

BASIS OF THE GROUP

BUSINESS ACTIVITIES

Sale of HSH Nordbank AG on 28 February 2018

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

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

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

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

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

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

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

Headquarters, regional focus, clients and products

HSH Nordbank AG was established in June 2003 by the merger of Hamburgische Landesbank Girozentrale with Landesbank Schleswig-Holstein Girozentrale, and is managed in the form of a German public limited company (*Aktiengesellschaft* – AG). The headquarters of the Bank are located in Hamburg and Kiel.

HSH Nordbank is one of the leading banking partners for upper medium-sized enterprises in the core region of Northern Germany. HSH Nordbank is also active throughout Germany primarily in the corporate and real estate clients business. The focus of the project financing business in the Corporate Clients division (Energy & Utilities and Logistics & Infrastructure business areas) is also on the rest of Europe. The Bank conducts business with shipping clients throughout the world. Based on classical loan financing, HSH Nordbank offers a wide range of individual financing solutions and products tailored to the needs of corporate clients, wealthy private clients, savings banks and institutional clients.

Segments, divisions and locations

The business activities of HSH Nordbank are split between the Core Bank and the Non-Core Bank in line with the Bank's value creation structures. The Core Bank includes the long-term strategic business divisions. These include the Corporate Clients, Real Estate, Shipping and Treasury & Markets segments. The Non-Core Bank includes the non-strategic and predominantly non-performing legacy portfolios, most of which date back to the years prior to 2009 and which are being largely wound down as part of the privatisation process. The administrative divisions and overall bank positions are disclosed as segments not subject to reporting requirements in the "Other and Consolidation" division.

As part of the focusing of its business activities HSH Nordbank has significantly reduced its international network of locations over the past years and closed a number of branches abroad. HSH Nordbank continues to maintain branches in Singapore, Athens and Luxembourg as well as a representative office in Hong Kong in line with its strategic direction. The branch in Luxembourg primarily provides services for the Non-Core Bank. In Germany, HSH Nordbank is represented in Berlin, Düsseldorf, Munich, Stuttgart and Frankfurt am Main. The branches listed above are of secondary importance for understanding the Group situation of HSH Nordbank.

Equity holdings and scope of consolidation

HSH Nordbank has sharply reduced its equity holding portfolio over the past few years. At the 2017 year end, the scope of consolidation for the Group financial statements included, in addition to the parent company, HSH Nordbank AG, 53 fully consolidated subsidiaries compared to 57 fully consolidated subsidiaries as at 31 December 2016. Major additions to the scope of consolidation relate, in particular, to five single-ship companies that were included in the scope of consolidation for the first time:

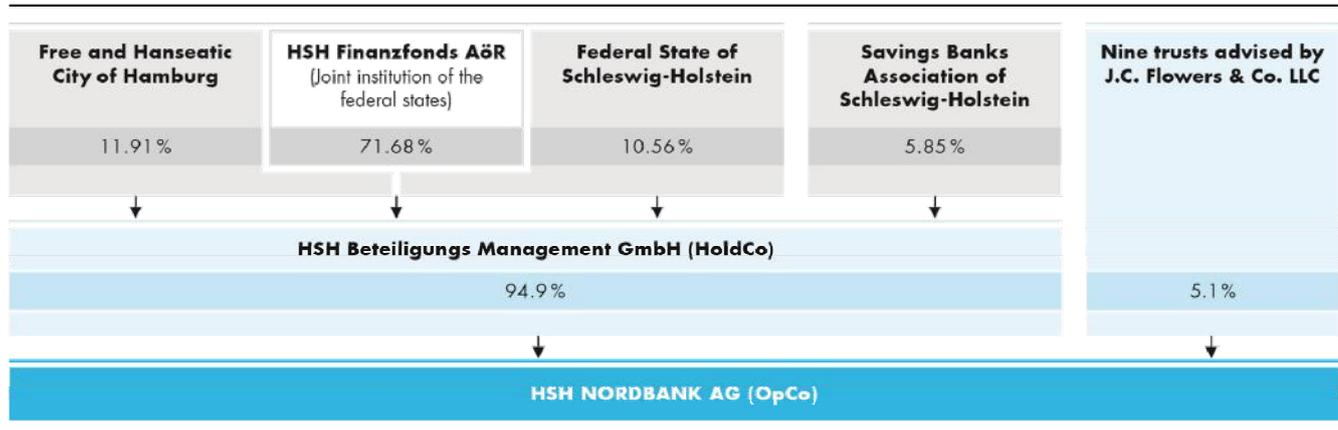
- Chasms Navigation Limited, Douglas, Isle of Man
- Cregneash Navigation Limited, Douglas, Isle of Man
- Curragh Navigation Limited, Douglas, Isle of Man
- Mooragh Navigation Limited, Douglas, Isle of Man
- Soderick Navigation Limited, Douglas, Isle of Man

