Report

Opinions

We have audited the annual financial statements of hsh portfoliomanagement AöR, which comprise the balance sheet as at 31 December 2017, the statement of profit and loss, the statement of cash flows and the statement of changes in equity for the financial year from 1 January 2017 to 31 December 2017, and notes to the financial statements, including the recognition and measurement policies presented therein. In addition, we have audited the management report of hsh portfoliomanagement AöR for the financial year from 1 January 2017 to 31 December 2017.

In our opinion, on the basis of the knowledge obtained in the audit,

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

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

Basis for the Opinions

We conducted our audit of the annual financial statements and of the management report in accordance with Section 317 HGB and the EU Audit Regulation No. 537/2014 (referred to subsequently as "EU Audit Regulation") and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer [Institute of Public Auditors in Germany] (IDW). Our responsibilities under those requirements and principles are further described in the "Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report" section of our auditor's report. We are independent of the Company in accordance with the requirements of European law and

German commercial and professional law, and we have fulfilled our other German professional responsibilities in accordance with these requirements. In addition, in accordance with Article 10 (2) point (f) of the EU Audit Regulation, we declare that we have not provided non-audit services prohibited under Article 5 (1) of the EU Audit Regulation. We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our opinions on the annual financial statements and on the management report.

Key Audit Matters in the Audit of the Annual Financial Statements

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual financial statements for the financial year from 1 January 2017 to 31 December 2017. These matters were addressed in the context of our audit of the annual financial statements as a whole, and in forming our opinion thereon, we do not provide a separate opinion on these matters.

Determination of the amount of the specific valuation allowances on loans and advances to customers related to ship financing

Please refer to the disclosures in the "Accounting policies" section of the notes for information on the recognition and measurement principles applied.

THE FINANCIAL STATEMENT RISK

Under loans and advances to customers, hsh pm discloses almost exclusively loans related to ship financing in the amount of EUR 1,643 million (previous year: EUR 2,013 million). These had been taken over from HSH Nordbank AG, Hamburg / Kiel (HSH Nordbank) in 2016 for the purpose of resolving the ship financing. Virtually all of the loans – ever since their acquisition by hsh pm – are non-performing loans related to ship financing. As of the reporting date of 31 December 2017, hsh pm reviewed all loans and advances to customers related to ship financing to determine the amount of the necessary specific valuation allowances. Owing to a persistently difficult market, further additions to the specific valuation allowances on loans and advances to customers related to ship financing of EUR 2.4 million were required again in the reporting period.

The determination of the amount of the necessary specific valuation allowances on loans and advances to customers related to ship financing is discretionary. It requires forward-looking estimates of expected contractual cash flows and / or of the expected cash flows from the liquidation of loan collateral or the disposal of loans and advances to customers related to ship financing. The cash flows are estimated based on the viability of continuing the ship financing arrangements taking the foreseeable development of significant value-determining assumptions and parameters into account. These include in particular the investment strategy (continued operation or recovery strategy), the future development of charter rates and operating costs of the ships financed and the expected realizable collateral values. These estimates are subject to considerable uncertainty.

Incorrect assumptions and parameters in terms of the amount of the expected cash flows (for example, depending on forecasts of the future trend in charter rates, operating costs and ship values) would constitute a risk that necessary specific valuation allowances have not been taken into consideration to an appropriate extent and the loans and allowances to customers related to ship financing are therefore not accurately measured in the financial statements.

OUR AUDIT APPROACH

Applying a risk-based audit approach, we used both control-based and assertion-based audit procedures to form our audit opinion. As a result, in collaboration with our KPMG loan experts, we performed the following audit procedures, among others.

First, we established an overview of trends in the shipping markets, obtained an insight into the development of the entity's ship loan portfolio, the associated counterparty risks, the methods applied and the internal control system in relation to the determination of specific valuation allowances on loans and advances to customers related to ship financing. To assess the appropriateness of the internal control system in relation to the determination of specific valuation allowances on loans and advances to customers related to ship financing, we conducted observations and surveys and inspected the regulations set down in writing.

We then satisfied ourselves of the effectiveness of relevant controls aimed at ensuring appropriate determination of specific valuation allowances on loans and advances to customers related to ship financing in accordance with the accounting principles.

We audited the appropriateness of the significant value-determining assumptions and parameters used in the determination of the specific valuation allowances as well as the operation of the measurement model used by hsh pm in the event of the implementation of a continued operation strategy or a recovery strategy for shipping loans by means of a conscious choice of individual exposures. Furthermore, through sampling we performed other assertion-based audit procedures for the remaining exposures with regard to the assumption regarding the investment strategy. Here, we especially reviewed the assumption made by hsh pm concerning the assignment to the relevant investment strategy and the amount of the specific valuation allowance on loans and advances to customers related to ship financing that was recognized in each case. For this, we assessed the information available for appraising the investment strategy as well as the carrying amount of collateral and future cash flows from the operation of ships.

In addition, we examined the parameters set for determining the loan loss allowances and provisions and the measurement model used by hsh pm with regard to their appropriateness. We placed particular emphasis on appropriate consideration of the market expectations and on consistency of the parameters set for the market expectations.

