DIRECTORS' REPORT

For the year ended December 30, 2017

Corporate Governance

HSH N Funding II (the "Company"), was incorporated on May 26, 2005 as an exempted company with limited liability under the laws of the Cayman Islands. The Company is a wholly owned subsidiary of HSH Nordbank AG (the "Bank") which also provides one out of the three current directors to the Company. The financial results of the Company are consolidated within the Bank's financial statements. The Company does not have any employees. Its day-to-day administration is delegated to MaplesFS Limited, an independent service organization, which also provides two directors to the Company from its employees for a fixed annual fee.

The Directors of the Company who held office during the period are as follows:

Cleveland Stewart (independent) (appointed September 3, 2008)
Laura Chisholm (appointed January 29, 2013).

The Directors held no interests in the Company as at April 30, 2018.

Activities and Review of the Development of the Business

The business of the Company is principally limited to the issuance of two classes of preference shares and the investment of the proceeds thereof. The terms of the Company's asset classes are similar to the terms of the Class A Preference Shares and Class B Preference Shares issued and as a result, all cash flows received are passed through or attributed to the holders of those preference shares. The value of both classes of preference shares in issue as at December 30, 2017 amounted to US$966,989,951 (December 2016 US$1,040,799,194)

The principal risks the Company faces include (i) credit risk within the various asset classes, mainly the counterparty risk associated with the Bank, and (ii) liquidity risk because an illiquid secondary market could have an adverse effect on the value of the Company's assets and consequently the holders of preference shares. The direct exposure to market risk including changes in interest rates and foreign exchange rates is not significant.

The Company earned US$36,276,800 (December 30, 2016: US$36,276,800) as scheduled interest income from its asset classes during the period and paid dividends on the Class B Preference Shares of NIL (December 30, 2016: NIL).

It is not intended that the business of the Company will diversify. The Company does not engage in the field of research and development.

Impairment of financial assets

On February 6, 2013, an announcement was made by HSH Nordbank relating to financial planning which will result in net losses for the business years 2013 and 2014. The financial results from the years 2017 to 2020 will then be used to write up hybrid instruments to par value. Therefore in the Company's opinion, no such loss events have occurred during the year ended December 31, 2014 or subsequently and the reductions in the nominal amount of the Silent contribution are not considered to be permanent. Also the non-payment of coupons is not considered to be an impairment trigger as there is no obligation to pay such coupons in the event that HSH Nordbank has insufficient distributable profits. Accordingly, no impairment is required to be recognised on the Company's investment in the Silent contribution. On June 8, 2017, the Bank announced that the next coupon payment on Silent contributions will only take place in the year 2020 for the fiscal year 2019. However, on February 28, 2018, a share purchase agreement was signed whereby the shares of the Bank were sold to a consortium of private equity investors and the next coupon payment is now expected to take place in the year 2024 for the fiscal year 2023.

Going Concern

Due to the limited recourse nature of the Company's contractual arrangements, the Directors of the Company are of the opinion that the Company will be able to pay its debts as they fall due. Therefore, the financial statements have been prepared on a going concern basis, notwithstanding the current financial position of the Company and the carrying values of the Company's asset classes which were predominantly issued by the Bank. It is noted that if any conditions precedent to the proposed sale of the Bank are not met then the Bank will cease new business and manage its assets with the aim of winding down the business.

Results and Allocation

The Company reported a profit for the period of US$73,555,322 (December 30, 2016: US$31,707,786) and issued NIL Class A Preference Shares.

All potential profit or losses which may crystallize as a result of the Company holding or realizing its asset classes will be attributed to the holders of the preference shares and not to the Company itself.

Management's Statement of Responsibility for Financial Reporting

The financial statements of the Company have been prepared by management. Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies or making accounting estimates that are reasonable in the circumstances.

Statement on True and Fair View

The Directors of the Company state that, to the best of their knowledge:

- the unaudited financial statements dated as at April 30, 2018, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and

- this report gives a true and fair view of the state of affairs of the Company as at the balance sheet date and of the course of affairs during the financial period of the Company together with a description of the principal risks the Company faces.