The additions resulted from the realisation of collateral in connection with restructuring measures relating to a loan exposure. In the context of this realisation of collateral, HSH Nordbank AG transferred the shares in five single-ship companies that had been pledged to it to another party which holds the shares for HSH Nordbank AG on a fiduciary basis. In September 2017, the ships held by the single-ship companies were sold. Since then, these subsidiaries have no longer had any operational business activities.

Disposals relate, in particular, to the companies DEERS Green Power Development Company S.L., Madrid, and Solar Holdings S.à.R.L., Luxembourg, which are no longer included in the Group financial statements, and to six companies from the Mitco Group (single-purpose companies in the real estate sector). These disposals are the result of the sale of shares/loan receivables in the context of portfolio sales. The subsidiaries of HSH Nordbank AG do not have any branches that would be important in the interests of understanding the Bank's situation.

The impact of these changes to the scope of consolidation on the income statement is addressed, to the extent that the impact is material, in the "Earnings" section of this Group management report. More details on the scope of consolidation can be found in Note 5 (Scope of consolidation) in the notes to the Group financial statements.

OWNERSHIP STRUCTURE

**Ownership structure, guarantee and EU proceedings**

The principal owner of HSH Nordbank AG as at the 2017 year end is HSH Beteiligungs Management GmbH with a shareholding of 94.9%. Private investors advised by J.C. Flowers & Co. LLC also have a shareholding of 5.1%. The Free and Hanseatic City of Hamburg and the federal state of Schleswig-Holstein indirectly hold a combined shareholding of 89.35% via HSH Beteiligungs Management GmbH and 5.55% is held by the Savings Bank Association (Sparkassen- und Giroverband) for Schleswig-Holstein.

In order to secure the Bank's survival, the federal states of Hamburg and Schleswig-Holstein issued via HSH Finanzfonds AÖR a guarantee in favour of HSH Nordbank on 2 June 2009 that provided capital relief (second loss guarantee), but which did not affect liquidity at that time, under which payment defaults in a specified portfolio are hedged (mainly in the Non-Core Bank). In 2013, the guarantee facility was replenished after a reduction in 2011 from € 7 billion to the original facility of € 10 billion in view of the changed underlying conditions. This measure was initially provisionally approved by the EU Commission in 2013. At the same time, the EU Commission instituted state aid proceedings to investigate whether the replenishment of the guarantee is consistent with state aid rules.

In these EU state aid proceedings, the European Commission reached a formal decision on 2 May 2016 and thereby finally approved the replenishment of the second loss guarantee issued by the federal states. The decision is based on a catalogue of conditions and commitments provided by the Federal Republic of Germany, on behalf of the federal state owners of HSH Nordbank, to the EU Commission containing the fundamental aspects of the agreement, which include, among other things, the privatisation of HSH Nordbank AG by 28 February 2018 as a central requirement.

The purpose of the structural measures envisaged in the list of conditions and commitments is to improve the financial and risk situation and create the basis for a sustainable structure and viable business model.

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

Further details on the second loss guarantee are set out in Note 3 of the notes to the Group financial statements. Details regarding the impact of the guarantee on the net assets, financial position and earnings in 2017 are set out in the "Economic report" section. Further information on the EU decision can be found in the Business developments section under "Major developments and events" as well as in the "Forecast, opportunities and risks report".

FUTURE OWNERSHIP STRUCTURE

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

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

Membership in the German Savings Banks Finance Group

HSH Nordbank is a member institution of the German Savings Banks Finance Group. The German Savings Banks Finance Group has an institutional guarantee scheme: This scheme protects deposits held at a savings bank, Landesbank or a Landesbausparkasse. The objective of the protection scheme is to protect the member institutions and avert emerging or existing financial difficulties at these institutions.

The Deposit Guarantee Act (EinSiG) entered into force in Germany on 3 July 2015. The Act implements the relevant EU Directive. The German Savings Banks Finance Group has designed its proven protection scheme to meet these statutory requirements, and the scheme has been recognised as a deposit guarantee fund under the EinSiG.

