portfoliomanagement

SCHLESWIG-HOLSTEIN · HAMBURG

ANNUAL REPORT 2019

TABLE OF CONTENTS

This is an English translation of the original German version of the Annual Report. We would like to point out that the translation is non-binding and for convenience only and that only the original German version of the audited annual report is authoritative.

portfoliomanagement

SCHLESWIG-HOLSTEIN · HAMBURG

/ KEY FIGURES [1]

Portfolio

in EUR million	31 Dec. 2019	31 Dec. 2018	Change	Change in %
Outstanding loan amount	3,293	3,669	-376	-10.2
Carrying amount	1,427	1,479	-52	-3.5

- The outstanding loan amount refers to the amounts due from customers, comprising outstanding loan principal and unsettled interest receivables. The decrease in the amounts due as of the reporting date is primarily attributable repayments of principal and loan losses. The appreciation of the US dollar had an opposite effect.
- The carrying amount as of 31 December 2019 was EUR 1,427 million. The year-on-year decrease stems mainly from principal payments and proceeds from the sale of ships, whereas providing liquidity support had a moderately increasing effect and the stronger US dollar also lifted the carrying amount.

Results of operations

in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018	Change	Change in %
Net interest income	22,957	28,320	-5,363	-18.9
Net commission income	138	5,232	-5,094	-97.4
Other comprehensive income [1]	2,283	3,132	-849	-27.1
Personnel expenses	-6,200	-6,599	398	-6.0
other administrative expenses	-18,824	-21,369	2,546	-11.9
Net result from loan loss allowances and provisions	-5,330	7,301	-12,630	>-100
Net income (+) / net loss (-) for the year	-5,505	15,104	-20,609	>-100

[1] excluding result from foreign currency translation

- The decline in net interest income is attributable to a year-on-year decrease in interest income and a year-on-year increase in interest expenses incurred in connection with funding.
- There was also a significant decline in net commission income as a result of lower commission income from restructuring fees whereas commission expenses remained stable.
- Although legal consulting costs charged on to customers and recognized in other comprehensive income were down sharply, the underlying costs were also significantly lower.

[1] Figures taking into account rounding differences

- Personnel expenses were down moderately year-on-year. portfoliomanagement employed an average of 55.6 full-time employees (previous year: 59.9 full-time employees) during 2019.
- Other administrative expenses predominantly include material outsourcing costs, one-time costs for projects, costs of support services in day-to-day business operations and legal consulting costs.
- The sharply lower net interest and net commission income and the substantially reduced other comprehensive income were enough to cover general and administrative expenses, as a result of which portfoliomanagement reported a breakeven result before loan loss allowances and provisions and before revaluation. Together with a net loss on loan loss allowances and provisions, this resulted in a net loss for the year (previous year: net income for the year).

Net assets

in EUR thousand	31 Dec. 2019	31 Dec. 2018	Change	Change in %
Loans and advances to customers	1,426,917	1,479,176	-52,260	-3.5
Liabilities to banks	138,581	0	138,581	-
Debt securities issued	1,880,658	2,096,017	-215,358	-10.3
Total assets / equity and liabilities	2,023,345	2,102,738	-79,392	-3.8

- Loans and advances to customers match the carrying amount of the portfolio as shown above.
- Liabilities to banks served to provide funding for the loan portfolio, some of it being short-term.
- In addition to the US dollar issues and euro bonds placed on the capital markets in 2017, the portfolio contained additional short-dated securities (ECP program) with an equivalent value in euros of EUR 589 million at the end of 2019.
- The total assets/total equity and liabilities figure is largely determined by the loan portfolio and the associated funding.

Rating

	Short term	Long term
Moody's Investors Service (last confirmed on 10 February 2020)	P-1	Aa1
Fitch Ratings (last confirmed on 31 October 2019)	F1+	AAA

- The guarantees provided by the sponsors have enabled portfoliomanagement to achieve very good unchanged ratings since October 2016.

Employees

	31 Dec. 2019	31 Dec. 2018	Change (Number)	Change in %
Full-time employees	51.6	59.5	-7.9	-13.3

- As a result of the ongoing portfolio reduction, the number of employees declined in the financial year ended.

FOREWORD OF THE EXECUTIVE BOARD

Ladies and Gentlemen,

Over the past financial year, we once again achieved a positive operating result and further reduced our portfolio. As the low level of interest income associated with this was offset by a decline in personnel and administrative expenses, we can look back on a generally successful financial year 2019.

The outstanding loan amount at the end of the year was EUR 3,293 million – this corresponds to a year-on-year reduction of EUR 376 million (-10.2%). The decrease in loans and advances to customers as of the reporting date was primarily attributable to principal repayments and loan losses. The carrying amount as of 31 December 2019 was EUR 1,427 million. The drop of EUR 52 million compared to the previous year's reporting date (-3.5%) was mainly due to principal payments and the reduction of receivables from the sale of ships. The appreciation of the US dollar had an opposite effect. As a result, the volume of receivables was reduced further overall in financial year 2019.

The moderate improvement in the shipping markets in previous years continued at a low level in 2019. Global economic developments had completely different effects on employment days and charter rates in the individual ship classes within the portfolio. Overall, however, portfoliomanagement's borrowers benefited from rising demand for tonnage coupled with an increase in demolition volume.

Coronavirus (COVID-19) has spread around the world since the start of 2020 and is having an increasingly negative impact on the shipping markets relevant to portfoliomanagement. The as-yet-unforeseeable one-off effects of this could significantly impact the result for the year in 2020 and extend the winding-up period. Further measures to wind down the portfolio such as restructuring and the liquidation of loan collateral will continue in 2020, with progress determined to a large extent by market developments. As a result, the outlook is once again subject to considerable uncertainty, as the impact of the spread of coronavirus (COVID-19) on the remainder of the year cannot be conclusively assessed at present.

The ratings issued by Moody's and Fitch (Aa1 and AAA) were also confirmed in 2019 and should ensure that portfoliomanagement can continue to comfortably obtain funds on the capital market. Together with the guarantees from our sponsor states, we can build on a stable foundation, even in what are currently challenging times.

We started 2020 with 154 ships serving as collateral. This means that the number of ships in the portfolio fell by 19 during the past financial year, a reduction of 40% since the Institution was established. Nevertheless, our planning shows that the rate of unwinding will slow. Around two-thirds of the loans have been restructured, while interest and principal repayments are currently within the agreements concluded.

We are working intensively with customers on the final third. Although many challenges remain, some of these involve exposures with complex legal structures and isolated cases of geopolitically challenging areas where the ships operate. These can restrict portfoliomanagement's options in the various liquidation scenarios.

portfoliomanagement is already in the wind-down phase after three-and-a-half years. This alone is nothing special for an asset resolution entity. However, the fact that we have reached this point after two-and-a-half years of development and only a short consolidation phase shows that we have pushed ahead with the unwinding of the portfolio rapidly while preserving the value of the assets. At the same time, there is currently no change to the forecast for the winding-up period originally made ten years ago. Our task remains to inspire a skilled and motivated team to fulfill the task of winding up the portfolio – while at the same time gradually dismantling the Institution.

We have set ourselves an ambitious goal with our 'Windjammer' project, which involves switching our servicing from Hamburg Commercial Bank AG to IBM Deutschland GmbH. After regular operations will commence, we will see a significant drop in administrative expenses in the coming years. Although the project has certainly challenged us in 2019 and the first few months of 2020, we are confident that we can bring it to a successful conclusion at the end of the first half of 2020. This is part of what sets the portfoliomanagement team apart.

We are still working with highly motivated colleagues who tackle and effectively solve the challenges of an asset resolution entity, and we would like to express our thanks for their efforts. However, it is also important that we work with our sponsors to set a course for the future to ensure that we can carry out our asset resolution work to the outstanding level of quality expected of us right to the end. Despite all the uncertainty, we are confident about the year ahead.

Kiel, 24 March 2020

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. It also performs its responsibilities pursuant to the Schleswig-Holstein Corporate Governance Code and the Hamburg Corporate Governance Code.

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
/ approving and formally adopting the annual financial statements

The Advisory Board of portfoliomanagement held a total of five meetings in 2019. Further resolutions were adopted by written circular.

At its meetings, the Advisory Board focused on the progress of restructuring and resolution activities, project topics such as the migration of portfolio servicing from Hamburg Commercial Bank AG to IBM Deutschland GmbH or the discussed transfer of further portfolios to portfoliomanagement, as well as funding and liquidity. The Board also discussed a break-even analysis for forecasting the duration of the institution's operations and the development of the personnel (cost) structure.

In 2019, the members of the Advisory Board worked closely with the institution's governing bodies in the interest of the institution, particularly with the Executive Board. Together they ensured that the Advisory Board had all the information it needed to fulfill its responsibilities. The members were thus able to fully meet their obligations to advise and monitor the Executive Board in its management of the business. The Advisory Board received regular and timely oral and written reports from the Executive Board covering the position of the entity and key management issues by way of documents prepared to a high standard, especially quarterly reports and asset resolution reports. The Advisory Board was informed regularly of further developments at portfoliomanagement through quarterly risk reports and the reports of the Internal Audit department.

As part of reviewing compliance with the Codes, the Advisory Board also scrutinized the quality and efficiency of its activities. This resulted in the Advisory Board confirming the structure and effectiveness of its working practices. The governing body operates in a climate of openness and trust.

The auditor reported on the audit to the Advisory Board, explaining the result of the audit of the 2019 annual financial statements in detail. No objections were raised. At its meeting on 22 April 2020, the Advisory Board therefore formally adopted and approved the annual financial statements and management report for the 2019 financial year prepared by the Executive Board of portfoliomanagement.

The Advisory Board would like to take this opportunity to thank the Executive Board and all employees of portfoliomanagement for their work on behalf of the entity in 2019.

Kiel, 22 April 2020

Udo Philipp, State Secretary
Chairman of the Advisory Board

/ MANAGEMENT REPORT

1. FUNDAMENTAL INFORMATION ABOUT PORTFOLIOMANAGEMENT

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 "portfoliomanagement"), 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 portfoliomanagement 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.

portfoliomanagement 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 portfoliomanagement pursuant to section 8b(2) of the FMStFG.

The sponsors of portfoliomanagement 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 portfoliomanagement was issued and the members of the Advisory Board and Executive Board were appointed.

portfoliomanagement was entered in the commercial register of the Kiel local court under reference number HRA 9377 KI on 8 June 2016. Since 1 January 2019, the institution has been operating under the name "portfoliomanagement". In legal transactions and therefore also in the commercial register, the name "hsh portfoliomanagement AöR" will remain.

1.1.2. Share capital, guarantor liability and institutional liability

portfoliomanagement 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, as previously, there are no plans to do so.

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 portfoliomanagement if creditors cannot be satisfied from the assets of portfoliomanagement (guarantor liability).

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

1.1.3. Registered office of portfoliomanagement

The registered office of portfoliomanagement is situated in Kiel. portfoliomanagement also has offices in Hamburg.

1.1.4. Governing bodies of portfoliomanagement

The governing bodies of portfoliomanagement are:

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

The Executive Board of portfoliomanagement has two members. The Executive Board manages the business of portfoliomanagement 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 (legal successor: Hamburg Commercial Bank AG, Hamburg)
- approving the asset resolution plan
- appointing the members of the Executive Board
- appointing the auditor of the financial statements
- approving and formally adopting the annual financial statements
- formally approving the actions of the members of the Executive Board

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, Hamburg/Kiel
- (legal successor: Hamburg Commercial Bank AG, Hamburg)
- formally approving the actions of the members of the Advisory Board
- approving the asset resolution plan

1.1.5. Organizational structure of portfoliomanagement

The organizational structure at portfoliomanagement 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
- 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. Company officers (information security, money laundering, compliance and data protection) are also allocated to this Board Department for organizational and reporting purposes.

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

1.2. ECONOMIC BACKGROUND

Pursuant to section 2 of the State Treaty and in accordance with the requirements in section 8b(1) of the FMStFG, portfoliomanagement is responsible for recovering or resolving the loan receivables taken over from hsh Nordbank AG (legal successor: Hamburg Commercial Bank AG) on a profit-oriented basis.

The loan receivables acquired amounted to a total of approx. EUR 4.2 billion as of 30 June 2016. The consideration paid by portfoliomanagement 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.

In order to meet its responsibilities, portfoliomanagement has been authorized to raise loans to fund its acquisition of risk exposures, commence operations and support its ongoing business activities. The authorization limit for this purpose currently stands at EUR 3.43 billion.

In addition to the extent of the asset resolution process and the associated reduction in risk, the measure of a successful resolution for portfoliomanagement is its 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.

1.3. INTERNAL MANAGEMENT

1.3.1. Financial key performance indicators used to achieve the strategic objectives

portfoliomanagement's goal is to resolve the loan portfolio while preserving as much of its value as possible. The challenge here lies in strategic management of the portfolio of non-performing loans related to ship financing. 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 refined continually.

portfoliomanagement has aligned the strategic management of its business activities with its asset resolution plan, which defines objectives and action to be taken by portfoliomanagement for the portfolio's short- and medium-term resolution. A key performance 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, adjusted for currency effects. General administrative expenses are also a financial key performance indicator.

The changes in the financial key performance indicators are presented in the management report in section 2.3.3 Results of operations (general and administrative expenses) and 2.2.2 Asset resolution report (reduction of loan portfolio). The Executive Board informs the Advisory Board of these changes in regular reports during the year.

1.3.2. Non-financial key performance indicator – employees

portfoliomanagement's employees are critical to its success. The number of employees, measured in full-time equivalents, is the performance indicator for personnel management purposes.

The Institution has been reducing its workforce since 1 July 2019. While the headcount as of 31 December 2018 still corresponded to 59.5 full-time equivalents, this figure fell to 51.6 full-time equivalents as of 31 December 2019. In addition to reducing the workforce, another key objective of further human resources work is to simultaneously retain employees with proven expertise in core functions, taking into account the fact that portfoliomanagement will exist for a limited period of time.

When selecting employees, portfoliomanagement, 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 all other functions of both Board Departments also succeeded in attracting experts with long-standing track records in their respective areas of specialist activity.

2. REPORT ON ECONOMIC POSITION

Quantitative information in the following chapters of the management report may contain rounding differences. The main sources on which the following explanations in the report sections 2.1 Economic environment and 4. Report on expected developments are based are Clarksons Research, the International Monetary Fund (IMF) and market reports from various shipping brokerage houses such as Howe Robinson Partners and others.

2.1. MACROECONOMIC ENVIRONMENT

In 2019, portfoliomanagement continued to manage the portfolio of shipping loans it acquired in 2016, succeeding in reducing both the portfolio itself and the number of ships serving as collateral during the year under review. The economic performance of such merchant ship financing is primarily impacted by the charter and sales revenues achievable in the market by each ship. As a result, the following statements focus on charter and value-related developments in the shipping markets in 2019.