For and on behalf of the Board of Directors of the Company on 30 April, 2018

____

Cleveland Stewart, Director

Financial Statements of

HSH N FUNDING II

December 31, 2017

HSH N FUNDING II

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KPMG

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Independent Auditors' Report to the Directors

Opinion

We have audited the financial statements of HSH N Funding II (the "Company"), which comprise the statement of financial position as at December 31, 2017, the statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2017, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRS").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the "*Auditors' Responsibilities for the Audit of the Financial Statements*" section of our report. We are independent of the Company in accordance with International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants ("IESBA Code") together with ethical requirements that are relevant to our audit of the financial statements in the Cayman Islands, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Notes 1 and 7 of the financial statements which describe that the Company is economically dependent on HSH Nordbank AG (the "Bank") and that the ability of the Company to continue as a going concern is directly impacted by the financial position of the Bank. The Bank's ability to continue as a going concern and support the Company is dependent on a number of factors as described in Note 1 to the financial statements. Our opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

In arriving at our audit opinion above on the financial statements the key audit matter that had most significance in our audit was as follows:

Independent Auditors' Report to the Directors (continued)

Valuation of Silent Contribution [US$ 260,413,608 (2016: US$ 113,639,179)] and Class B preference shares [US$ 321,955,951 (2016: US$ 395,765,194)]

Refer to pages 15 to 16 (accounting policy) and note 3 and 5 (financial disclosures).

Description of key audit matter	***How the matter was addressed in our audit***
The Silent Contribution is measured at fair value by management. Management uses a discounted cash flow model to determine the fair value of the Silent Contribution. Class B preference shares are measured at amortised cost plus adjustments with respect to the application of IAS39.AG8. Refer to note 1 of the financial statements for an understanding of the structure of the Company and these Financial Instruments and note 2 for the related accounting policies. There is a significant risk relating to the valuation of these Financial Instruments given the judgemental nature of the matters that require consideration by management.	Our procedures included: • Assessing whether the valuation of the Financial Instruments were prepared using procedures, processes and techniques which are sufficient and appropriate; • Challenging the material assumptions used by management in the valuation of the Financial Instruments based on our knowledge of the Company, the Bank and publically available external data sources; • Re-performing the calculations which support the valuation of the Financial Instruments; • Considering the accuracy of fair value disclosures. No material exceptions were noted as part of our testing.

Other Information

Management is responsible for the other information. The other information comprises the information included in the supplemental unaudited information, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

KPMG

Independent Auditors' Report to the Directors (continued)

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. 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 financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgement and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, 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 opinion. 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 control.
- Obtain an understanding of internal control relevant to the audit 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 the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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 relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, 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 financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is Luke Murray.

KPMG

April 30, 2018

HSH N FUNDING II

Statement of Financial Position

December 31, 2017
(stated in United States dollars)

	Note	2017	2016
Assets			
Available-for-sale financial assets			
Silent Contribution	3,7,8	260,413,608	113,639,179
Loans and receivables			
Loan receivable	4,7,8	553,000,000	553,000,000
Interest receivable	4,7,8	9,069,200	-
Cash and cash equivalents	7,8	203,594	9,272,794
Total assets	US$	822,686,402	675,911,973
Liabilities and Equity			
Liabilities			
Class B preference shares	5,8	321,955,951	395,765,194
Other liabilities		1,528	1,528
		321,957,479	395,766,722
Equity			
Share capital	6	10,000	10,000
Class A preference shares	6	645,034,000	645,034,000
Revaluation reserve	2(c)(viii)	(178,203,088)	(361,507,238)
Retained earnings/(accumulated loss)		33,888,011	(3,390,511)
		500,728,923	280,145,251
Total liabilities and equity	US$	**822,686,402**	**675,911,973**

See accompanying notes to financial statements.