OUR OBSERVATIONS

The assumptions established by hsh pm in relation to the investment strategy and the parameters for deriving the expected cash flows from the operation of ships or the collateral evaluation for the assessment of the amount of the specific valuation allowance on loans and advances to customers related to shipping loans are appropriate. In the individual cases that we reviewed, the assumptions and parameters were effectively applied.

The estimates of the expected cash flows made by hsh pm take account of current market expectations in relation to charter rates, operating costs or the development of the market value of the ships and are based on reasonable assumptions and parameters.

Other Information

Management is responsible for the other information. The other information comprises:

– the remaining parts of the annual report, with the exception of the audited annual financial statements and management report and our auditor's report.

Our opinions on the annual financial statements and on the management report do not cover the other information, and consequently we do not express an opinion or any other form of assurance conclusion thereon.

In connection with our audit, our responsibility is to read the other information and, in so doing, to consider whether the other information

– is materially inconsistent with the annual financial statements, with the management report or our knowledge obtained in the audit, or
– otherwise appears to be materially misstated.

Responsibilities of Management and the Supervisory Board for the Annual Financial Statements and the Management Report

Management is responsible for the preparation of the annual financial statements that comply, in all material respects, with the requirements of German commercial law applicable to business corporations, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles. In addition, management is responsible for such internal control as they, in accordance with German Legally Required Accounting Principles, have determined necessary to enable the preparation of annual financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the annual financial statements, management is responsible for assessing the Company's ability to continue as a going concern. They also have the responsibility for disclosing, as applicable, matters related to going concern. In addition, they are responsible for financial reporting based on the going concern basis of accounting, provided no actual or legal circumstances conflict therewith.

Furthermore, management is responsible for the preparation of the management report that as a whole provides an appropriate view of the Company's position and is, in all material respects, consistent with the annual financial statements, complies with German legal requirements, and appropriately presents the opportunities and risks of future development. In addition, management is responsible for such arrangements and measures (systems) as they have considered necessary to enable the preparation of a management report that is in accordance with the applicable German legal requirements, and to be able to provide sufficient appropriate evidence for the assertions in the management report.

The supervisory board is responsible for overseeing the Company's financial reporting process for the preparation of the annual financial statements and of the management report.

Auditor's Responsibilities for the Audit of the Annual Financial Statements and of the Management Report

Our objectives are to obtain reasonable assurance about whether the annual financial statements as a whole are free from material misstatement, whether due to fraud or error, and whether the management report as a whole provides an appropriate view of the Company's position and, in all material respects, is consistent with the annual financial statements and the knowledge obtained in the audit, complies with the German legal requirements and appropriately presents the opportunities and risks of future development, as well as to issue an auditor's report that includes our opinions on the annual financial statements and on the management report.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Section 317 HGB and the EU Audit Regulation and in compliance with German Generally Accepted Standards for Financial Statement Audits promulgated by the Institut der Wirtschaftsprüfer (IDW) will always detect a material misstatement. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual financial statements and this management report.

We exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual financial statements and of the management report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinions. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Obtain an understanding of internal control relevant to the audit of the annual financial statements and of arrangements and measures (systems) relevant to the audit of the management report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of these systems of the Company.
- Evaluate the appropriateness of accounting policies used by management and the reasonableness of estimates made by management and related disclosures.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in the auditor's report to the related disclosures in the annual financial statements and in the management report or, if such disclosures are inadequate, to modify our respective opinions. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to be able to continue as a going concern.

- Evaluate the overall presentation, structure and content of the annual financial statements, including the disclosures, and whether the annual financial statements present the underlying transactions and events in a manner that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Company in compliance with German Legally Required Accounting Principles.
- Evaluate the consistency of the management report with the annual financial statements, its conformity with [German] law, and the view of the Company's position it provides.
- Perform audit procedures on the prospective information presented by management in the management report. On the basis of sufficient appropriate audit evidence we evaluate, in particular, the significant assumptions used by management as a basis for the prospective information, and evaluate the proper derivation of the prospective information from these assumptions. We do not express a separate opinion on the prospective information and on the assumptions used as a basis. There is a substantial unavoidable risk that future events will differ materially from the prospective information.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with the relevant independence requirements, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, the related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the annual financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Other Legal and Regulatory Requirements

Further Information pursuant to Article 10 of the EU Audit Regulation
We were elected as auditor by the annual general meeting on 13 October 2017. We were engaged by the supervisory board on 18 December 2017. We have been the auditor of the hsh portfoliomanagement AöR since the financial year 2017.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the audit committee pursuant to Article 11 of the EU Audit Regulation (long-form audit report).

German Public Auditor Responsible for the Engagement

The German Public Auditor responsible for the engagement is Mr. Ronny Kühn.

Munich, den 28 March 2018

KPMG AG
Wirtschaftsprüfungsgesellschaft
[Original German version signed by:]

Kühn	Peter
Wirtschaftsprüfer	Wirtschaftsprüfer
(German Public Auditor)	(German Public Auditor)

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