2.1.1. Overview of the shipping markets

Prices on the shipping markets are primarily determined by the relationship between supply and demand. In shipping, this means the balance between the amount of available tonnage and the demand for maritime transport capacity. The amount of available tonnage is calculated based on the total transport capacity of the relevant fleet. It increases when new ships are delivered and decreases when ships go out of service, usually as a result of demolition or decommissioning. On the other hand, demand is impacted by various segment-specific macroeconomic factors depending on the market segment. Across all segments, demand for maritime transport generally correlates strongly with trends in international trade, more than 80% of which is conducted by sea.

Uncertainty also persisted in 2019 as a result of geopolitical tensions, the USA's trade conflict with China and the lack of clarity over Brexit, impacting the global economy and associated seaborne. Maritime trade volumes grew by only around [1] 1.1% for the year as a whole, lagging significantly behind global economic output (GDP) of approx. 2.9%. This figure marked the lowest maritime trade volume growth since 2009.

[1] Due to rounding differences and possible subsequent adjustments of the data basis, the figures in the report on economic position are always stated with the addition "approx." or "around".

Market developments for the 2019 financial year differed in the individual container ship, tanker and bulker categories. Charter rates for container ships and tankers rose year-on-year across all size classes, while bulker charter rates remained below the previous year's level overall. Looking at second hand prices across all asset classes, only second-hand tanker prices rose compared to the previous year.

2.1.2. Container market

The global supply of container ship tonnage in terms of TEU capacity increased by around 4.0% in 2019, while the number of ships only rose by around 2%. This ratio illustrates the continuing trend toward larger ships. Overall, approx. 158 container ships (approx. 1,060,700 TEU) were delivered in the 2019 financial year, of which around 50 were large container ships each with a capacity of over 10,000 TEU, which once again made a strong contribution to tonnage growth. At around 92 ships (approx. 182,600 TEU), demolition activity levels were higher than in 2018, when only around 65 ships (approx. 117,500 TEU) were demolished.

Even in the smaller size classes below the Panamax class that are represented in the portfoliomanagement portfolio, the volume of deliveries exceeded that of demolitions in 2019, leading to an overall increase in transport capacity in these classes. Approx. 21 ships (around 12,100 TEU) in the size class from 100 TEU to 999 TEU were delivered, while there were approx. 14 demolitions during the same period (approx. 8,800 TEU). There were 61 deliveries (around 95,800 TEU) in the size class from 1,000 TEU to 1,999 TEU as well as 52 demolitions (approx. 73,800 TEU). Approx. 19 ships (around 50,500 TEU) from 2,000 TEU to 2,999 TEU were delivered, while nine ships were demolished (approx. 19,300 TEU).

The fleet size in the traditional Panamax segment of around 4,400 TEU once again shrank only slightly in 2019. Ships in this class have been considered particularly problematic in recent years. Originally designed to fit the measurements of old locks on the Panama Canal that have since been expanded, these ships have efficiency disadvantages, as the lock restrictions no longer apply and the ships were also optimized for once-customary higher steam speeds with correspondingly high fuel consumption. Although this meant that there were no deliveries of new Panamax ships again in 2019, demolition activity also remained at a low level, with just four ships demolished in 2019 (approx. 16,500 TEU) after only one demolition in 2018. A total of 41 ships (approx. 174,500 TEU) were demolished in 2016 and 2017 combined.

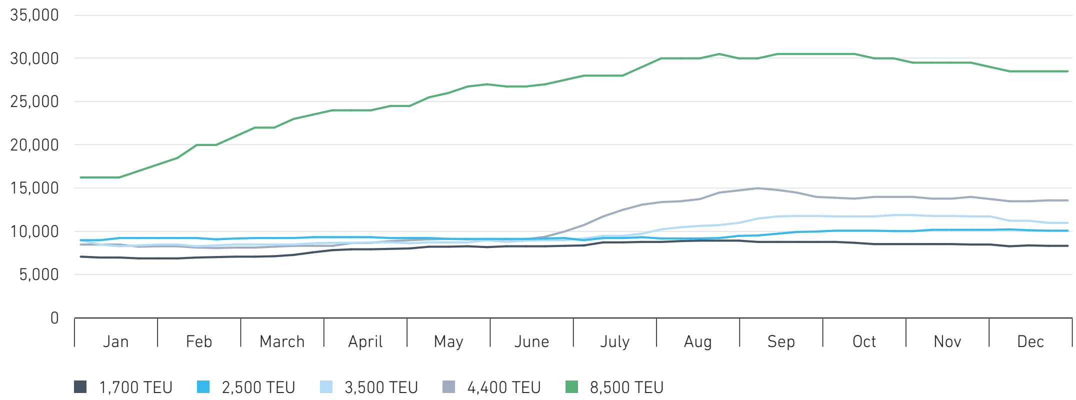
There was a total of around 357 container ships in the order books of shipyards worldwide at the end of 2019, of which approx. 77 were ordered during the year under review. Almost three times as many ships – around 213 container ships – were ordered in the previous year. At year-end, the order book was equivalent to around 10.5% of existing fleet capacity across all size classes, thus remaining at a very low level historically. In the size class below 3,000 TEU, this ratio was around 10.8%, between 3,000 TEU and 7,999 TEU it was only around 0.6%, and for ships from 8,000 TEU upwards it was around 16.0%. Each of these class-specific ratios have diminished compared to the end of 2018.

In terms of demand, the previous years' trend also showed 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 2.2 times faster than the global economy between 1997 and 2008, the gap between these growth rates after the financial crisis of 2008/2009 narrowed significantly between 2010 and 2019, resulting in an average factor of around 1.33 annually over this period.

In percentage terms, global container sea traffic grew by around 1.8% overall year-on-year in 2019, while global GDP rose by approx. 2.9%. As a result, worldwide container trade grew slower than the global economy in 2019 for the first time since 2015. Intraregional and Far East-Europe trade grew at a comparably strong rate in 2019, where the year-on-year rise was around 3.5% and around 4.2% respectively. The secondary global North-South and East-West routes recorded no or only low growth of approx. 0.7%. Trading on the trans-Pacific route, which includes China-USA traffic, decreased by around 2.2%.

The Clarksons Average Container Index, which tracks charter rates for all common size classes, rose almost continuously during 2019, ending the year around 34.7% higher than at the start of the year. Post-Panamax (8,500 TEU) and Panamax (4,400 TEU) ships recorded the most significant improvements with increases of approx. 71.4% and 60.6% respectively during the course of the year. At the end of 2019, the charter rates for post-Panamax ships were around USD 39,500 per day. For ships of this size class in particular, the fact that part of the fleet was temporarily unavailable to the charter market due to the retrofitting of exhaust gas cleaning systems (scrubbers) had a positive one-off impact. After some delay, this had a slightly stimulating effect on charter rates for Panamax ships, which were around USD 13,550 per day at the end of 2019. The rates in the 3,500 TEU class rose by around 30.1% between January and December 2019, reaching approx. USD 11,125 per day by the end of the year. Rates in the 2,500 TEU class increased by around 11.2% over the course of the year, with ships in this size class earning approx. USD 10,150 per day by the year-end. Charter rates in the 1,700 TEU class rose by around 19.3% during the year under review, reaching approx. USD 8,350 per day by the end of the year. Rates in the 1,000 TEU class only increased by around 4.0% to approx. USD 6,250 per day in December 2019.

Clarksons container charter rates 6–12 months 2019 in US dollar per day



Prices for used container ships generally declined, which meant they did not move in line with charter rates. The Clarksons Container Ship Second-Hand Price Index, which tracks various size and age classes, fell by around 4.1% in January of the year under review before remaining relatively stable. At the end of the year, the index was approx. 5.1% lower than its level in January 2019.

Second-hand prices for ten-year-old ships in the post-Panamax class at 8,800 TEU improved by around 1.7% during the course of the year. These prices were approx. USD 30.5 million at the end of December 2019. Second-hand prices for ten-year-old ships in the Panamax class around 4,500 TEU fell in the first half of the year before stabilizing and rising again at the end of the year. These prices were approx. USD 11.0 million in December 2019, in line with prices in January 2019. In the size class around 3,200/3,600 TEU, second-hand prices for ten-year-old ships dropped by approx. 20.5% between the start of the year and around May 2019 before stagnating at around USD 8.75 million.

In the size class around 2,500 TEU, prices for ten-year-old ships fell by around 33.3% over the course of the year to reach approx. USD 9.0 million at year-end. Prices for ten-year-old ships also dropped by around 26.2% in the 1,650 TEU/1,750 TEU class, with these prices most recently sitting at approx. USD 7.75 million. The indicative sales prices in December 2019 for the sub-Panamax classes mentioned here were below the average value over the past five years, with prices in the Panamax class slightly above the five-year average. Second-hand prices for ten-year-old ships in the post-Panamax class have only been recorded since September 2016, with the 2019 average exceeding the average since September 2016.

2.1.3. Tanker market

Global demand for tanker tonnage grew slower than supply during the 2019 financial year, after this trend was reversed in the previous year.

Around 327 tankers (approx. 36.9 million DWT) were delivered in 2019, of which around 100 (approx. 4.0 million DWT) were pure product tankers. A similar number of ships – around 312 (approx. 23.8 million DWT) – were delivered in the previous year. Demolition activity declined year-on-year, with only around 77 ships (approx. 3.4 million DWT) demolished in 2019, of which 36 (approx. 0.5 million DWT) were pure product tankers. In 2018, the total demolition figure was still around 200 tankers (approx. 20.1 million DWT), including 71 pure product tankers (approx. 2.2 million DWT). The crude oil tanker fleet grew on a net basis by around 4.1% in 2019, while the product tanker fleet increased by around 4.6%.

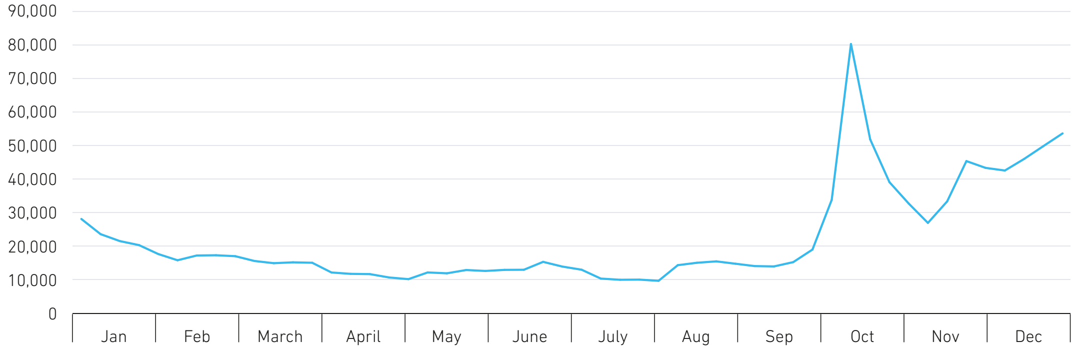
At the end of 2019, the order book still comprised around 440 tankers, including 115 pure product tankers. A total of around 204 ships were ordered during the year under review, including approx. 42 pure product tankers.

At year-end, the order book for crude tankers was equivalent to around 8.4% of existing fleet capacity across all size classes, while the order book for product tankers above 10,000 DWT was equivalent to around 6.7%.

In 2019, demand for oil transport by sea rose by approx. 0.5% for crude oil and fell by around 0.8% for oil products. Total export volumes fell by 0.7% (crude oil) and 3.4% (oil products) in 2019. In addition to export volume limits (crude oil) imposed by OPEC, export volumes declined from Venezuela and Iran – as a result of unrest and sanctions – in particular. Lower oil demand, weaker refinery margins and limited arbitrage opportunities particularly limited trading in oil products in 2019.

The Clarksons Average Tanker Earnings Index, which tracks the short-term revenue situation in different tanker classes, stood at around USD 23,400 in January 2019. Apart from some seasonal fluctuations, it then fell until the end of the third quarter of 2019, which meant the index stood at around USD 10,800 in July. This was followed by a moderate recovery in revenues for the rest of the third quarter of 2019 and a significant upturn in the fourth quarter, with the index reaching a monthly average of around USD 51,200 in October 2019, its highest level since mid-2008. The index stood at around USD 48,000 in December 2019. For comparison, the 2018 average for this index was around USD 11,200.

Clarksons Average Tanker Earnings Index 2019 in US dollar per day



This recovery from around September 2019 primarily resulted from an improvement in charter rates for larger crude oil tankers. Geopolitical tensions in the Gulf of Oman between the United Arab Emirates, the United Kingdom and the USA with Iran from around May 2019, when a total of six merchant ships were attacked, a US drone was shot down and a refinery in Saudi Arabia was attacked, resulted in a rise in oil prices and maritime risk insurance premiums. This was followed by the USA placing sanctions on subsidiaries of Chinese shipping company COSCO in September 2019, as the firm had allegedly done business with Iran. This meant that tankers placed under these sanctions were decommissioned, depriving the market of capacity. In view of the global sulphur cap effective 1 January 2020, many ships were retrofitted with what are known as 'scrubbers' from the summer months onwards, which meant that these ships were also unavailable to the market during retrofitting. All of these factors were conducive to the market improvement for large tankers. At the same time, product tanker markets also experienced a revival, albeit to a lesser extent.

One-year charter rates for Handysize product tankers with a capacity of around 37,000 DWT rose by around 16.0% during 2019, which meant that rates of approx. USD 14,500 per day were being achieved in December 2019. The one-year charter rates of product tankers with a capacity of around 47,000 DWT to 48,000 DWT increased by approx. 15.1% in the same period, with ships chartered for around USD 16,000 per day in December. The rates for product tankers with around 74,000 DWT (so-called LR1 product tankers) also rose by approx. 33.0%, with one-year contracts for around USD 19,250 per day at the end of December 2019.

Prices for used tankers rose by around 14.0% across all size classes and ages during the year. As a result, the second-hand price level was around 6.6% above the ten-year average at the end of the year. Second-hand prices for ten-year-old Handysize product tankers rose by around 7.1% during the year under review, reaching approx. USD 15.0 million by the end of 2019. The value of ten-year-old product tankers with 47,000 DWT increased by around 15.2% to reach approx. USD 19.0 million by the end of the year. Prices for LR1 product tankers rose by around 14.3%, reaching approx. USD 20.0 million by the end of 2019.

2.1.4. Dry bulk market

As in 2018, demand for dry bulk tonnage grew at a slower pace than supply in 2019, and the situation on the dry bulk market deteriorated over the course of the year.