Approved on behalf of the Board of Directors on April 30, 2018

LAURA CHISHOLM

__________________________Director

CLEVELAND STEWART

__________________________Director

HSH N FUNDING II

Statement of Comprehensive Income

For the year ended December 31, 2017
(stated in United States dollars)

	Note		2017	2016
Income				
Net change in revised discounted cash flows (Silent Contribution)	2(c)(viii),3		(36,530,721)	22,255,099
Interest income on loan	4,7		36,276,800	36,276,800
			(253,921)	58,531,899
Finance costs				
Net change in revised discounted cash flows (Class B preference shares)	2(c)(viii),5		(73,809,243)	26,824,113
			(73,809,243)	26,824,113
Net income for year		US$	73,555,322	31,707,786
Other comprehensive loss				
Net change in fair value of available-for-sale financial assets	2(c)(viii),3		183,305,150	(59,484,049)
			183,305,150	(59,484,049)
Comprehensive income/(loss) for the year		US$	256,860,472	(27,776,263)

See accompanying notes to financial statements.

HSH N FUNDING II

Statement of Changes in Equity

For the year ended December 31, 2017
(stated in United States dollars)

		Note	Share Capital	Class A Preference Shares	Revaluation Reserve	Retained Earnings /(Accumulated losses)	Total
Balance at January 1, 2016	US$		10,000	645,034,000	(302,024,189)	1,178,503	344,198,314
Net income for year			-	-	-	31,707,786	31,707,786
Class A dividend paid		6(a)i	-	-	-	(36,276,800)	(36,276,800)
Net change in fair value of available-for-sale financial assets		3	-	-	(59,484,049)	-	(59,484,049)
Balance at December 31, 2016	US$		10,000	645,034,000	(361,508,238)	(3,390,511)	280,145,251
Net income for year			-	-	-	73,555,322	73,555,322
Class A dividend paid		6(a)i	-	-	-	(36,276,800)	(36,276,800)
Net change in fair value of available-for-sale financial assets		3	-	-	183,305,150	-	183,305,150
Balance at December 31, 2017	US$		10,000	645,034,000	(178,203,088)	33,888,011	500,728,923

See accompanying notes to financial statements.

HSH N FUNDING II

Statement of Cash Flows

For the year ended December 31, 2017
(stated in United States dollars)

		2017	2016
Cash provided by/(applied in):			
Operating activities			
Net income for year		73,555,322	31,707,786
Add/(deduct) net changes in non-cash operating balances:			
Net change in revised discounted cash flows (Class B preference shares)		(73,809,243)	26,824,113
Net change in revised discounted cash flows (Silent Contribution)		36,530,721	(22,255,099)
Movements in:			
Interest receivable		(9,069,200)	-
Increase in cash and cash equivalents during year		27,207,600	36,276,800
Financing activities			
Class A dividends paid		(36,276,800)	(36,276,800)
Decrease in cash and cash equivalents during year		(9,069,200)	-
Cash and cash equivalents at beginning of year		9,272,794	9,272,794
Cash and cash equivalents at end of year	US$	203,594	9,272,794
Supplementary information on cash flows from operating activities:			
Interest received		27,207,600	36,276,800

1. Incorporation and background information

HSH N Funding II ("the Company") was incorporated on May 26, 2005 as an exempted company with limited liability under the laws of the Cayman Islands for the purpose of carrying on business as an investment company. The Company is a wholly owned subsidiary of HSH Nordbank AG (the "Bank"). The financial results of the Company are consolidated by the Bank.

The objectives for which the Company has been established are limited by the Memorandum of Association to entering into transaction documents and exercising its rights and performing its obligations in connection therewith. The Company issued 500,000 Class B preference shares in the aggregate nominal amount of US$500,000,000 to Banque de Luxembourg, a société anonyme incorporated in Luxembourg (the "Fiduciary") and used the proceeds to acquire a silent capital interest in the commercial enterprise (*Handelsgewerbe*) (the "Participation") of the Bank in the form of a *Stille Gesellschaft* pursuant to an agreement providing for an asset contribution to the Bank in the amount of US$500,000,000 (the "Silent Contribution") and dated June 17, 2005 (the "Participation Agreement").