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

External influencing factors and processes

Besides the EU decision and the privatisation that was promised within this context, other relevant material external factors influencing HSH Nordbank's business include economic and financial market developments (movements in the EUR/USD exchange rate, interest rate level, inter alia), developments in the relevant industry sectors such as the shipping industry (particularly charter rates and ship values) or the real estate market, regulatory requirements and discretionary decisions made by the supervisory authorities, external ratings, assessments of capital market participants and other stakeholders, as well as the further course of the privatisation process up until the closing date.

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

OBJECTIVES AND STRATEGY

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

In principle, the Bank's overarching goal is to continually develop its business model, which is firmly rooted in the northern German region. In doing so, it takes into account the requirements resulting from a rapidly changing banking environment on the one hand. On the other hand, the Bank, which will be relieved of legacy burdens, EU restrictions and complex guarantee structures in the future, is focusing on its realignment, the aim being to create a risk-optimised and agile corporate structure. A needs-based service and product portfolio,

which will be continually optimised to meet client needs, and a sustainable high-performance and efficient organisation structure of what will, in the future, be a private bank will form the basis for this. The Bank's individual objectives are embedded in the strategic architecture.

Based on the Bank's mission statement, in which the objectives, strategy, purpose and values are combined in an appropriate framework, HSH Nordbank's strategy architecture includes the following central components:

STRATEGY ARCHITECTURE



The strategic risk framework, which, as a framework document, describes the direction of the Bank's risk management and establishes the foundation for the risk culture, provides consistent guidelines for effectively aligning the organisation and business operations to the basic risk-strategy principles.

The strategic risk framework includes the risk coverage potential (risk capacity), which is determined on the basis of the capital and liquidity resources available, as well as key guidelines for risk-conscious actions on the part of the Bank and the cornerstones of a sustainable risk culture. These provide the framework for the development of the Risk Appetite Statement (RAS) and the risk strategy.

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

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

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

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

The business strategy, which is defined by the Management Board, describes the overriding strategic direction with regard to the business model and business area portfolio of the Bank. This transposes the overall strategic model into a specific strategic direction and plan. It describes the Bank's objectives for each key business activity and the measures to be taken to achieve these objectives. With regard to the intended change of ownership, long-term objectives take the strategic vision of a bank that is established in a private-sector environment into account. The focal point of this strategic direction lies in ensuring sustainable profitability and a sustainable capital structure, ensuring a manageable risk profile, establishing long-standing and solid customer relationships, distributing high-quality financial products and services, as well as pursuing an active cross-selling approach.

The operating business model of HSH Nordbank is undergoing targeted further development in the light of the privatisation process. The narrow framework provided to date by the guarantee structure, the EU proceedings and the catalogue of commitments and conditions will be redefined as a result of the Bank's transition from a public-sector institution to a private bank. This will create new business potential for the strategic areas of the Core Bank and provide opportunities for the Bank to further reduce the complexity of its structure. The business potential will be described for each business area in the context of the business area strategy and backed up by specific implementation measures in the various areas. An essential component for defining strategic goals and monitoring implementation are quantitative performance indicators, which are defined by a bank-wide target system as the basis for measuring performance and the effectiveness of the business strategy.

A consistent risk strategy is determined on the basis of the business strategy and the strategic risk framework. This includes developments in the key business activities planned in the business strategy taking due account of risk strategy factors and liquidity aspects as well as of the measures required to achieve these goals.

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

Functional strategies are defined based on the basis of the Bank's core business strategies. The long-term IT objectives are set in the IT strategy. Developments in the key business activities planned for the business areas and the Bank's digitalisation strategy are also taken into account. The personnel management tools required for the monitoring and support of HSH Nordbank are anchored in the human resources strategy.

Taking account of the business and risk strategy, the lending standards define a binding and comprehensive framework for all parties concerned under which the lending business may be conducted.

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

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

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

Realignment of the Bank

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

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

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

The Bank's competitive realignment in the long term is characterised by strong and solid financial key figures. In this respect, the Bank has defined a strategic target vision. Within this context, the Bank is striving, as part of the realignment process, to achieve a CET1 capital ratio of at least 15% and, following the implementation of the portfolio transaction, an NPE ratio of around 2%. The strategic vision is that the realigned bank will have total assets of around € 55 billion, a cost-income ratio of approximately 40% and profitability before taxes of more than 8%.

Strategic targets of the Core Bank's business fields

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

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

Furthermore, product sales covering the entire range of services over and above traditional lending transactions will continue to be driven forward to strengthen sustainable client relationships and exploit the business potential in the product divisions. This applies, in particular, to the intensification of syndication activities, which should result in an increase in non-interest-related income.