Approx. 430 ships (around 41.1 million DWT) were delivered from the order books during the year under review; this figure was around 299 bulkers in the previous year (approx. 28.3 million DWT). Deliveries in 2019 included 84 bulkers in the Handysize size class of 10,000 DWT to 39,999 DWT, 132 Handymaxes and Supramaxes between 40,000 DWT and 64,999 DWT, 134 Panamaxes of 65,000 DWT to 99,999 DWT and 80 Capesizers between 100,000 DWT and 320,000 DWT. These deliveries contrasted with a lower demolition volume compared to 2017 and 2016 of 82 ships (approx. 7.8 million DWT), with only 56 demolitions in 2018 (approx. 4.4 million DWT). As a result, the fleet grew by around 4.0% in terms of DWT in 2019.

At the end of 2019, the order book for bulkers comprised approx. 810 ships with an average capacity of around 101,100 DWT. Of these, approx. 245 ships were newly ordered in 2019. Around 365 orders from 2018 are still awaiting delivery. At year-end, the order book was equivalent to around 9.9% of existing fleet capacity, thus remaining at a low level in the context of the last ten years; the order book represented around 24.8% of the sea-going fleet on average.

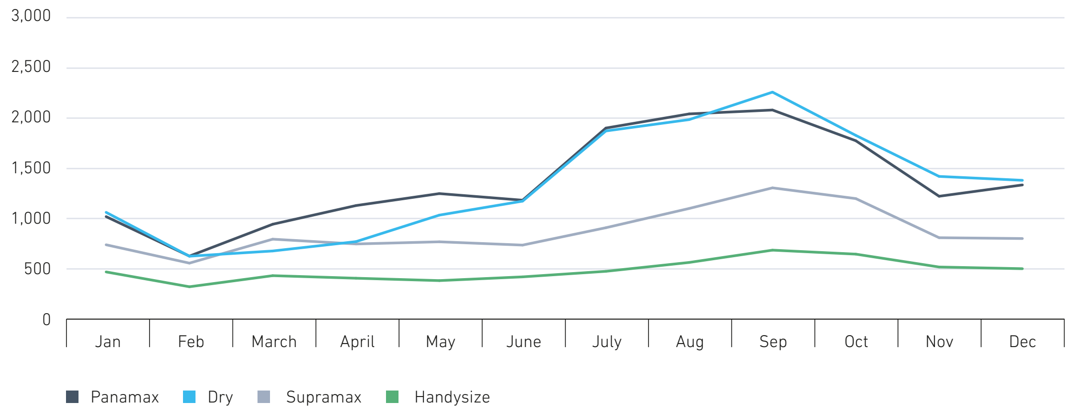
As with container ships and tankers, part of the bulker capacity (around 1.1% in this case) was temporarily removed from the market in 2019 for the retrofitting of scrubbers.

During the year under review, global imports of the most important bulk cargo by tonnes, iron ore, fell by around 1%, primarily as a result of the dam breach at a Brazilian iron ore mine at the start of 2019, which deprived the market of significant cargo volumes. Brazilian iron ore exports totaled around 337.5 million tonnes in 2019; this figure was still at around 386.9 million tonnes in the previous year. As a result, Brazil remained the world's second-largest exporter of iron ore in 2019 after Australia (with an export volume of 840.3 million tonnes). Together, both lands accounted for more than 80% of global iron ore exports in the year under review. Shipments of the other 'major bulks', coal and grain, rose by approx. 2.4% in 2019. Soya bean trading stagnated in 2019, due in part to the trade dispute between China and the USA. Export volumes of 'minor bulks' such as steel and agricultural products grew by around 2.0% overall in 2019. In global terms, transport volumes for all bulk commodities, i.e. all major and minor bulks, grew by around 1.2%.

As the overarching indicator of freight rates on the bulk commodities market, the Baltic Dry Index (BDI) showed negative performance in the first quarter of 2019, then rose until the end of the third quarter of the year before declining again in the fourth quarter of 2019. At around 1,341 points, the BDI's average in 2019 was virtually unchanged from 2018. The index's five-year average is 1,046 points, while its ten-year average is 1,277.

Although the segment-specific Baltic Indices also performed well over the course of the year, their 2019 averages were below those of the previous year. The average value of the Panamax Index was around 1,375 points in 2019, having been 1,450 in 2018. The Supramax Index was around 874 points on average in 2019, down from 1,030 in 2018. The average value of the Handysize Index was 489 points in 2019, having been 597 in 2018.

Baltic Indices 2019 in index points



Ship prices in the second-hand market generally showed a downward trend during the year, with the consolidated Clarksons Bulk Carrier Second-Hand Price Index finishing the year around 5.7% lower than at the start of January. As a result, the second-hand price level was around 17% below the ten-year average at the end of the year. Second-hand prices for ten-year-old Handysize bulkers fell by around 21.7% during the year under review, reaching approx. USD 9 million by the end of 2019. The price of ten-year-old Supramax bulkers dropped by around 10.7% and was approx. USD 12.5 million by the end of the year. Prices for ten-year-old Panamax bulkers with 76,000 DWT decreased by around 10.0% to reach USD 13.5 million by the end of the year. Prices of five-year-old Kamsarmax bulkers with 82,000 DWT generally remained stable during the course of the year, with second-hand prices of around USD 23.5 million in December 2019.

2.2. COURSE OF BUSINESS

2.2.1. Overview

In financial year 2019, portfoliomanagement's business activities and results were dominated by the management of the loan portfolio and its performance. portfoliomanagement also focused on a project where measures were taken in connection with the plan to transfer key administrative activities supporting portfolio resolution from Hamburg Commercial Bank AG to the new service provider, IBM Deutschland GmbH, which uses a different technical banking platform. This placed a considerable strain on resources during the past year, which was reflected both in the tie-up of internal capacities and in one-time external project costs. The project was set up in the first quarter of 2019 and will end once the loan and treasury holdings have been migrated to the new loan accounting system and administrative activities have been fully taken over by IBM, probably during the first half of 2020.

portfoliomanagement reported an almost breakeven result before loan loss allowances and provisions and before foreign currency translation of EUR 0.2 million for 2019 (previous year: EUR 8.6 million). This was due essentially to the fact that sharply lower net interest and net commission income totaling EUR 23.1 million (previous year: EUR 33.6 million) and other comprehensive income of EUR 2.3 million (previous year: EUR 3.1 million) were reduced by general and administrative expenses of EUR 25.0 million (previous year: EUR 28.0 million). In the past year, a deterioration in market inputs used to measure loans and advances led to a marginal net loss on loan loss allowances and provisions of EUR 5.3 million (previous year: net gain of EUR 7.3 million). Together with a moderate net loss on foreign currency translation of EUR 0.4 million (previous year: EUR 0.8 million), this resulted in a net loss for the year of EUR 5.5 million overall (previous year: net income for the year of EUR 15.1 million). For detailed notes on the changes in the individual components of earnings, please refer to section 2.3.3 Results of operations.

The following paragraphs contain a discussion of earnings for the financial year as compared to asset resolution planning for 2019:

Business performance in 2019 was considerably better than projected at the level of the result before loan loss allowances and provisions and before foreign currency translation. The key drivers of the operating result made a positive contribution to this. On the other hand, the result from loan loss allowances and provisions was worse than projected. The positive trend in the result before loan loss allowances and provisions and before revaluation only partly offset the unanticipated negative trend in the net result from loan loss allowances and provisions, resulting in a net loss for the year that was slightly above forecast.

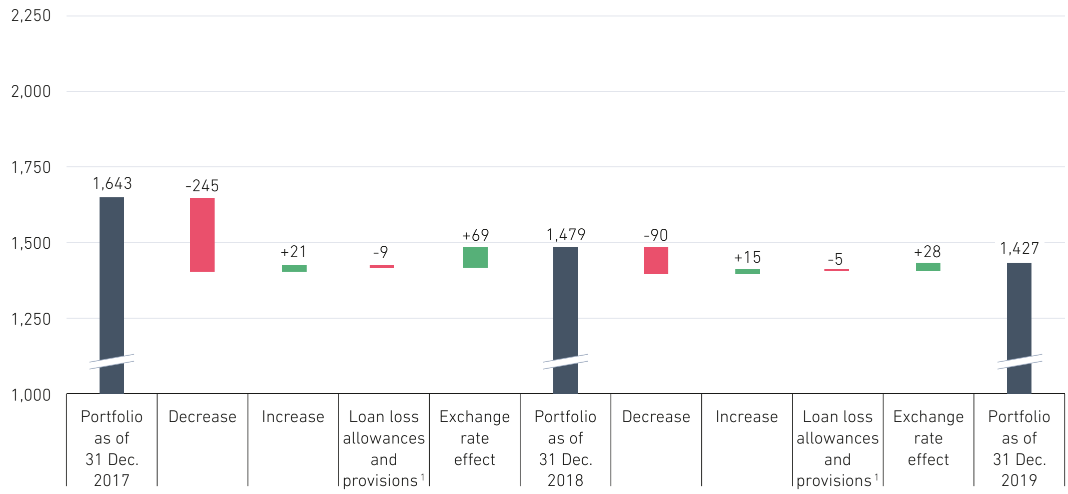
While net interest and net commission income was considerably higher than planned, administrative and personnel expenses were moderately lower and personnel expenses were significantly higher than projected. The reduction in the number of full-time employees, which was moderately higher than planned, played a significant part in this trend. Other comprehensive income was better than expected, as the entity received considerable reimbursements from customers for legal consulting costs and portfolio insurance. Due to the stronger-than-projected fall in US dollar LIBOR on the predominantly floating-rate exposures, interest income was below forecast overall. This effect was more than offset by lower interest expenses, helped by US dollar LIBOR. By far the largest portion of the stronger than expected decrease in administrative expenses was due to lower legal consulting costs and project budgets that were not fully utilized.

2.2.2. Asset resolution report

An asset resolution report in which portfoliomanagement 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 in the past two financial years:

Changes in the carrying amount of the portfolio in EUR million



[1] Balance of additions to and reversals of loan loss allowances and provisions

In financial year 2019, the carrying amount of the portfolio before exchange rate effects, which has been defined as a key performance indicator, decreased by a total of EUR 80 million to EUR 1,399 million. This change can be attributed to three effects. The reduction in the loan portfolio is mainly due to principal payments of EUR 90 million. On the other hand, the carrying amount increased slightly by a total of EUR 15 million mainly in connection with liquidity support provided for individual borrowers. The figure reported for loan loss allowances and provisions as of 31 December 2018 was increased slightly by EUR 5 million as of 31 December 2019, thus reducing the carrying amount accordingly. Furthermore, the exchange rate prevailing on the balance sheet date was applied to loans denominated almost exclusively in US dollars. Due in particular to the stronger US dollar compared with 31 December 2018, the carrying amount increased by EUR 28 million as a consequence of exchange rate effects. The total carrying amount of the portfolio as of 31 December 2019 was EUR 1,427 million. The reduction in carrying amount achieved in 2019 before exchange rate effects is moderately below plan.

Incoming payments from interest and principal payments in financial year 2019 totaled around EUR 148 million.

The outstanding loan amount in the portfolio declined by EUR 376 million to EUR 3,293 million in financial year 2019. The decrease is mainly attributable to principal payments and loan losses and would have been around EUR 62 million higher if the US dollar had not appreciated against the euro.

2.3. NET ASSETS, FINANCIAL POSITION AND RESULTS OF OPERATIONS OF PORTFOLIOMANAGEMENT

2.3.1. Net assets

The following table shows the assets and liabilities of portfoliomanagement:

Balance sheet [1]

in EUR thousand	31 Dec. 2019	31 Dec. 2018	Change
Assets			
Cash reserve	7,285	5,889	1,396
Loans and advances to banks	43,586	77,737	-34,151
Loans and advances to customers	1,426,917	1,479,176	-52,260
Prepaid expenses	4,311	4,241	69
Deficit not covered by equity	540,151	534,647	5,505
Other items	1,095	1,048	48
TOTAL ASSETS	**2,023,345**	**2,102,738**	**-79,392**
Liabilities			
Liabilities to banks	138,581	0	138,581
Liabilities to customers	0	88	-88
Debt securities issued	1,880,658	2,096,017	-215,358
Other liabilities	1,736	3,329	-1,593
Deferred income	268	469	-201
Provisions	2,102	2,835	-732
TOTAL LIABILITIES	**2,023,345**	**2,102,738**	**-79,392**

[1] Figures taking into account rounding differences

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

The cash reserve and loans and advances to banks of EUR 50.9 million in total decreased significantly as of the reporting date (prior-year reporting date: EUR 83.6 million).

The net assets of portfoliomanagement are dominated by the loan portfolio taken over from HSH Nordbank AG (legal successor: Hamburg Commercial Bank AG) on 30 June 2016. The portfolio almost exclusively comprises US dollar-denominated, non-performing loans related to ship financing. The portfolio is measured at cost after making allowance for specific valuation allowances calculated as of the reporting date.

The carrying amount of loans and advances to customers decreased by EUR 52.3 million to EUR 1,426.9 million as of 31 December 2019 as a result of loan repayments received, liquidity support for individual borrowers, low net additions to valuation allowances, and after taking into account exchange rate effects. For more information, please refer to the previous section 2.2.2 of the management report.

Prepaid expenses are comprised of discounts and costs for the issuance of bonds (EUR 3.6 million; previous year: EUR 2.7 million) as well as prepaid invoice amounts (EUR 0.7 million; previous year: EUR 1.5 million).

Liabilities to banks (EUR 138.6 million; previous year: EUR 0 million) served to provide short-term funding for the loan portfolio.

For information on the change in debt securities issued, please refer to the next section (2.3.2 Financial position).

Other liabilities (EUR 1.7 million; previous year: EUR 3.3 million) are almost exclusively made up of trade payables (EUR 1.6 million; previous year: EUR 3.1 million).

Deferred income (EUR 0.3 million; previous year: EUR 0.5 million) primarily consists of the bond premiums that will be reversed over the maturity of the bond on a straight-line basis.

Provisions (EUR 2.1 million; previous year: EUR 2.8 million) were recognized in the amount dictated by prudent business practice and mainly comprised provisions for auditing costs, invoices outstanding and the preparation of financial statements. The decrease of EUR 0.7 million is predominantly attributable to the utilization of loan loss provisions of EUR 0.3 million and the reversal of provisions for register corrections in the amount of EUR 0.2 million.

At the end of the current financial year, portfoliomanagement reported a deficit not covered by equity of EUR 540.1 million (previous year: EUR 534.6 million), mainly as a consequence of the loan loss allowances and provisions recognized in financial year 2016. There is no risk to the continued existence of portfoliomanagement 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

In its endeavors to ensure that it has sufficient liquidity at all times while minimizing currency risk, portfoliomanagement's focus in 2019 was once again on further strengthening its short-term funding base by utilizing the European commercial paper program implemented in 2017.