The Fiduciary financed the purchase of Class B preference shares with proceeds from issuance of US$500,000,000 HSH Nordbank Silent Participation Hybrid Equity Regulatory (SPHERE) Securities in the denomination of US$1,000 (the "SPHERE Securities") on a fiduciary basis at 100% of the principal amounts. The Fiduciary acquired the Class B preference shares at the sole risk of the holders of the SPHERE Securities. The SPHERE Securities are listed on the Euronext Amsterdam Exchange. The Bank has entered into a support undertaking agreement with the Fiduciary that the Company will at all times be in a position to meet its dividend obligations under the Class B preference shares if and when due as contemplated in the Company's Memorandum and Articles of Association.

Going concern

The ability of the Company to continue as a going concern is directly linked to the same assumption being applicable at the Bank level. The financial accounting and measurement in these financial statements are based on the assumption that the Bank is a going concern. The Bank's corporate planning forms the basis for the going concern assumption.

Bank corporate planning

At the Bank level, the basis for the corporate planning and in particular the planning for the movement in loan loss provisions take information available to it at this point in time into account. These assessments are dependent on factors that are mostly outside the control of the Bank and are therefore subject to a significant degree of uncertainty. By way of an example, material uncertainty factors with regard to the development of loan loss provisions include the development of the relevant market parameters such as freight and charter rates, ship values, the US dollar exchange rate and changes regarding macroeconomic trends.

1. Incorporation and background information (continued)

One key assumption used in the Bank's corporate planning in view of the ongoing sale process of the Bank is that the outstanding conditions for the closing of the privatisation transaction are fulfilled and that the privatisation process is completed successfully as a result.

Simultaneously with the successful conclusion of the share purchase agreement, the Bank concluded an agreement on the sale of an extensive portfolio consisting largely of non-performing loans (in particular ship financing) to a special-purpose entity from the sphere of the investors (the portfolio transaction). The closing of the portfolio transaction is subject, first of all, to the approval of the German Federal Cartel Office (Bundeskartellamt) and also depends on the closing of the share purchase agreement.

The successful execution of this portfolio transaction and the associated reduction in the non-performing exposure ratio are key assumptions used in the Bank's corporate planning over and above successful privatization.

A further significant assumption with regard to corporate planning is the termination of the Sunrise guarantee. In light of the privatisation, the Bank and HSH Beteiligungs Management GmbH reached an agreement with HSH Finanzfonds AöR on the premature termination of the agreement on the provision of a guarantee facility in return for a compensation payment made by the Bank to HSH Finanzfonds AöR in an amount of € 100 million (cancellation agreement). As a result, the corporate planning assumes that, taking into account the settlement procedures set out in the cancellation agreement, the entire guarantee facility of €10 billion will be drawn down by the Bank and paid by the guarantor to the Bank. The implementation of the cancellation agreement is also subject to the condition precedent of the successful closing of the share purchase agreement, corresponding notification sent to the parties to the portfolio transaction and, as a result, to the condition precedent of the closing of the portfolio transaction.

As it is not, however, possible to objectively predict the course and outcome of the privatisation process, the privatisation process involving the Bank creates significant uncertainty regarding the implementation of the corporate planning, as well as accounting and measurement, based on the assumption that the business activities are continued.

The assumption of the Bank as a going concern for accounting and measurement purposes and the assumption of the continued going concern of the Bank and significant group companies is based, in particular, on the share purchase agreement concluded on February 28, 2018, in which HSH Beteiligungs Management GmbH sold 94.9 % of the shares in the Bank to various funds of Cerberus European Investments LLC, J.C. Flowers & Co. LLC, Golden Tree Asset Management L.P., Centaurus Capital LP and BAWAG P.S.K. AG (hereinafter referred to as the "bidders") being closed and implemented.

1. Incorporation and background information (continued)

This is subject, in particular, to the proviso that:

- the necessary approvals are granted by the competent competition authorities, in particular in Germany and Austria,

- the federal state parliaments in Hamburg and Schleswig-Holstein approve the share purchase agreement,

- the competent banking supervisory authority (European Central Bank (ECB), German Federal Financial Supervisory Authority (BaFin) and Commission de Surveillance du Secteur Financier (CSSF Luxembourg) grants the necessary approvals,

- the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure,

- the German Savings Banks Association (DSGV) confirms that the Bank 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),

- HSH Finanzfonds AöR submits a final settlement report on the second loss guarantee granted by HSH Finanzfonds AöR and

- the bidders pay the portion of the purchase price attributable to them on the closing date.