The aim is to intensify new business in the Corporate Clients division. The approach of expanding business throughout Germany in the existing locations will be consistently continued in order to achieve this in a highly competitive market environment. At the same time, the potential in the core region of northern Germany as well as in the project financing business in the Energy & Utilities and Logistics & Infrastructure business areas abroad is to be exploited in a focused manner. In particular with regard to conventional corporate clients, market access is being enhanced further by way of digitalisation strategies.

The Real Estate Clients division will continue to make a risk-conscious contribution to the Bank's balanced portfolio mix taking account of the development in the German real estate markets. The profitability of transactions is the major driver for the sustained

improvement in the Bank's risk/return profile. In the future, the Bank aims to expand cautiously its international activities with established internationally active clients of the Bank in European metropolitan regions.

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

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

The client divisions are generally supported by products and services provided by the Treasury & Markets, Transaction Banking and Structured Finance divisions in order to ensure an integrated product range and exploit cross-selling potential.

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

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

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

Continuous improvement in the Bank's efficiency remains a high priority for HSH Nordbank. It has revised its cost and efficiency targets for the period to 2022 in view of the challenging banking environment with intensive competition and constantly increasing regulatory requirements. Within this context, it also takes into account the requirements resulting from the Bank's realignment. The objective is to achieve a sustainable, competitive cost-income ratio. As a result, HSH Nordbank is aiming to achieve a further reduction in

administrative expenses and a cost/income ratio of around 40% in the medium term.

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

IT STRATEGY

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

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

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

MANAGEMENT SYSTEM

Key value drivers and key indicator and ratio system

The Bank's integrated management system is aimed at the targeted management of key value drivers – income, efficiency/costs and profitability, risk, capital and liquidity – in line with the statutory requirements (SREP, BCBS 239). The Bank uses a risk-adjusted key indicator and ratio system for this purpose that ensures that the Bank is managed in a uniform and effective manner. The HSH Nordbank Group is managed mainly on the basis of figures for the Group prepared in accordance with the International Financial Reporting Standards (IFRS)/the relevant prudential rules.

In addition, a multi-level contribution margin accounting system is also used to manage the individual business fields. Other components of the Overall Bank management system are the annual strategy and planning process, plan/actual comparisons and targets agreement and

assessment process. The key value drivers are managed by three management committees composed of representatives of the top management level. Further information regarding this is included in the Risk Report under “Risk management by central committee structure” and “Risk reporting and measurement systems”.

Management indicators of the IFRS Group

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

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

In addition, the NPE ratio and the coverage ratio will be reported exclusively at Group level in the future. They will no longer be reported for the Non-Core Bank and Core Bank because, following the implementation of the portfolio transaction, an analysis of this ratio broken down into the Non-Core Bank and Core Bank compared with the Group will not provide any significant added informational value. With regard to the liquidity ratios, the Bank is focusing on the regulatory figures: liquidity coverage ratio (LCR) and net stable funding ratio (NSFR). The minimum survival period in the combined stress scenario, which was previously shown among the most important key management indicators, is no longer used as the most important key management indicator within the context of internal control. As far as its most important indicators are concerned, the Bank's internal management of the liquidity situation focuses on the regulatory liquidity ratios LCR and NSFR.

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

DEFINITION OF THE MOST IMPORTANT MANAGEMENT INDICATORS

Most important management indicators	Definitions
Net income before taxes	Net income before taxes is equivalent to the IFRS result generated before deducting tax expense.
CIR = Cost/income ratio	The CIR is a cost efficiency ratio that measures administrative expenses as a percentage of total income plus other operating income.
RoE = Return on equity	RoE is calculated as the ratio of income before taxes to average equity capital disclosed on the balance sheet and shows the return on capital. The risk-adjusted allocation of the average equity capital disclosed on the balance sheet is determined on the basis of the regulatory capital committed.
NPE ratio = Non-performing exposure	The NPE ratio measures the sum of the risk positions (EaD, exposure at default) of borrowers in default as a percentage of the sum of the Bank's risk positions.
Coverage ratio	The coverage ratio is calculated as the quotient of the loan loss provisions (individual valuations allowances and general loan loss provisions) recognised on risk positions and the sum of the risk positions in default.
Pro forma CET1 ratio (phase-in, same period) = Common Equity Tier 1	The CET1 ratio is defined as the quotient of the core Tier 1 capital excluding hybrid instruments and the sum of the risk-weighted assets, expressed as a percentage. The CET1 ratio is determined in the same period calculation (i.e. taking the Group financial statements into account) in accordance with the transitional rules (phase-in) of the Capital Requirements Regulation (CRR). "Pro forma" means that the capital ratio is calculated based on the hypothetical assumption that, for the items included in the reference portfolio for the second loss guarantee, the RWA are recognised in line with the credit risk rules and not in line with the rules regarding securitisation. Within this context, loan loss provisions that have been set up are still recognised in a manner that reduces the capital requirements in line with the regulatory requirements.
LCR = Liquidity coverage ratio	The LCR represents the security provided to the Bank in the event of a short-term acute liquidity stress scenario of more than 30 days by maintaining a liquidity buffer (short-term stress test ratio). The LCR is calculated as the ratio of highly liquid assets to net cash outflows over the next 30 days. It is calculated internally at subgroup level for the purposes of internal control. Unlike in the previous year, the LCR is calculated without taking the institutional protection into account, i.e. taking into account the limit on the deposit guarantee for client deposits of € 100,000 per client.
NSFR = Net stable funding ratio	The NSFR (QIS) shows that stable long-term funding is secured by the Bank under stress conditions. The amount of stable funding available over one year must be sufficient to cover the existing long-term funding required. The NSFR is calculated as the quotient of the amount of available and required stable funding (≥ 1 year). It is calculated at subgroup level for the purposes of internal control.