The debt securities issued in the amount of EUR 1,880.7 million (previous year: EUR 2,096.0 million) concern the US dollar issues placed on the capital markets under the debt issuance program with an equivalent value in euros of EUR 890.2 million as well as the euro bonds issued amounting to an aggregate EUR 400.0 million, plus accrued interest in each case (EUR 1.7 million). Short-dated securities were also issued as part of the ECP program. Commercial paper with a total equivalent value in euros of EUR 588.8 million and maturity dates in 2020 comprise a volume of USD 566.0 million and EUR 85.0 million.

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. 2019			31 Dec. 2018		
in EUR thousand	US dollar issues	Euro issues	Total issues	US dollar issues	Euro issues	Total issues
2019	0	0	0	630,471	190,000	820,471
2020	949,291	85,000	1,034,291	437,213	0	437,213
2021	446,264	150,000	596,264	438,230	150,000	588,230
2022	0	100,000	100,000	0	100,000	100,000
2023	0	150,103	150,103	0	150,103	150,103
TOTAL	**1,395,555**	**485,103**	**1,880,658**	**1,505,914**	**590,103**	**2,096,017**

Since October 2016, the ratings, which were last confirmed on 31 October 2019 (Fitch) and 10 February 2020 (Moody's), 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 guarantees provided by the sponsors and the two established issuance programs for short- and long-dated issues, these ratings will make it easier for portfoliomanagement to obtain funding through the international capital markets.

Please also refer to the cash flow statement for information on the financial position of portfoliomanagement. In addition to the statement of changes in equity, the cash flow statement has been prepared as an extension 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

The following table shows the breakdown of results of operations:

Income statement [1]

in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018	Change
Net interest income	22,957	28,320	-5,363
Net commission income	138	5,232	-5,094
Other result [2]	2,283	3,132	-849
Personnel expenses	-6,200	-6,599	398
Other administrative expenses	-18,824	-21,369	2,546
Depreciation and amortization	-138	-129	-9
Result before loan loss allowances and provisions, and before foreign currency translation	**216**	**8,587**	**-8,371**
Result from loan loss allowances and provisions	-5,330	7,301	-12,630
Result from foreign currency translation [3]	-389	-783	394
Taxes (including Other taxes)	-2	-1	0
NET INCOME (+) / NET LOSS (-) FOR THE YEAR	**-5,505**	**15,104**	**-20,609**
Loss brought forward from the previous year	-534,647	-549,751	15,104
NET ACCUMULATED LOSSES	**-540,151**	**-534,647**	**-5,505**

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 EUR 5.4 million decline in net interest income to EUR 23.0 million is attributable to a year-on-year decrease in interest income (EUR 62.0 million; previous year: EUR 64.8 million) and a year-on-year increase in interest expenses (EUR 39.0 million; previous year: EUR 36.5 million). Interest income in the past financial year was driven by the prior-year restructuring, which generally increased the ability to pay interest on the predominantly floating-rate exposures. Interest income was also helped by the stronger US dollar during the year. The reduction in interest payments in connection with exposures repaid or terminated (EUR 2.6 million; previous year: EUR 10.9 million) and the continuous fall in US dollar LIBOR in the course of the year more than offset the positive effects and led to an overall decline in interest income. The year-on-year increase in interest expenses was also the result of the US dollar being stronger during the year while US dollar LIBOR fell.

Net commission income likewise showed a significant decline of EUR 5.1 million to EUR 0.1 million (previous year: EUR 5.2 million). While commission expenses were in line with the prior-year figure (EUR 0.6 million) at EUR 0.5 million, commission income received dropped to EUR 0.7 million in the same period (previous year: EUR 5.8 million) due in particular to lower restructuring fees as a result of restructuring measures no longer necessary.

Cost reimbursements from third parties (EUR 1.7 million; previous year: EUR 2.7 million), in particular as a result of charging on legal consulting costs (EUR 1.2 million; previous year: EUR 2.4 million), reversals of provisions (EUR 0.3 million; previous year: EUR 0.4 million) and refunds of value-added tax (EUR 0.2 million; previous year: EUR 0.0 million) were the main contributors to other comprehensive income of EUR 2.3 million (previous year: EUR 3.1 million).

Personnel expenses were down moderately year-on-year (EUR 6.2 million; previous year: EUR 6.6 million). portfoliomanagement employed an average of 55.6 full-time employees (previous year: 59.9 full-time employees) during 2019.

Other administrative expenses amounted to EUR 18.8 million (previous year: EUR 21.4 million). The largest items were costs for material outsourcing arrangements (EUR 7.3 million; previous year: EUR 8.9 million), one-time costs in connection with the transfer of key administrative activities supporting portfolio resolution to a new service provider (EUR 2.6 million; previous year: EUR 9 thousand), the cost of support services in day-to-day business operations (EUR 1.9 million; previous year: EUR 1.0 million) and legal consulting costs (EUR 1.8 million; previous year: EUR 5.2 million). Costs for legal consulting services mainly relate to the lending business and were partly charged on to customers; the related income (EUR 1.2 million; previous year: EUR 2.4 million) was recognized in the other comprehensive income.

In financial year 2019, loan loss allowances and provisions decreased from the previous year, making a negative earnings contribution of EUR -5.3 million (previous year: EUR 7.3 million). This was due to deteriorating market parameters for the measurement of receivables.

The negative result from foreign currency translation amounted to EUR 0.4 million (previous year: EUR 0.8 million). In accordance with section 340h in conjunction with section 256a of the Handelsgesetzbuch (HGB - German Commercial Code), the loss is presented net after making allowance for temporary residual foreign currency exposure.

The financial year closed with a net loss for the year of EUR 5.5 million (previous year: EUR 15.1 million). Net accumulated losses for 2019 amounted to EUR 540.1 million (previous year: EUR 534.6 million).

2.3.4. Overall assessment of the net assets, financial position and results of operations of portfoliomanagement

portfoliomanagement does not currently have any share capital. However, in its business activities, portfoliomanagement can rely on the institutional liability and guarantor liability on the part of the sponsors of portfoliomanagement, i.e. the Federal State of Schleswig-Holstein and the Free and Hanseatic City of Hamburg. This means that the net assets of portfoliomanagement are well structured. As of 31 December 2019, portfoliomanagement reported a deficit of EUR 540.1 million not covered by equity (previous year: EUR 534.6 million).

portfoliomanagement ensured that, overall, it had sufficient liquidity at its disposal at all times during the course of the year. In the opinion of portfoliomanagement, the existing ratings, the guarantees provided by the sponsors 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 2019 were satisfactory in the light of portfoliomanagement's business activities. The significant year-on-year decrease in net interest and net commission income and a considerable decrease in other comprehensive income was covered by a reduction in general and administrative expenses, resulting in an almost breakeven operating result that was significantly higher than expected. This, together with the unexpected, moderately negative result from loan loss allowances and provisions and an only slightly negative result from foreign currency translation, resulted in a net loss for the year of EUR 5.5 million (previous year: net income for the year of EUR 15.1 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 FMStFG, portfoliomanagement 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). portfoliomanagement is considered an "obliged entity" within the meaning of section 2(1) of the Geldwäschegesetz (GWG – German Money Laundering Act). Section 15 of the Finanzdienstleistungsaufsichtsgesetz (FinDAG – German Act Establishing the Federal Financial Supervisory Authority) must be applied accordingly.

The KWG requires portfoliomanagement 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 as well as 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, portfoliomanagement followed the Federal Financial Supervisory Authority's Circular 09/2017: Minimum Requirements for Risk Management (MaRisk BA) to the extent logically applicable to portfoliomanagement in view of its special circumstances as an asset resolution entity.

Risk management is a key component of the overall management of portfoliomanagement. Risk management at portfoliomanagement is tasked with providing support 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 portfoliomanagement are defined. Overall responsibility for risk management at portfoliomanagement, including the risk measurement, management and monitoring methods and processes to be used, is assigned to the Executive Board. Each quarter, a risk report informs the Executive Board and the Advisory Board about the risk situation.

In order to assess the materiality of risks, portfoliomanagement performs a general risk inventory annually and as needed as the foundation for an overall risk profile of portfoliomanagement. 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. Other material risks identified in the most recent risk inventory carried out in December 2019 were market risk, liquidity risk and operational risk. Responsibilities and processes, management and monitoring measures and risk tolerances (including limits and risk classifications) are laid down in the risk strategy for these material risks.

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

The Risk Controlling & Strategic Wind-down Planning unit is tasked with independently monitoring and communicating portfoliomanagement's risks and providing support to the Executive Board for 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 – including new risks such as coronavirus. During regular internal reporting, the current, negative developments resulting from the spread of coronavirus are also analyzed and their impact on the risk types relevant for portfolio management – counterparty credit risk, liquidity risk and funding risk – is assessed and also subjected to stress scenarios. The Risk Controlling & Strategic Wind-down Planning unit analyzes risk positions and limit utilization and recommends risk-mitigation measures, if required. portfoliomanagement's risk management system is part of Internal Audit's audit planning process.

3.2. RISK MANAGEMENT GOALS

portfoliomanagement's risk management system aims to identify at an early stage, analyze and disseminate information about portfoliomanagement'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 portfoliomanagement 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 to be enhanced by assigning responsibilities at portfoliomanagement as follows:

- The Risk Controlling & Strategic Wind-down Planning unit is organizationally separate from the other units. This is where independent reporting (risk control function) is performed, including the quarterly risk report, the quarterly asset resolution report and the annual asset resolution plan. It also incorporates the methodology for all risk types as well as for risk classification.
- The Loans unit monitors individual exposures regularly (at least annually) based on borrower units. It is also responsible for the quarterly revaluation of collateral based on external expert valuation reports.
- Restructuring Management is organizationally separate from the Loans unit and is responsible for developing and implementing recovery and asset resolution strategies.
- In the Treasury & Finance unit, Treasury is responsible for the funding strategy as well as managing and planning short- and long-term liquidity and managing exchange rate risks.
- External market data is obtained from recognized market data providers such as MSI.
- The Executive Board has the power to decide on the recognition of loan loss allowances and provisions.

3.3. COUNTERPARTY CREDIT RISK

3.3.1. Definition

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

3.3.2. Strategic direction

portfoliomanagement'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, portfoliomanagement will review the existing courses of action on a case-by-case basis to select the most economically beneficial option from an asset resolution perspective.

In the case of exposures with a positive recovery outlook, portfoliomanagement 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 order to optimize cash flows.

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, portfoliomanagement'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.

3.3.3. Management and monitoring

Counterparty credit risk is minimized mainly through maximum credit limits set by portfoliomanagement 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. Loan loss allowances and provisions are calculated on a borrower basis. In addition, the Restructuring Management and Loan units report regularly, at least once a year, on all credit exposures to the Credit Committee.

portfoliomanagement 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.

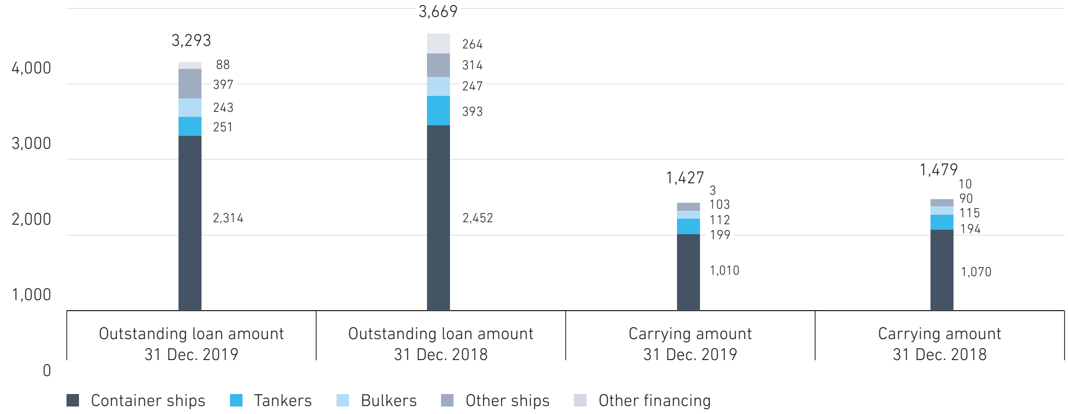
3.3.4. Credit risk

portfoliomanagement 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 acquired portfolio consists almost entirely of non-performing loans. The carrying amount of the portfolio as of 31 December 2019 was EUR 1,427 million, Down substantially on the outstanding loan amount of EUR 3,293 million. In the reporting period, the outstanding loan amount decreased by 10% and the carrying amount by 4%. Details of the measurement of collateral are provided in the accounting policies in the notes.

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 (70% of the outstanding loan amount or 71% 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 19 in the financial year to 154 due to restructuring and liquidation.

Breakdown of the loan portfolio by ship segment in EUR million

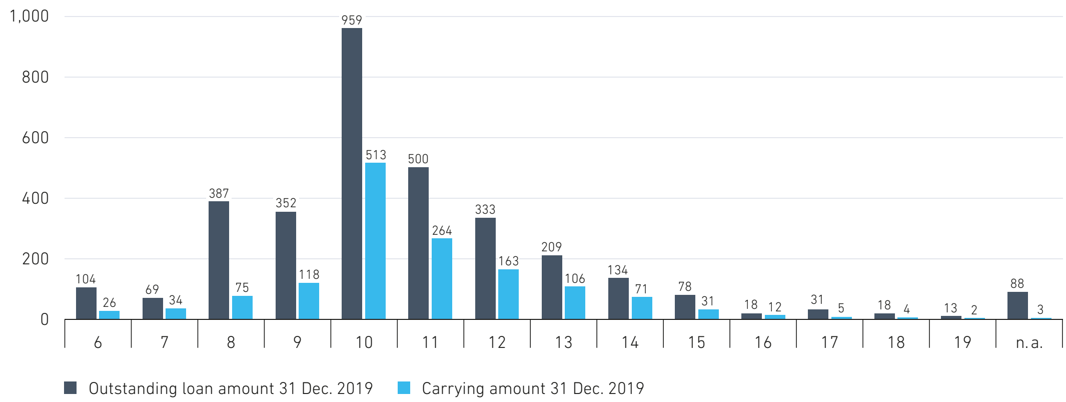


The loan portfolio is concentrated on a few large borrower units. In terms of the carrying amount of the loan receivables, the ten largest borrower units account for 81% of the portfolio.

Around 99% of the outstanding loan amounts and the carrying amounts are denominated in US dollars, with a very small percentage being denominated in euros.

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 as of 31 December 2019 was 10.5 years.

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



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

- Risk class 0 comprises all borrowers subject to regular monitoring (no borrowers as of the reporting date)
- Risk class 1 comprises borrowers subject to intensive monitoring (20% default rate)
- Risk class 2 consists of borrowers in default[2] with a positive going concern outlook
- Risk class 3 comprises defaulted borrowers that are in liquidation because recovery is not expected

[2] 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.

The exposure management system treats all exposures as defaulted, irrespective of their risk class.