If any of the conditions set out above for the closing of the share purchase agreement are not met, and if no agreement can be reached between the parties involved in each case, in particular if the EU Commission reaches the conclusion, in the course of its viability review, that the planned new corporate structure will not lead to a business model that is profitable in the long term, then the Bank will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event that the Bank is wound down as a result of the above or for other reasons, or if its rating is downgraded or other adverse developments emerge, then this could trigger outflows of short-term funds and fundamentally restrict the Bank's funding options. In the case of major unexpected fund outflows, additional measures will need to be taken by the owners and/or third parties to strengthen the liquidity situation.

It is further required that acceptance by market participants and other relevant stakeholders necessary for the successful implementation of the Bank's future business model is maintained or gained.

2. Significant accounting policies

These financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS"). The accounting policies have been applied consistently by the Company. Significant accounting policies and their effect on the financial statements are as follows.

(a) Use of estimates

The preparation of financial statements in accordance with IFRS requires management to make estimates and assumptions that affect the application of accounting policies and the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of income and expenses during the year. Actual results could differ from those estimates. The disclosures in accordance with IAS 1.125 are made (additionally to the information provided in this note) in notes 3, 5, 8 and 9.

(b) Profit participation under the Participation Agreement, interest income, Class B dividends and Class A dividends

Profit participation under the Participation Agreement and interest income are recognised on an accruals basis. Class A and Class B dividends are recognised in accordance with the Articles of Association.

(c) Financial instruments

(i) Classification

A financial asset is any asset that is cash, a contractual right to receive cash or another financial asset, or to exchange financial instruments with another enterprise under conditions that are potentially favorable or an equity instrument of another enterprise. Financial assets comprise cash and cash equivalents, Interest Receivable, Silent Contribution and loan receivable.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset or to exchange financial instruments with another enterprise under conditions that are potentially unfavorable. Financial liabilities comprise Class B preference shares and other liabilities.

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(i) Classification (continued)

Financial assets that are classified as loans and receivables include cash and cash equivalents and loan receivable.

The Company has classified its investments in Silent Contribution as available-for-sale. Available-for-sale assets are those that are not held for trading purposes and which may be sold in response to needs for liquidity, changes in interest rates, exchange rates, rating changes or significant decreases in credit quality. All financial liabilities are classified as financial liabilities measured at amortized cost. The Company classifies financial instruments issued as financial liabilities or equity instruments in accordance with the substance of the contractual terms of the instruments. Please see note 11 of the financials for the impact on classification and measurement of financial assets and liabilities upon adoption of IFRS 9 on January 1, 2018.

(ii) Recognition

The Company recognizes financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instrument.

(iii) Measurement

Financial instruments are measured initially at cost which is the fair value of the consideration given or received.

Subsequent to initial recognition all financial assets that are classified as loans and receivables, are measured at their amortized cost using the effective interest rate method, less impairment losses, if any. All financial instruments classified as available-for-sale assets are measured at fair value.

All financial liabilities are subsequently measured at amortized cost, being the amount at which the liability was initially recognized less any principal repayments plus any amortization (accrued interest) of the difference between that initial amount and the maturity amount.

IAS 39.AG8 prescribes that the carrying amount of financial assets or liabilities shall be adjusted if an entity revises its estimates of payments or receipts. As of December 31, 2009 IAS 39.AG8 was applicable for the first time for the Silent Contribution and the Class B preference shares and affected the carrying value of these financial instruments as at that date.

The recalculated carrying amounts as at December 31, 2009, resulted initially from computing the present value of estimated future interest and redemption cash flows at the financial instruments' original effective interest rate. In subsequent periods, estimates are revised leading to a write-up or write-down of the financial instruments.

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(iii) Measurement (continued)

The related net income or expense is recognized in the statement of comprehensive income (see notes 3 and 5).

Applying IAS 39.AG8 involves substantial assumptions, which are accompanied by uncertainties. These uncertainties are described in paragraph (iv) of this note.