Based on key value drivers and their important management indicators the following matrix of management indicators shows the key performance indicators relevant for the Core Bank and Non-Core Bank.

MATRIX OF MANAGEMENT INDICATORS

		Group	Core Bank	Non-Core Bank
Income	Net income before taxes	x	x	x
Efficiency and profitability	CIR	x	x	
	RoE	x	x	
Risk	NPE ratio	x	x	x
	Coverage ratio	x		x
Capital	Pro forma CET1 ratio	x		
Liquidity	Survival period	x		
	LCR	x		
	NSFR	x		

HSH Nordbank also uses the following two additional important management indicators for the specific management of the Core Bank and Non-Core Bank.

ADDITIONAL, MOST IMPORTANT MANAGEMENT INDICATORS OF THE CORE BANK AND NON-CORE BANK

Core bank	New business	New business includes, on the one hand, completely new credit risk incurred by the Bank designated as "acquisition of new loan" under the client responsibility of a Market division and, on the other, increases in the existing credit risk designated as a "loan increase" under the client responsibility of a Market division (also where the loan term is prolonged concurrently). Restructuring commitments – also in the case of increases in existing credit risks – are not taken into account in determining new business.
Non-Core Bank	Total assets	Total assets is the sum of the assets on the asset side or the sum of the total capital on the liability side of a balance sheet as at the balance sheet reporting date.

The extent of the indicators used at HSH Nordbank for managing the overall bank goes far beyond the important management indicators listed in this section and includes many other supporting key performance indicators, which are used by management for the purposes of managing and allocating financial resources in an effective and integrated manner. Further details regarding the key figures and ratios used for risk management are set out in the Risk Report.

HSH Nordbank also updated and refined its recovery/resolution plans in accordance with the statutory requirements. The recovery and early warning indicators defined in the German Recovery and Resolution Act (*Sanierungs- und Abwicklungsgesetz, SAG*) and by the EBA (European Banking Authority) are regularly monitored and assessed in order to be able, where necessary, to implement targeted measures on a timely basis.

Management Board remuneration

The remuneration system for the Management Board of HSH Nordbank meets all relevant, regulatory requirements. In addition, particular attention was paid to ensuring that the remuneration system complies with the guarantee agreement of the federal states as well as the catalogue of conditions and commitments imposed by the EU in the initial EU proceedings for the approval of the granting of the second loss guarantee. The limit on the fixed monetary remuneration of each board member of a maximum of € 500,000 per year as long as HSH Nordbank AG is not capable of making dividend distributions is therefore implemented in the remuneration system. The options provided for in the EU decision of May 2016 regarding the adjustment of Management Board compensation were not used. The Management Board has unilaterally waived until further notice the granting of a success bonus following successful privatisation, which was granted to the Supervisory Board as part of the EU decision of May 2016.

General agreements have not been concluded for the early termination of a Management Board member's contract without good cause. However, it is contractually agreed that – in accordance with Section

4.2.3 of the German Corporate Governance Code – any agreed payments to a departing member of the Management Board may not exceed the value of two years' fixed annual salary (including fringe benefits) and the total of the fixed salary for the remaining term of the employment period.

In the year under review, no member of the Management Board received payments or promises of payment from a third party in respect of their activities as a Management Board member. The same also applies to payments or promises of payment from companies, with which HSH Nordbank maintains significant business relationships.

Further information on Management Board remuneration is set out in Note 65 (Related parties).