The outstanding loan amount and the carrying amount of the loan receivables are spread across three of the four portfoliomanagement risk classes. A total of 95% of the outstanding loan amount or 98% of the carrying amount of the loan receivables is attributable to borrowers assigned to risk class 1 or risk class 2. No borrower has been assigned to risk class 0 as of the 31 December 2018 and 31 December 2019 reporting dates.

Risk structure of the loan portfolio in EUR million

In addition to the aforementioned credit risk, portfoliomanagement 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 50.9 million at 31 December 2019.

3.3.5. Counterparty risk from derivatives and settlement risk

As of the reporting date, there were no derivatives in the 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 portfoliomanagement 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. Furthermore, no settlement risks materialized in 2019. portfoliomanagement 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 portfoliomanagement's advance performance, the counterparty will fail to provide the consideration owed either in whole or in part.

3.3.6. Issuer risk

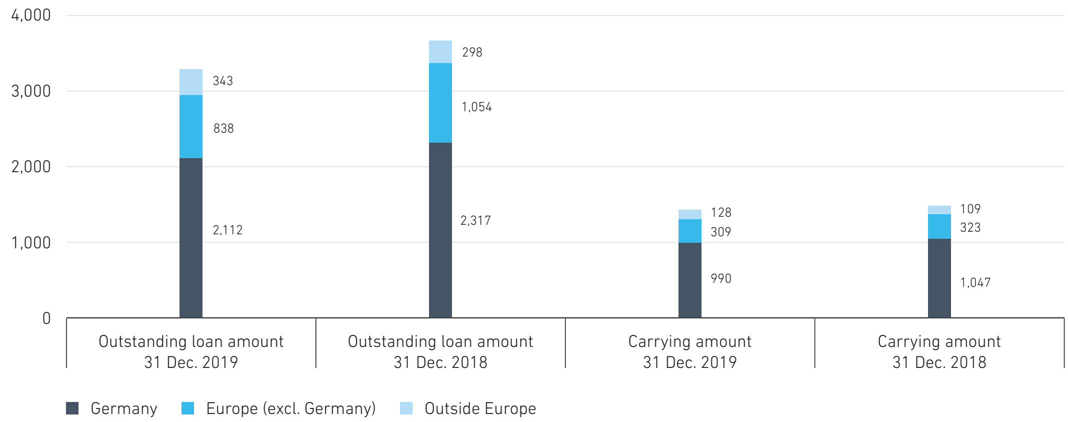
At the reporting date of 31 December 2019, portfoliomanagement was not subject to any issuer risk. Issuer risk is the risk of a loss due to a credit rating deterioration or default of an issuer. Issuer risk becomes a material element of counterparty credit risk as soon as portfoliomanagement were to acquire securities for its own portfolio.

3.3.7. 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 64% (63% at the end of 2018) of the outstanding loan amount is attributable to borrowers with their place of business in Germany, as is 69% (71% at the end of 2018) 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 2018) of the outstanding loan amount and 9% (7% at the end of 2018) 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

portfoliomanagement 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 comprises interest rate risk and foreign currency risk.

3.4.2. Strategic direction

portfoliomanagement'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 for mitigating foreign currency risk laid down in the business strategy is executed by the Treasury & Finance unit by obtaining funding for balance sheet items at matching currencies and by entering into spot transactions to close open currency positions – 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 portfoliomanagement to take action, because changes in the expected cash flows must be addressed quickly by modifying and adjusting currency hedging. For example, this is the case when calculating loan loss allowances and provisions in the event of resulting changes in amortized cost.

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 portfoliomanagement. 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, the change in the market value of the interest exposure book (interest rate sensitivities), 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%). The periodic net interest income is also considered taking into account an interest rate change of 25 basis points. In this context, only interest payments that are considered recoverable are taken into account on the assets side.

In terms of portfoliomanagement'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, portfoliomanagement can be subject to funding risk when interest rates rise. In this case, funding costs increase, while cash flows from principal and interest payments by mostly non-performing borrowers remain stable or increase only marginally. An increased interest expense would therefore be detrimental to the income statement, because borrowers would have to use the available financial resources to a greater extent for interest payments at the expense of principal payments 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. Foreign currency risk arises from possible changes in the value of open foreign currency positions as a result of changes in the EUR/USD exchange rate. An exchange rate movement directly affects the market value of these items. The foreign currency sensitivity is calculated using exchange rate fluctuations of 1%; open positions and loans payable on demand are included in this calculation. The risk driver for foreign currency risk at the end of the year was the US dollar, as it is the one foreign currency remaining in the portfolio and accounts for approx. 99% of the loan portfolio.

The management of interest rate risk is challenging for portfoliomanagement, since receiving contractually agreed cash flows depends on the creditworthiness of borrowers in the portfolio of non-performing loans and therefore future developments of the 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 ship financing managed by portfoliomanagement 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 portfolio of non-performing loans, this gives rise to a 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 2019, portfoliomanagement's interest rate risk determined on a net present value basis in view of a shift in yield curves by one basis point is EUR 157 thousand. The periodic interest rate risk in the event of a shift in yield curves by 25 basis points amounts to EUR 338 thousand as of the measurement date for calendar year 2020. Interest rate risks are low in relation to the total volume of assets and liabilities and were insignificant in the full financial year.

Interest rate risk is limited across currencies using a total sensitivity figure and applying individual maturity ranges.

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%, portfoliomanagement's foreign currency risk would be EUR 2,201 thousand at the reporting date. Given that most funding is obtained in US dollars, the currency risk as of the reporting date of 31 December 2019 is low.

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

3.5. LIQUIDITY RISK

3.5.1. Definition

portfoliomanagement 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 objective of portfoliomanagement'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 liquidity buffer.

Due to the guarantees provided by and the institutional liability and guarantor liability assumed by the Free and Hanseatic City of Hamburg and the State of Schleswig-Holstein, liquidity risk primarily arises from systemic liquidity bottlenecks in the market and, less commonly, from a lack of funding options for portfoliomanagement. When the market as a whole is in crisis, portfoliomanagement 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 could adversely affect the liquidity situation of portfoliomanagement for a short period.

portfoliomanagement 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, portfoliomanagement can access short-term liquidity assistance from the Free and Hanseatic City of Hamburg and the Federal State of Schleswig-Holstein. In order to ensure that liquidity is obtained at favorable terms, portfoliomanagement maintains relationships with banks and investors (e.g. establishing an issuing program, establishing a European commercial paper program, establishing contact with banks with strong placement records) and maintains a presence on international financial markets. This is intended to enable portfoliomanagement to react to changes in the market situation depending on capital market parameters.

In implementing its funding strategy, portfoliomanagement is aiming for a balance between short-term and long-term funding. Surplus liquidity generated during asset resolution activities is either temporarily invested at standard market terms or, if possible and appropriate, used to repay portfoliomanagement'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 is carried out in the Treasury & Finance unit, which conducts short-term and medium-term liquidity planning. This enables liquidity needs to 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 resolution of the portfolio while preserving as much of its value as possible. Mismatched currencies and concentration risks are to be avoided as much as possible, as long as this is economically feasible.

The Risk Controlling & Strategic Wind-down Planning unit 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 is intended to provide information about possible future liquidity bottlenecks.

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

As of the reporting date, portfoliomanagement has sufficient liquidity. In addition to liquidity received from debt service by borrowers, portfoliomanagement obtains short-term funding from fixed-term deposits and the placement of commercial paper and medium-term funding from standard market instruments for procuring liquidity. If necessary, portfoliomanagement 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 six months).

Taking into account the liquidity assistance that is available at short notice, as of the 31 December 2019 reporting date portfoliomanagement has a positive liquidity balance of between EUR 81 million and EUR 1,019 million throughout the next twelve months.

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

portfoliomanagement 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 portfoliomanagement that could lead to deterioration in the net assets, financial position or results of operations of portfoliomanagement. 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

portfoliomanagement 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 identify risks to avoid loss events from occurring or to mitigate their effects. 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 portfoliomanagement 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 portfoliomanagement.

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 and on the losses documented in the loss database.

The OpRisk risk inventory serves to identify changes in the risk profile of portfoliomanagement. In the event of negative changes, this allows portfoliomanagement 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 assess their operational risks in terms of severity and likelihood of occurrence.

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.

In the 2019 calendar year, losses totalling approx. EUR 29 thousand were identified in connection with operational risks.

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 identified. The management of operational risks is thus not primarily concerned with managing loss events but with 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 service quality and performance by service providers as well as operational stability.

3.6.4. Outsourcing

For the purpose of resolving the loan portfolio transferred, portfoliomanagement outsourced administrative functions, including to Hamburg Commercial Bank AG and Dataport AöR (IT). By June 2020, key administrative activities supporting portfolio resolution are expected to be transferred from Hamburg Commercial Bank AG to the new service provider IBM Deutschland GmbH, which uses a different technical banking platform.

The requirements for the outsourcing process are derived from the State Treaty and the efficiency rule; specifically, they stipulate that non-strategic areas and services that do not create value and can be rendered cost-effectively by external service providers should be outsourced. In addition to functions required from a legal or supervisory perspective, portfoliomanagement focuses its business activities on its strategic core competencies.

With the support of central outsourcing management, portfoliomanagement conducts control and monitoring processes to monitor its outsourcing activities 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 portfoliomanagement. The objective of these measures is to continually improve existing processes, structures and service definitions. The details of outsourcing management practices are presented in the organizational manual.

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

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

- Strategic management: Monitoring and alignment of the service provider's services to the requirements of the service recipient (e.g. departments of portfoliomanagement)
- 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 departments) relating to the provision of services or interfaces to other departments
- Risk management: Outsourcing risks are monitored in outsourcing management within the corporate management department

The outsourcing management team creates a quarterly Executive Board report on the quality of the services provided by the outsourcing companies as well as their management and monitoring. The general risk report also contains a summary.

In cases where termination of the outsourcing agreement for material outsourcing activities is planned or expected, portfoliomanagement 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, portfoliomanagement has to review the corresponding courses of action for feasibility. Such reviews are carried out regularly and on a case-by-case basis.

3.7. OTHER RELEVANT BUT NOT MATERIAL RISKS

The most recent general risk inventory carried out in December 2019 showed that portfoliomanagement is exposed to strategic risk, business risk, regulatory risk and insurance 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. portfoliomanagement's strategic goal is to resolve the transferred portfolio while preserving as much of its value as possible. Due to its particular focus as an asset resolution entity, portfoliomanagement makes no proactive strategic decisions 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 business purpose of portfoliomanagement.

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, portfoliomanagement'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 portfoliomanagement is subject as an asset resolution entity is low despite the high likelihood of occurrence.

Insurance risks are defined as the risks that arise when insurance payments are not made or not made in full. For example, this may be the case due to a non-enforceable legal position relating to an existing insurance policy or uninsurable risks.

3.8. SUMMARY OF THE RISK SITUATION AS OF 31 DECEMBER 2019

portfoliomanagement was established to acquire the risk positions of HSH Nordbank AG (legal successor: Hamburg Commercial Bank 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 154 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 portfoliomanagement to liquidate collateral for these loans. The focus of the credit portfolio is on the container ship segment, which accounts for 71% 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 81% of the carrying amount. Both in terms of the outstanding loan amount (90%) and the carrying amount (91%), most of the borrowers have their place of business in Europe. portfoliomanagement'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. In particular, the increasingly onerous effects of coronavirus on the global economy since the beginning of 2020 will also be of material importance for the portfolio and very likely have a negative effect on its development. 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.

In relation to the total volume of assets and liabilities, market risk is low with a BPV of EUR 157 thousand and a periodic interest rate risk of EUR 338 thousand for calendar year 2020. As of the reporting date, 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 reporting date amounted to EUR 2,201 thousand and is fairly low from a risk perspective.

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

In the OpRisk risk inventory, operation were identified in terms of their relevance, analyzed and assessed to determine their likelihood of occurrence and total potential loss. The risk areas classified as critical mainly belong to the sub-risk types personnel risk, project risk, process risk and outsourcing risk.

A central loss database in which reported losses are documented on an ad hoc basis and managed was established to assess and manage operational risks.

In the 2019 calendar year, losses totalling approx. EUR 29 thousand were identified in connection with operational risks.

4. REPORT ON EXPECTED DEVELOPMENTS

In its January 2020 update, the IMF forecast global economic growth (GDP) for 2020 to be around 3.3%. Global growth in the previous year was around 2.9%. Total maritime trade in tonnes is expected to grow by around 2.8% in 2020, which would mean that growth will be around 1.6 percentage points higher than the previous year's figure. However, this outlook relies on the assumption that social unrest will not intensify and geopolitical tensions will not escalate, especially between the United States and Iran. Further worsening of relations between the USA and its trading partners and deepening economic frictions between other countries could also have a negative impact on the forecast.

In mid-January 2020, the USA and China signed a "phase one" trade agreement in which China declared its intention to import additional US goods worth around USD 162 billion by 2021. Mutual concessions on existing and announced tariffs, particularly on US imports from China, are also planned. Overall, the trade agreement is likely to have a positive impact on the shipping markets. Benefits come primarily from lower tariffs on some US imports from China, potential support for back-hauling of trans-Pacific volumes and an improvement in global economic sentiment. Despite the phase one deal, US tariffs remain in place on approx. USD 250 billion of imports from China, which will likely have a negative impact on trade between these two economies again in 2020.

Coronavirus (COVID-19) has spread around the world since the start of 2020 and has turned into a pandemic. Since then, it has had an increasingly negative impact on trade and the financial markets. As there is considerable uncertainty regarding the containment of the virus disease, it is currently assumed that its negative effects on the global economy will be noticeable.

The global cap on fuel sulphur content required to be observed since the beginning of 2020 is also likely to have further effects on shipping markets in 2020. In 2019, it transpired that the supply of tonnage was temporarily tightened in particular by the retrofitting of exhaust gas cleaning systems (scrubbers) on mainly large size classes, reductions in speed (slow steaming) and the use of tankers as floating fuel storage units. To some extent, therefore, these developments contributed to market improvements. However, vessels without scrubbers have to bunker low-sulphur fuels, which in Rotterdam at the beginning of February 2020 were around 69.3% more expensive than high-sulphur heavy fuel oil. This price difference could put vessels without scrubbers at a disadvantage; this goes especially for ships with relatively high consumption.

After supply growth outstripped demand growth in the container, tanker and bulker segments in 2019, the trend is forecast to reverse in 2020, at least for crude oil and product tankers. However, past experience has repeatedly shown that supply and demand forecasts in the shipping industry have to be adjusted during the year due to the markets' volatility and strong links with the global economy.

4.1. CONTAINER SHIPPING

At the beginning of 2020, the most important container ship classes in the portfolio of portfoliomanagement were Panamax (approx. 21.7% of the total carrying amount), Postpanamax (approx. 20.0%), ships below 3,000 TEU (approx. 19.5%) and ships of around 3,500 TEU (approx. 9.8%).