(iv) Determination of Fair Values

The determination of fair values for certain financial instruments is for the sole purpose to present the respective information in note 8 of these financial statements.

Fair Value is defined in accordance with IAS 39 as the price at which a financial instrument can be traded between two informed, willing and independent parties who are under no obligation to deal.

The fair value of financial instruments is determined on the basis of the listed prices on an active market (mark-to-market), or if this is not possible on the basis of recognized valuation techniques and models (mark-to-matrix or mark-to-model).

The mark-to-market method is used if a market price is available at which a transaction could be performed or has been performed. This is generally the case for securities traded on liquid markets. The mark-to-matrix method is used to determine fair value where no market price is available under the mark-to-market method. If a fair value cannot be determined from the market or transaction prices of a financial instrument, either it is derived from the prices of comparable financial instruments or a model valuation is conducted with parameters that are almost completely observable in the market. This method has been applied to measure the fair value of the Class B Shares as well as the fair value of the Silent Contribution. These financial instruments are linked to the listed SPHERE securities, which are listed on the Stock Exchange in Amsterdam.

The fair value is determined by the mark-to-model valuation using a suitable model if a valuation cannot be derived, either of adequate quality or at all, using the mark-to-market or mark-to-matrix method.

The fair value of the Loan Receivable is determined by discounting contractual cash flows taking into account rating-related spreads.

(v) Derecognition

The Company derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the financial asset and the transfer qualifies for derecognition in accordance with IAS 39. A financial liability is derecognized when the obligation specified in the contract is discharged, cancelled or expired.

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(v) Derecognition (continued)

The Company uses the specific identification method to determine gains or losses on derecognition for financial assets that are sold.

(vi) Impairment of financial assets

In accordance with IAS 39, a financial asset is assessed as at each reporting date to determine whether there is any objective evidence that it is impaired. Such evidence that a financial asset is impaired includes observable data that may come to the attention of the Company about any of the following examples of loss events: significant financial difficulty of the issuer or obligor; a breach of contract, such as a default of delinquency in interest of principal payments, granting to the borrower a concession that the lender would not otherwise consider; it becomes probable that the borrower will enter bankruptcy, administration or other analogous financial reorganisation; or, the disappearance of an active market for that financial asset because of financial difficulties.

If in a subsequent period the amount of an impairment loss decreased and the decrease can be objectively related to an event occurring, after the write-down, the write-down is reversed through the statement of comprehensive income.

On February 6, 2013, an announcement was made by the Bank relating to financial planning which will result in net losses for the business years 2013 and 2014. The financial results from the years 2017 to 2020 will then be used to write up hybrid instruments to par value. Therefore in the Company's opinion, the reductions in the nominal amount of the Silent contribution are not considered to be permanent. Also the non-payment of coupons is not considered to be an impairment trigger as there is no obligation to pay such coupons in the event that the Bank has insufficient distributable profits. Accordingly, no impairment is required to be recognised on the Company's investment in the Silent contribution. On June 8, 2017, the Bank announced that the next coupon payments on Silent Contributions will only take place in the year 2020 for the fiscal year 2019. However, as further outlined in note 12, the next coupon date is now expected to take place in the year 2024 for the fiscal year 2023.

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(vii) Fair value disclosures

IFRS 7 outlines disclosures to be made with respect to fair value measurements within the financial statements. All financial instruments designated at fair value are categorised with a three-level hierarchy that reflects the significant of inputs used in measuring fair values. The fair value hierarchy is as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quotes prices included with Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: inputs for the asset or liability that are based on observable market data (unobservable inputs).

Specific disclosures are required when fair value measurements are categorised as Level 3 in the fair value hierarchy. Furthermore, changes in valuation techniques from one period to another, including the reasons therefore, are required to be disclosed for each class of financial instruments.

(viii) Specific instruments

Cash and cash equivalents
For the purposes of the statement of cash flows, cash and cash equivalents includes current accounts with original maturities of three months or less.

Silent Contribution
Available-for-sale assets are those that are not held for trading purposes and which may be sold in response to needs for liquidity, changes in interest rates, exchange rates, rating changes or significant decreases in credit quality. The Silent Contribution is classified as available-for-sale assets.