In the container shipping segment, transport capacity (TEU) growth of approx. 3.1% and demand growth (TEU) of around 2.8% is expected for 2020.

Around 70% of the expected tonnage growth (TEU) in 2020 will be driven by deliveries of additional large container ships with slot capacity between 11,000 TEU and 23,800 TEU. Overall, approx. 220 container vessels are expected to be delivered, including 21 in the size class between 100 TEU and 999 TEU, 74 between 1,000 TEU and 1,999 TEU, 70 between 2,000 TEU and 2,999 TEU, nine between 3,000 TEU and 7,999 TEU and 46 above 11,000 TEU.

After 2019, a rise in demolition volume is once again expected in 2020, with current estimates forecasting around 280,000 TEU of demolished capacity. Approx. 6.0% of the existing fleet is over 20 years old, and many of these ships are expected to be taken out of the market due to old age over the next few years. This rate is significantly higher among smaller ships below the Panamax class. The fleet size for large container ships in particular is likely to increase further in 2020, with current estimates predicting tonnage growth of around 9.4%. The fleet in the size class below 3,000 TEU is expected to experience the second-highest growth in 2020 at around 3.1%, while the class from 8,000 TEU to 11,999 TEU is likely to increase by 1.9%. The fleet in the class from 3,000 TEU to 7,999 TEU is predicted to shrink by around 2.0% overall. Container ships in the portfoliomanagement portfolio consist exclusively of small and medium-sized classes ranging from 800 TEU to 8,800 TEU.

With the exception of trans-Pacific trading routes, where TEU volumes are anticipated to decline by around 0.1% in 2020, growth is expected for all other major trading routes. However, the forecast for growth on the trans-Pacific trading route in particular could still be impacted by the initial agreements in the trade conflict between the USA and China. Intraregional trade is again expected to record the strongest growth at around 3.9%, followed by (secondary) East-West routes with growth of approx. 2.9%, North-South routes at 2.8% and the Far East-Europe with 2.1% growth.

For 2020, a temporary reduction in overall capacity of around 1.9% is expected as a result of the retrofitting of scrubbers and the time associated with this task. In addition, the tonnage reduction is likely to be supported by lower average speeds, which had already fallen by around 2.0% in 2019.

In summary, portfoliomanagement expects the container markets to remain stable in its most important size classes in 2020 despite the anticipated increase in overcapacity. However, the outlook is affected by high levels of uncertainty surrounding the world economy and international politics.

4.2. TANKER SHIPPING

At the beginning of 2020, the most important tanker classes in the portfolio of portfoliomanagement were Handysize product tankers (approx. 7.5% of the total carrying amount) and LR1 product tankers (approx. 3.9%).

Crude oil tanker capacity is expected to rise by around 3.4% and product tanker capacity by approx. 2.4% in 2020. The predicted growth in demand is around 3.8% for crude oil tankers and approx. 4.8% for product tankers.

Overall, 244 tankers are expected to be delivered in 2020, including 67 pure product tankers and 77 chemical/product tankers. By contrast, around 5.0% (by DWT) of the current tanker fleet is at least 20 years old and is likely to be taken out of the market due to old age over the next few years.

Demand for oil transport by sea will be largely driven by global oil demand and the origin of supply quantities. Global oil demand is expected to increase by around 1.3% in 2020, with output likely to rise by around 1.8%. Demand grew by approx. 1.3% in 2019, while output stagnated. Non-OECD states in Asia are viewed as the primary drivers of demand. Stronger demand from the petrochemical industry is also expected. Uncertainty on the demand side is primarily based on expectations for the global economy. Coronavirus is also expected to negatively impact demand, with the initial effects already evident in the first quarter of 2020 due to the reduction in travel and transport activity in China and thus lower oil and fuel consumption. Environmental policy decisions such as limiting emissions and increasing efficiency, particularly in OECD countries, will have an increasing influence on oil demand in the future. On the supply side, the USA is the strongest growth driver by volume according to forecast, while Norway is likely to top the table in percentage terms with growth of around 22%, followed by Brazil with predicted growth of approx. 11%. OPEC also plays an important role on the supply side – as indicated most recently in connection with coronavirus – in adjusting output to the development of future oil prices.

The switch to low-sulphur fuels is likely to have a positive impact on growth in the oil products market, as there will be a growing need to transport gas oil and other compliant fuels from refineries into consuming regions. At the same time, conventional heavy fuel oil transport volumes are expected to decline, as this will only be required by a minority of ships with emission control systems in the future.

A temporary tonnage reduction is also forecast for tankers in 2020 as a result of the retrofitting of scrubbers and the time associated with this task. In terms of total capacity, around 1.6% of the crude tanker fleet and 0.7% of the product tanker fleet is likely to be absorbed.

As a result, portfoliomanagement expects charter rates and second-hand market prices for both crude oil and product tankers to be stable or rise in 2020 based on the fundamental data forecast, which suggests a further reduction in the overcapacity observed in recent years.

4.3. BULK SHIPPING

At the beginning of 2020, the most important bulker classes in the portfolio of portfoliomanagement were Panamax (approx. 4.2% of the total carrying amount) and Supramax (approx. 3.4%).

Global demand for bulk shipments is expected to grow by around 2.0% in 2020, with the bulker fleet (DWT) likely to expand by approx. 3.7% over the same period.

Fleet growth in 2020 will predominantly be driven by large size classes such as Capesize bulkers and the Panamax class; of the latter, around 120 'Kamsarmaxes' will be delivered, each with approx. 82,000 DWT. A total of 526 bulkers with a total tonnage of approx. 51 million DWT are expected to be delivered, with an average capacity per ship of around 97,000 DWT. Around 6.9% of the current fleet (approx. 60.9 million DWT) is at least 20 years old and can be considered as being potentially available for demolition over the next few years.

On the demand side, growth will primarily be driven by Asia, with China alone representing more than 71% of demand for the most important bulk cargo, iron ore. Global iron ore exports declined by around 1.0% in 2019, while Chinese imports stagnated. Another increase in global imports of around 3.0% is anticipated in 2020, with Chinese iron ore imports also likely to rise by approx. 3.0%. On the supply side, Brazil is likely to boost export volumes by around 11.0% in 2020 after performance declined here in 2019 as a result of the catastrophic dam breach. Australia is predicted to increase export volumes by around 3.0% in 2020. Fairly weak growth of 1.0% is expected for the second most important 'major bulk', coal. Overall, demand for all major and minor bulk goods is likely to grow by 2.0% in each case in 2020.

A temporary tonnage reduction is also forecast for bulkers in 2020 as a result of the retrofitting of scrubbers and the time associated with this task, albeit with a lower reduction for this individual segment than in the previous year. In terms of total capacity, around 0.8% of the bulker fleet is likely to be absorbed, compared to 1.1% in 2019.

In summary, the fundamental data for the dry bulk market is expected to exert pressure on charter rates and second-hand prices. As the dry bulk market is strongly linked to China's economic development, the current forecasts are likely to be revised downwards in future in light of the anticipated effects of coronavirus on the economy. As a result, dry bulk markets could be placed under even greater pressure than previously assumed in 2020.

4.4. IMPACT ON PORTFOLIOMANAGEMENT

The forecast for 2020 is based on the asset resolution plan approved in the fourth quarter of 2019. It is subject to considerable uncertainty and is impacted by factors such as the coronavirus outbreak, the impact of which on the remainder of the year cannot be conclusively assessed at the time of preparing this management report. This means that the actual performance of portfoliomanagement may differ significantly from the forecast.

portfoliomanagement expects its relevant shipping markets to remain fundamentally stable in 2020, In light of this, portfoliomanagement believes that the financial situation of its borrowers will generally develop in a similar way as in the previous year. Work in 2020 will again focus on the management of the loan portfolio, such as restructuring efforts and the liquidation of loan collateral. In this context, the actual market development is of critical importance. At the end of 2020, the carrying amount of the portfolio before exchange rate effects is likely to be roughly at the level reached at the end of 2019. The effects of the new coronavirus could give rise to as-yet unforeseeable one-off impacts.

The financial position for 2020 will primarily be driven by any issuance activity required as part of the established issuance program.

The results of operations for 2020 will be driven by the expected sharp decrease in net interest income and the likewise reduced other comprehensive income in combination with substantially lower other administrative expenses.

Interest income received in 2020 will be significantly lower than in the previous year due to the fall in US dollar LIBOR. Interest expenses in 2020 are also expected to be well below the prior-year figure as a result of further falls in variable refinancing rates. A lower-than-expected decrease in US dollar LIBOR would result in higher interest income and and higher interest expenses, which should not significantly influence overall net interest income.

Net commission income will remain at the low prior-year level.

Other comprehensive income will reach a considerably weaker positive level as a result of lower cost reimbursements compared to the previous year.

According to planning, the number of full-time employees will remain virtually constant. To ensure the continued successful reduction of the loan portfolio, personnel expenses will be moderately increased as part of personnel management initiatives to promote employee loyalty. At the same time, other administrative expenses are expected to be significantly lower than in the previous year due mainly to lower costs for material outsourcing arrangements, for support services in day-to-day business operations and for legal and strategy consulting. As a result, general and administrative expenses are likely to be down significantly on the prior-year figure overall.

The decline in general and administrative expenses is only enough to partly offset the expected sharp decrease in net interest income and the similarly strong decline in other comprehensive income, as a result of which the operating result is forecast to be a slightly negative figure.

The development of loan loss allowances and provisions primarily depends on expectations for the development of generally cyclical and volatile shipping markets. The generally stable market outlook for 2020 and the corresponding development in borrowers' situations is contrasted by an aging collateral portfolio. Based on market expectations when the projections were drawn up in the fourth quarter of 2019, the restructuring planned for 2020 provides the potential to reverse an amount of loan loss allowances and provisions that would lead to a net gain on loan loss allowances and provisions were this development to occur.

It remains to be seen whether this positive result from loan loss allowances and provisions can overcompensate for a potentially negative operating result. A markedly positive result for the year is expected for 2020, subject to fundamental market uncertainties.

From today's perspective, the increasingly negative effects of the coronavirus pandemic on the global economy since the start of 2020 are also impacting portfoliomanagement's planning assumptions, which are adversely impacted by this event. As a result, the result for the year is likely to be noticeably worse than planned. Please refer to the additional comments in the notes to the annual financial statements, in the section entitled "Events of particular significance after the balance sheet date".

5. REPORT ON OPPORTUNITIES

In 2020, two significant factors could have a positive effect on the shipping markets if they were to develop accordingly: firstly, the future course of the trade conflict between the USA and China; and secondly, developments around the global cap on fuel sulphur content in effect since 1 January 2020.

In January 2020, initial progress was made in the trade conflict under a “phase one” trade deal. Nevertheless, significant barriers to trade remain in the form of punitive tariffs. An unexpectedly swift, comprehensive agreement would provide the shipping markets with a boost, as uncertainty would be removed. In the course of the negotiations, it is also possible that the parties will commit to stronger trade than has so far been the case; in this respect, the USA is making specific demands on China in relation to its imports of agricultural products, for example. A development of this kind would provide opportunities primarily for the dry bulk markets.

In connection with the introduction of the global sulphur cap on 1 January 2020, various vessels in the global fleet were and are being retrofitted with exhaust gas cleaning systems (scrubbers). This development will continue at least until well into 2020, as a result of which the vessels concerned will not be available on the charter market for the time it takes to retrofit them. In 2019, it transpired that retrofits at shipyards often take much longer than originally planned. In this context, the outbreak of coronavirus in China could lead to further delays, as many scrubber retrofits are carried out in Chinese shipyards. If this actual shortage of supply is larger or lasts longer than previously forecast, this could provide an opportunity for the shipping markets.

In connection with the sulphur cap, another relevant factor for the shipping markets is the future trend in the price of marine fuels with a low and high sulphur content. Currently, all vessels in the portfoliomanagement portfolio must use low-sulphur fuels. At the beginning of 2020, these were initially much more expensive than conventional heavy fuel oil. As a result, vessels with scrubbers that are still able to burn relatively cheap, high-sulphur heavy fuel oil were particularly attractive on the charter market. Ships without scrubbers, on the other hand, were in lower demand or only in demand at lower charter rates. By February 2020, however, the difference in fuel prices had slowly diminished again. If this development continues and the price difference contracts further in the course of the year, this could present an opportunity for the vessels in the portfoliomanagement portfolio, as they would become more cost-effective for charterers.

Finally, it should be noted that events that cannot be planned for may have a positive impact on the shipping markets over the short term and in this respect may represent an opportunity. A more recent example was the strong upturn in tanker markets in October 2019, triggered in part by US sanctions. Environment-related events may also have a positive impact on the shipping markets, at least temporarily, if they result in delays in handling at large ports or in transport routes being shifted, for example.

The factors described above would have various positive effects for portfoliomanagement. 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 could tend to accelerate the reduction in the loan portfolio as compared with asset resolution planning.

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

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.

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 the accounting may not comply with the German accepted accounting principles. These risks could adversely impact confidence in portfoliomanagement (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

portfoliomanagement has outsourced material aspects of its financial reporting:

/ The loan accounting for the credit portfolio acquired in mid-2016 is carried out by Hamburg Commercial Bank 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:

  – providing support in financial accounting (including accounts receivable and accounts payable)
  – asset accounting
  – preparing the tax declarations for value-added tax, corporate tax and trade tax as well as the preparation of the tax accounts and the e-balance sheet
  – 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 assuring the quality of and controlling the quarterly reports and the annual financial statements of portfoliomanagement 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.

portfoliomanagement implemented additional measures to mitigate the risks in the financial reporting process related to the outsourcing of activities.

Please refer to the details in section 3.6.4 of the risk report entitled "Outsourcing".

6.3. ORGANIZATION OF THE INTERNAL CONTROL SYSTEM

The Executive Board is responsible for the propriety of the financial reporting process.

For this purpose, portfoliomanagement set up an ICS authority based in the Organization team in the Business Management department. It ensures that the accounting-related ICS at portfoliomanagement is established and developed further on a regular basis.

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 minimized 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 is defined in the organizational manual of portfoliomanagement. 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 portfoliomanagement sets out that the ICS control cycle must be gone through once per year in line with the specifications of the Executive Board. The ICS framework was revised in 2019 and adopted by the Executive Board on 6 November 2019.

6.4. CONTROLS TO MINIMIZE THE RISK OF ERRORS IN FINANCIAL REPORTING

portfoliomanagement's ICS relevant to the financial reporting process has a large number of internal controls. The controls are item-based and risk-oriented. The dual control principle is applied in the preparation of the annual financial statements and the management report.

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

The contractual regulations with RuT and its internal organization likewise ensure a functioning ICS here. portfoliomanagement satisfied itself of this on the basis of the long-form audit report prepared by Warth & Klein Grant Thornton AG Wirtschaftsprüfungsgesellschaft in accordance with IDW AuS 951 (new version) and various discussions.

The structural and process organization should ensure completeness, accuracy and authorization, including access to data related to financial reporting.

6.5. INTERNAL AUDIT UNIT

Internal Audit at portfoliomanagement is a dedicated, independent unit. Its task is to carry out systematic, regular audits to verify that the entity complies with statutory and regulatory requirements, that risk management and the ICS are appropriate and effective, and that processing is carried out properly. Internal Audit's auditing activities take into account all of portfoliomanagement's activities and processes. These activities are based on risk-based annual audit planning that is approved by the entire Executive Board. The Internal Audit unit also monitors and validates the timely rectification of the problems identified in audit findings as part of reviews (follow-up).

/ ANNUAL FINANCIAL STATEMENTS

of hsh portfoliomanagement AöR

BALANCE SHEET

as of 31 December 2019

ASSETS

in Euro		31 Dec. 2019	31 Dec. 2018
1. Cash reserve			
Balances with central banks		7,285,016.75	5,889,235.73
thereof with Deutsche Bundesbank EUR 7,285,016.75 (previous year: EUR 5,889,235.73)			
2. Loans and advances to banks			
a) Payable on demand	15,098,866.21		50,861,506.15
b) Other loans and advances	28,487,330.13		26,874,875.84
		43,586,196.34	77,736,381.99
3. Loans and advances to customers		1,426,916,527.79	1,479,176,256.99
4. Intangible fixed assets			
Purchased concessions, industrial and similar rights and assets, and licenses in such rights and assets		149,728.00	236,359.00
5. Tangible fixed assets		41,675.00	70,630.00
6. Other assets		904,167.47	740,775.33
7. Prepaid expenses		4,310,743.28	4,241,387.05
8. Deficit not covered by equity		540,151,396.50	534,646,754.49
TOTAL ASSETS		**2,023,345,451.13**	**2,102,737,780.58**

EQUITY AND LIABILITIES

in Euro		31 Dec. 2019	31 Dec. 2018
1. Liabilities to banks			
With agreed maturity or notice period		138,581,105.47	0.00
2. Liabilities to customers			
Other liabilities			
Payable on demand		0.00	87,923.00
3. Debt securities issued			
Bonds issued		1,880,658,439.20	2,096,017,125.94
4. Other liabilities		1,735,591.74	3,328,551.08
5. Deferred income		267,803.64	469,297.09
6. Provisions			
Other provisions		2,102,511.08	2,834,883.47
7. Equity			
a) Net loss for the year	-540,151,396.50		-534,646,754.49
b) Deficit not covered by equity	540,151,396.50		534,646,754.49
		0.00	0.00
TOTAL EQUITY AND LIABILITIES		**2,023,345,451.13**	**2,102,737,780.58**

Other obligations			
Irrevocable loan commitments		12,771,200.76	8,384,279.48

INCOME STATEMENT

for the period from 1 January 2019 to 31 December 2019

in Euro		1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018
1. Interest income from lending and money market transactions	61,954,321.90		64,820,442.33
thereof negative interest income deducted EUR 103,296.78 (previous year: EUR 139,700.23)			
2. Interest expenses	-38,997,584.74		-36,500,640.15
thereof negative interest expenses deducted EUR 8,000.00 (previous year: EUR 146,620.68)			
		22,956,737.16	**28,319,802.18**
3. Commission income	674,224.62		5,826,384.88
4. Commission expenses	-536,661.90		-594,689.01
		137,562.72	**5,231,695.87**
5. Other operating income		2,284,560.51	3,235,802.27
6. General and administrative expenses			
a) Personnel expenses			
aa) Wages and salaries	-5,253,308.84		-5,634,271.93
ab) Social security, post-employment and other employee benefit costs	-947,054.19		-964,212.14
thereof in respect of postemployment benefits EUR 241,583.54 (previous year: EUR 240,663.06)			
	-6,200,363.03		-6,598,484.07
b) Other administrative expenses	-18,823,706.12		-21,369,261.22
		-25,024,069.15	-27,967,745.29
7. Depreciation, amortization and write-downs of tangible and intangible fixed assets		-137,712.04	-128,600.51
8. Other operating expenses		-390,586.66	-886,472.83
9. Write-downs of and valuation allowances on loans, advances, receivables and certain securities, and additions to loan loss provisions		-5,329,546.99	0.00
10. Income from reversals of write-downs of receivables and certain securities and from the reversal of loan loss provisions		0.00	7,301,090.95
11. Result from ordinary activities		-5,503,054.45	15,105,572.64
12. Other taxes not included in item 8		-1,587.56	-1,353.10
13. NET LOSS / NET INCOME		**-5,504,642.01**	**15,104,219.54**
14. Loss brought forward from the previous year		-534,646,754.49	-549,750,974.03
15. NET ACCUMULATED LOSSES		**-540,151,396.50**	**-534,646,754.49**

NOTES

GENERAL DISCLOSURES AND EXPLANATIONS

portfoliomanagement 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 (hereinafter called "portfoliomanagement"), Kiel, as an entity under German public law with full legal capacity in accordance with section 8b of the FMStFG.

portfoliomanagement 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 portfoliomanagement 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.

portfoliomanagement 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

In accordance with section 2(7) of the State Treaty, portfoliomanagement prepares annual financial statements and a management report within three months of the end of a financial year.

portfoliomanagement 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 portfoliomanagement 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 2019 consist of a balance sheet as of 31 December 2019, an income statement for the period from 1 January to 31 December 2019 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 264(1) sentence 2 of the HGB in conjunction with section 264d of the HGB. portfoliomanagement 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 2018 were used as comparative amounts for the balance sheet. The prior-year comparative period comprising financial year from 1 January to 31 December 2018 was used for the income statement.

Pursuant to section 2(1) of the RechKredV, portfoliomanagement 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

Accounting and measurement are based on the going-concern assumption. The going-concern assumption is based on the fact that the Free and Hanseatic City of Hamburg and the State of Schleswig-Holstein as sponsors pursuant to section 5(2) of the State Treaty ensure that portfoliomanagement remains fully operational as an institution for the duration of its existence (institutional liability). Furthermore, 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 portfoliomanagement if creditors cannot be satisfied from the assets of portfoliomanagement (guarantor liability).

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. The acquired loans were allocated to current assets regardless of their remaining maturities because these loans were acquired for unwinding 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.

The ongoing measurement of the loans related to ship financing is carried out by taking into account any loan increases, debt waivers and repayments made in the meantime and assessments updated as of the reporting date regarding both the ability of the individual ships within the existing financing to continue as a going concern and the useful lives of the ships. Loans and advances to customers whose ships are forecast to continue as a going concern as of the balance sheet date were measured using the net cash inflows generated by ship operating activities available to service the loans. These were based on forecasts of future trends in the net cash inflows generated by ship operating activities published for benchmark ships by a recognized market data provider. The uncertainty regarding the expected development has been reflected by applying a risk discount that rises over time to the forecasts of future charter rates prepared by the external provider. Loans and advances to customers, for whose ships no positive going-concern assumption exists as of the reporting date, were measured at the market value of the ship less a discount to cover the expected costs of disposal.

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 (seven-year average).

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 31 December 2019 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.

portfoliomanagement 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 contained in IDW Accounting Principle IDW AcP BFA 3 relating to specific issues of the loss-free measurement of interest-related transactions in the banking book (interest exposure 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.

portfoliomanagement has not made any use of the option to recognize deferred tax assets in the annual financial statements for the period ended 31 December 2019.

portfoliomanagement makes use of the option under section 340f(3) of the HGB in conjunction with section 32 sentence 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 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 7.3 million (31 December 2018: EUR 5.9 million).

2. Loans and advances to banks

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Payable on demand	15,099	50,862
Other loans and advances	28,485	26,829
	43,584	77,691
Pro rata interest	2	46
TOTAL	**43,586**	**77,737**
Of which subordinated loans and advances	0	0
Due within		
3 months	28,485	26,829
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

3. Loans and advances to customers

in EUR thousand	31 Dec. 2019	31 Dec. 2018
TOTAL	**1,426,917**	**1,479,176**
Of which:		
Pro rata interest	3,666	523
Loans and advances with indefinite maturity	0	0
Subordinated loans and advances	0	0
Payable on demand	107,390	203,609
Due within		
3 months	6,498	7,624
More than 3 months up to 1 year	20,332	45,075
More than 1 year up to 5 years	717,141	683,398
More than 5 years	571,890	538,947

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. 2019	371	149
Additions	21	1
Disposals	0	0
31 Dec. 2019	392	150
Accumulated depreciation / amortization 1 Jan. 2019	135	78
Additions	107	30
Disposals	0	0
31 Dec. 2019	242	108
Depreciation / amortization during the financial year	107	30
CARRYING AMOUNT, 31 DEC. 2019	**150**	**42**
Carrying amount 31 Dec. 2018	236	71

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 three to five years.

Tangible fixed assets comprise individual assets as well as an aggregate item for low-value assets with a cost of EUR 250.00 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. Tangible fixed assets include operating and office equipment amounting to EUR 8 thousand (previous year: EUR 12 thousand).

5. Other assets

Other assets comprise the following items:

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Receivables from the tax office	885	307
Receivables in connection with the sale of ships	0	424
Other	19	10
TOTAL	**904**	**741**

Receivables from the tax office relate to withheld investment income tax and the solidarity surcharge payable thereon as well as VAT refund receivables.

6. Prepaid expenses

Prepaid expenses consist of the following items:

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Discount from the issuing business	3,599	2,714
prepaid invoice amounts	712	1,527
TOTAL	**4,311**	**4,241**

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 540.1 million (previous year: EUR 534.6 million) comprises the loss brought forward from financial year 2018 (EUR 534.6 million) and the net loss for 2019 (EUR 5.5 million).

8. Liabilities to banks

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Payable on demand	0	0
With agreed maturity or notice period	137,974	0
	137,974	0
Pro rata interest	607	0
TOTAL	**138,581**	**0**
Due within		
3 months	48,959	0
More than 3 months up to 1 year	89,015	0
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. 2019	31 Dec. 2018
Payable on demand	0	88
Other liabilities with agreed maturity or notice period	0	0
Pro rata interest	0	0
TOTAL	**0**	**88**
Due within		
3 months	0	0
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

10. Debt securities issued

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Bonds issued	1,880,658	2,096,017
TOTAL	**1,880,658**	**2,096,017**
Of which:		
Amounts due in the following year	1,035,581	822,655

This item comprises bearer bonds in the amount of EUR 400 million (previous year: EUR 400 million) and USD 1,000 million (EUR 890.2 million) (previous year: USD 1,500 million or EUR 1,310 million). portfoliomanagement also issued short-dated commercial paper in the amount of EUR 85 million (previous year: EUR 190 million) and USD 566 million (EUR 503.8 million) (previous year: USD 220 mill or EUR 192.2 million). Pro rata interest of EUR 1.7 million (previous year: EUR 3.8 million) is also reported under this item.

11. Other liabilities

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Trade payables	1,566	3,122
Taxes and social security expenses	160	201
Credit card invoices	10	6
TOTAL	**1,736**	**3,329**

Trade payables mainly relate to outsourcing costs (EUR 1.1 million; previous year: EUR 1.5 million) and legal and consulting costs (EUR 0.2 million; previous year: EUR 1.1 million).

The vast majority of taxes and social security expenses is attributable to amounts not yet paid for December 2019.

12. Deferred income

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Premium from the issuing business	153	351
Other	115	118
TOTAL	**268**	**469**

Premiums from issuing business relate to bearer bonds and commercial paper issued. They are reversed over the term of the bonds.

13. Other provisions

in EUR thousand	1 Jan. 2019	Addition	Reversal	Use	31 Dec. 2019
Auditing costs	647	677	9	638	677
Invoices outstanding	769	485	73	677	504
Preparation of financial statements	346	265	1	345	265
Lending business	494	5	0	257	242
Expected losses from executory spot transactions	74	197	0	74	197
Personnel	250	104	0	201	153
Archiving	30	11	0	0	41
Preparation / publication of annual report	13	13	0	13	13
BaFin levy	53	0	42	0	11
Register corrections	159	0	159	0	0
TOTAL	**2,835**	**1,757**	**284**	**2,205**	**2,103**

Provisions for auditing expenses relate to the expenses for the auditing of the annual financial statements. Provisions for outstanding invoices relate exclusively to outstanding invoices for ongoing legal advice and outsourced services. The costs of preparing the financial statements concern internal expenses and the costs of outsourcing work to an external service provider. Loan loss provisions relate to obligations in connection with the acquired loan portfolio. The measurement of a spot transaction that had not yet been settled as of the reporting date resulted in an executory negative result, which has been deferred. Personnel provisions mainly concern performance-related remuneration and residual leave entitlements.

Provisions for archiving costs have been recognized to cover the storage of business documents for the statutory retention periods. These provisions have been discounted.

14. Other obligations

in EUR thousand	31 Dec. 2019	31 Dec. 2018
Irrevocable loan commitments	12,771	8,384
TOTAL	**12,771**	**8,384**

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

Based on forecasts made as of the reporting date, portfoliomanagement 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. 2019	31 Dec. 2018
Assets		
Loans and advances to banks	41,128	73,557
Loans and advances to customers	1,414,626	1,463,074
	1,455,754	1,536,631
Liabilities		
Liabilities to banks	138,581	0
Liabilities to customers	0	88
Debt securities issued	1,395,555	1,505,914
Other liabilities	4	38
Other obligations	12,771	8,384
	1,546,911	1,514,424

INCOME STATEMENT DISCLOSURES

1. Net interest income

in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018
Interest income	61,954	64,821
Of which:		
Lending and money market transactions	62,057	64,961
Negative interest shown separately	-103	-140
Interest expenses	38,997	36,501
Of which:		
Lending and money market transactions	668	2,436
Positive interest shown separately	-8	-147
Debt securities issued	38,337	34,212
NET INTEREST INCOME, TOTAL	**22,957**	**28,320**

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. Interest income of EUR 2.6 million (previous year: EUR 10.9 million) was recognized in connection with exposures repaid or terminated and relates mostly to prior periods.

2. Net commission income

in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018
Commission income	674	5.826
Of which:		
Lending business	674	5.826
Commission expenses	536	594
Of which:		
Lending business	0	0
Securities and issuing business	514	561
Other	22	33
NET COMMISSION INCOME, TOTAL	**138**	**5.232**

Commission income is attributable to lending business and relates to processing and restructuring fees. A small amount was also recognized from vessel flagging-out fees.

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. 2019	1 Jan.–31 Dec. 2018
Third-party cost reimbursements	1,659	2,739
Income from the reversal of provisions	284	404
VAT refunds	230	0
Other	112	93
TOTAL	**2,285**	**3,236**

Cost reimbursements from third parties mainly relate to legal costs paid.

Income from the reversal of provisions is attributable to costs for register corrections, outstanding invoices, the BaFin levy and costs for the preparation of the annual financial statements.

4. General and administrative expenses

The breakdown of general and administrative expenses is as follows:

in EUR thousand	1 Jan.–31 Dec. 2019	1 Jan.–31 Dec. 2018
Personnel expenses	6,200	6,599
Other administrative expenses	18,824	21,369
TOTAL	**25,024**	**27,968**

The **personnel expenses** were incurred for an average of 63 employees (previous year: 66) of portfolio-management.

The breakdown of **other administrative expenses** is as follows:

in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018
Material outsourcing costs	7,298	8,935
Migration of portfolio resolution	2,609	9
Support for ongoing business operations	1,855	997
Legal consulting services	1,772	5,244
Preparation and auditing of financial statements	1,169	1,440
Organizational development	971	1,121
Personnel, IT, strategy and other consulting	761	801
Insurance premiums	388	450
Office space rent	376	364
Restructuring costs	333	540
Other personnel expenses	318	377
Lease/maintenance of hardware and software	232	42
Market data communication	196	185
Rating	152	236
Register corrections	36	0
Other	358	628
TOTAL	**18,824**	**21,369**

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. One-off project costs were incurred in connection with the planned transfer of significant back-office portfolio management administration work to a new service provider. Support for ongoing business operations mainly includes outsourced line activities of IT operations. Legal consulting costs relate mainly to lending business and were partly charged on; the related income was recognized in the income statement as other operating income. Expenses for the preparation and auditing of financial statements comprise pro-rata costs for the preparation and auditing of the annual financial statements for the period ended 31 December 2019. Expenses for enhancing the organization were incurred mainly for the enhancement of the IT architecture. Costs for personnel, IT, strategy and other consulting are almost exclusively attributable to strategy consulting.

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. 2019	1 Jan. – 31 Dec. 2018
Tangible fixed assets	30	30
Intangible fixed assets	108	99
TOTAL	**138**	**129**

6. Other operating expenses

The other operating expenses break down as follows:

in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2018
Net foreign currency translation income / expenses	389	783
Other	2	104
TOTAL	**391**	**887**

Application of section 340h of the HGB in conjunction with section 256a of the HGB resulted in a net foreign currency translation loss of EUR 0.4 million (previous year: net foreign currency translation gain of EUR 0.8 million).

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 loss from net loan loss allowances and provisions. It amounts to EUR 5.3 million (previous year: EUR 0 million).

8. Income from reversals of write-downs of receivables and certain securities and from the reversal of loan loss provisions

This item shows the net gain from net loan loss allowances and provisions. It amounts to EUR 0 million (previous year: EUR 7.3 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 term end in EUR thousand	**Payments** **1 Jan. 2020 – 31 Dec. 2020**	**Total payments over the fixed term**
Leases for office space	381	604
Service contracts related to outsourcing	6,681	11,480
TOTAL	**7,062**	**12,084**

2. Auditor's fee

Activities performed by the auditor

KPMG AG Wirtschaftsprüfungsgesellschaft audited portfoliomanagement's annual financial statements for the period ended 31 December 2019. In addition, specific services related to portfoliomanagement's annual financial statements and included in the audit were performed at an outsourcing company; quality assurance reviews were also carried out, in particular on issues specific to financial reporting, which were either triggered directly by the audit of the annual financial statements as of 31 December 2019 or used in the context of this audit. KPMG AG Wirtschaftsprüfungsgesellschaft also provided other services.

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

The auditor's fee amounted to EUR 0.7 million in the reporting period (previous year: EUR 0.8 million) and was incurred for the following services:

in EUR thousand	**1 Jan. – 31 Dec. 2019**	**1 Jan. – 31 Dec. 2018**
Auditing services	648	782
Other services	85	37
TOTAL	**733**	**819**

The audit fees of KPMG AG Wirtschaftsprüfungsgesellschaft in financial year 2019 were incurred for the audit of the 2019 annual financial statements (EUR 397 thousand; previous year: EUR 398 thousand), for specific audit procedures performed at an external service provider (EUR 201 thousand; previous year: EUR 195 thousand), and for quality assurance reviews particularly of issues specific to financial reporting (EUR 11 thousand; previous year: EUR 22 thousand). Other services amounting to EUR 85 thousand (previous year: EUR 37 thousand) relate to project-related quality assurance carried out in the financial year in connection with the introduction of a new loan accounting system.

The auditing services include subsequent charges for the previous year amounting to EUR 39 thousand (previous year: EUR 167 thousand).

3. Number of employees

The average number of employees at portfoliomanagement was as follows (not including the Executive Board):

	1 Jan. – 31 Dec. 2019			1 Jan. – 31 Dec. 2018		
Headcount	Full-time employees	Part-time employees	Total	Full-time employees	Part-time employees	Total
Men	24	7	31	29	5	34
Women	16	16	32	19	13	32
TOTAL	**40**	**23**	**63**	**48**	**18**	**66**

4. Governing bodies of portfoliomanagement

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

ADVISORY BOARD
Dr. Philipp Nimmermann, State Secretary (Chairperson und member until 28 February 2019)
Udo Philipp, State Secretary, Ministry of Finance of the State of Schleswig-Holstein (Chairperson from 1 March 2019 until 31 December 2019; Deputy Chairperson from 1 January 2020)
Dr. Sibylle Roggencamp, Senate Director, Ministry of Finance of the Free and Hanseatic City of Hamburg (Deputy Chairperson until 31 December 2019; Chairperson from 1 January 2020)
Christian Fischer, Counsel, Ministry of Finance of the Free and Hanseatic City of Hamburg (until 31 January 2019)
Prof. Dr. Stephan Schüller, businessman (from 1 February 2019)
Agnes Witte, Consultant, Ministry of Finance of the State of Schleswig-Holstein (until 28 February 2019)
Sabine Uplegger, Consultant, Ministry of Finance of the State of Schleswig-Holstein (from 1 March 2019 until 30 November 2019)
Corinna Warlich, German Public Auditor, Tax Consultant (from 1 December 2019)

BOARD OF SPONSORS
Dr. Andreas Dressel, Finance Senator of the Free and Hanseatic City of Hamburg (Chairperson until 31 December 2019)
Monika Heinold, Minister of Finance of the State of Schleswig-Holstein (Chairperson from 1 January 2020)

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 2019 financial year:

	Dr. Karl-Hermann Witte	Ulrike Helfer	Total
Composition in EUR thousand	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2019	1 Jan. – 31 Dec. 2019
Non-performance-related remuneration	216	325	541
Non-monetary benefits	8	11	19
Performance-related remuneration	37	41	78
Long-term incentive components	0	0	0
TOTAL	**261**	**377**	**638**

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 recognized in profit or loss in financial year 2019. Components involving long-term incentives do not form part of the contracts.

EVENTS OF PARTICULAR SIGNIFICANCE AFTER THE BALANCE SHEET DATE

Coronavirus (COVID-19) has spread around the world since the start of 2020 and is having an increasingly negative impact on the shipping markets relevant to portfoliomanagement. Previous developments related to coronavirus suggest that global economic growth will be adversely affected by the spread of the disease and subsequent disruption to the global economy in 2020. For example, this means that the ifo Institute anticipates a recession in Germany, the scale of which is subject to considerable uncertainty.

This development has not been taken into account in portfoliomanagement's plans for financial year 2020, which were approved in the fourth quarter of 2019 and continue to apply. At present, it appears likely that the virus will have a negative impact on the Institution's net assets, financial position and results of operations. This means there is a risk that loan loss allowances and provisions will have to be higher than planned and that net interest and net commission income will fall short of expectations. The distortions currently being observed in the capital markets will result in higher funding costs that will adversely affect the Institution's results of operations. In light of current uncertainty regarding the further development of the coronavirus pandemic, it is not currently possible to quantify its financial impact on portfoliomanagement; however, in the opinion of portfoliomanagement it is highly probably that this impact will be markedly negative.

Kiel, 24 March 2020

Ulrike Helfer Dr. Karl-Hermann Witte

CASH FLOW STATEMENT

for financial year 2019

in EUR thousand	1 Jan. – 31 Dec. 2019 [1]	1 Jan. – 31 Dec. 2018 [1]
1. Profit / loss for the period	-5,505	15,104
2. + / – Depreciation, amortization and write-downs on items of fixed assets / reversals of such write-downs	138	129
3. + / – Valuation allowances on loans, advances and receivables / reversals of such valuation allowances	14,100	9,656
4. + / – Increase / decrease in provisions	-732	-2,958
5. + / – Other non-cash expenses / income	-31,015	15,582
6. – / + Increase / decrease in loans and advances to banks	33,337	-18,479
7. – / + Increase / decrease in loans and advances to customers	98,365	239,842
8. – / + Increase / decrease in other assets relating to operating activities	-226	-1,041
9. + / – Increase / decrease in liabilities to banks	139,966	-663,729
10. + / – Increase / decrease in liabilities to customers	-88	71
11. + / – Increase / decrease in debt securities issued	-240,493	364,115
12. + / – Increase / decrease in other liabilities relating to operating activities	-1,794	-2,008
13. + / – Interest expense / interest income	-22,957	-28,320
14. + Interest and dividend payments received	58,851	64,543
15. – Interest paid	-40,529	-36,371
16. = Cash flows from operating activities (total of lines 1. to 15.)	**1,418**	**-43,864**
17. – Payments to acquire tangible fixed assets	-1	-6
18. + Proceeds from disposal of intangible assets	0	0
19. – Payments to acquire intangible fixed assets	-21	-234
20. = Cash flows from investing activities (total of lines 17. to 19.)	**-22**	**-240**
21. Net change in cash funds (total of lines 16.+20.)	1,396	-44,104
22. + Cash funds at beginning of period	5,889	49,993
23. = CASH FUNDS AT END OF PERIOD (TOTAL OF LINES 21. TO 22.)	**7,285**	**5,889**

COMPOSITION OF CASH FUNDS	31. Dec. 2019 [1]	31. Dec. 2018 [1]
Balances with central banks	7,285	5,889
= CASH FUNDS	**7,285**	**5,889**

[1] Figures taking into account rounding differences

STATEMENT OF CHANGES IN EQUITY

for financial year 2019

in EUR thousand	Loss brought forward	Net loss / Net income for the year	Net accumulated losses / deficit not covered by equity
Equity as at 1 Jan. 2018	-505,323	-44,428	-549,751
Appropriation of profit / loss 2017	-44,428	44,428	0
Net income for the year 2018	0	15,104	15,104
EQUITY AS AT 31 DEC. 2018	**-549,751**	**15,104**	**-534,647**
Equity as at 1 Jan. 2019	-549,751	15,104	-534,647
Appropriation of profit / loss 2018	15,104	-15,104	0
Net loss for the year 2019	0	-5,505	-5,505
EQUITY AS AT 31 DEC. 2019	**-534,647**	**-5,505**	**-540,151**

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 portfoliomanagement, 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 portfoliomanagement.

Kiel, 24 March 2020

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 2019, 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 2019 to 31 December 2019, 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 2019 to 31 December 2019.

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 institutions and give a true and fair view of the assets, liabilities and financial position of the Institution as at 31 December 2019 and of its financial performance for the financial year from 1 January 2019 to 31 December 2019 in compliance with German Legally Required Accounting Principles, and
- the accompanying management report as a whole provides an appropriate view of the Institution'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.

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 Institution 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 2019 to 31 December 2019. 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 section "Accounting policies" in 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 1,427 million (previous year: EUR 1,479 million). These had been taken over from Hamburg Commercial Bank AG (formerly: HSH Nordbank AG [1]) 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.

The determination of the amount of the necessary specific valuation allowances on loans and advances to customers related to ship financing is discretionary. The expected cash flows are allocated on the basis of the investment strategy (continued operation or liquidation strategy). The amount of the specific valuation allowances on loans and advances to customers related to ship financing for which a going-concern strategy is pursued is determined on the basis of the future expected cash flows generated by the ships' operation. hsh pm takes into account the uncertainties of the forecast by applying a discount on the market forecasts of an external provider that increases over the entire forecast period. In addition, determining the amount of the specific valuation allowances on loans and advances to customers related to ship financing now also takes into account the specific underlying financing structure including a separation of interest and principal payments. If a liquidation strategy applies, the fair value after costs to sell is used as the cash flow for determining the amount of the specific valuation allowances on loans and advances to customers related to ship financing.

[1] Upon entry in the commercial registers of Hamburg and Kiel on 4 February 2019, the HSH Nordbank AG was renamed Hamburg Commercial Bank AG.

Incorrect assumptions and parameters in terms of the investment strategy and 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 default risks were not taken into consideration to an appropriate extent by recognizing specific valuation allowances 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.

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. In particular, we examined the measurement model used by hsh pm, including the adoption of the relevant parameters and estimates in the underlying valuation process.

We audited the appropriateness of the specific valuation allowance determined in the event of a continued operation strategy or a recovery strategy for shipping loans by means of a conscious choice of individual exposures. In this context, we have also taken into account material effects on loan loss allowances and provisions resulting from restructuring measures. Furthermore, through sampling we performed other assertion-based audit procedures for the remaining exposures with regard to appropriate assumptions regarding allocation to an investment strategy and the derivation of expected cash flows and checked the calculation of the amount of the specific valuation allowance on loans and advances to customers related to ship financing recognized in each case.

OUR OBSERVATIONS

The assumptions and parameters established by hsh pm in relation to the investment strategy and the derivation of the expected cash flows for the assessment of the amount of the specific valuation allowances on loans and advances to customers related to ship financing are appropriate. In the individual cases that we reviewed, the assumptions made were appropriately applied.

Other Information

The management and/or the advisory board is responsible for the other information. The other information comprises the remaining parts of the annual report:

The other information does not include the annual financial statements, the audited management report and our related audit opinion.

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 audited portions of the management report or our knowledge obtained in the audit, or
– otherwise appears to be materially misstated.

Responsibilities of Management and the Advisory 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 institutions, and that the annual financial statements give a true and fair view of the assets, liabilities, financial position and financial performance of the Institution 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 Institution'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 Institution'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 advisory board is responsible for overseeing the Institution'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 Institution'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 Institution.

– 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 Institution'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 Institution 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 Institution 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 Institution'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 based on a resolution adopted by the advisory board on 19 September 2019. We were engaged by the advisory board on 29 September 2019. We have been the auditor of the Institution without interruption since the financial year 2017.

We declare that the opinions expressed in this auditor's report are consistent with the additional report to the advisory board 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 Ronny Kühn.

Munich, 25 March 2020

KPMG AG
Wirtschaftsprüfungsgesellschaft [Original German version signed by:]

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Wirtschaftsprüfer	Wirtschaftsprüfer

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