It is measured initially at cost which is the fair value of the consideration given and subsequently measured at and presented in the statement of financial position at fair value. The Silent Contribution is adjusted in accordance with the requirements of IAS 39.AG8 (note 2(c)(iii)). Accrued profit participations and the net result from the application of IAS 39.AG8 are recognized in the statement of comprehensive income. The remaining unrealized gains and losses arising from a change in fair value of available-for-sale instruments are recognized in other comprehensive income and presented within equity in the revaluation reserve. The inputs for the calculation of the Silent Contribution are based upon observable market data and accordingly the asset is categorized as a level 2 investment in the fair value hierarchy.

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(viii) Specific instruments (continued)

Pursuant to the EU Commission's requirements, the Bank is not permitted to make any payouts on profit participation capital and silent partnerships due to the Bank's net loss or balance sheet loss. In case of a successful completion of the privatization procedure, the Bank expects to pay dividends as well as distributions under the hybrid capital instruments. On June 8, 2017, the Bank announced that the next coupon payments on Silent Contributions will only take place in the year 2020 for the fiscal year 2019. However, as further outlined in note 12, the next coupon date is now expected to take place in the year 2024 for the fiscal year 2023.

Loan receivable
Loan receivable is subsequently measured at amortized cost, being the amount at which the loan receivable is measured at initial recognition minus principal repayments, and minus any write down for impairment or uncollectibility. The loan receivable is interest bearing with interest income being recognized in the statement of comprehensive income.

Class B preference shares
Class B preference shares are classified as a financial liability according to IAS 32.11 (a) and measured at amortised cost plus adjustments required to comply, if any with the requirements of IAS 39.AG8 (note 2(c)(iii)). Dividends on Class B preference shares and the net result from the application of IAS 39.AG8 are recognised as interest expense in the statement of comprehensive income as accrued.

According to IAS 39.10 embedded derivatives shall not be separated from the host contract and accounted for as a derivative if the value of the derivative would change in response to a non-financial variable that is specific to a party. The value of the Class B preference shares vary in response to a non-financial variable linked to the performance of the Bank.

(d) Offsetting

Financial assets and liabilities are offset and the net amount reported in the statement of financial position when a signed agreement clearly defines the enforceable right of the Company and another party to settle on a net basis or realize the asset and settle the liability simultaneously.

3. Silent Contribution

The Company acquired a silent capital interest in the aggregate amount of US$500,000,000 (2016: US$500,000,000) in the commercial enterprise of the Bank in the form of the Participation pursuant to the Participation Agreement dated June 17, 2005, providing for an asset contribution to the Bank in the amount of US$500,000,000 (2016: US$500,000,000).

(stated in United States dollars)

3. Silent Contribution (continued)

The Participation Agreement has no fixed redemption date and may only be redeemed when terminated by the Bank. The Bank may, if tax or regulatory changes occur, terminate the Participation Agreement only after providing two years notice thereof and approval therefore has been given by the German Banking Supervisory Authority. The Company shall be entitled to Profit Participations on the nominal contribution amount at a fixed rate of 7.25% p.a.

Pursuant to terms of the Participation Agreement profit participations will accrue on the principal amount for each fiscal year of the Bank or part thereof. No profit participations accrue to the extent payment thereof would lead to or increase an annual balance sheet loss, if there has occurred a reduction which has not yet been fully restored, in the case of regulatory interventions or if the termination date falls within such period.

The Company may share in the losses of the Bank after allocation to/from its reserves and retained earnings up to the principal amount of the Silent Contribution. Any such losses will reduce the principal amount of the Silent Contribution. If at any time, the principal amount of the Silent Contribution is reduced on account of a loss, the principal amount of the Silent Contribution will be re-credited in the years subsequent in which profits are recorded, provided that at no time shall the principal amount of the Silent Contribution be more than the principal amount of the Silent Contribution on the date of the Participation Agreement.

At December 31, 2017 the fair value of the level 2 investments, comprising solely of the Silent Contribution, was US$260,413,608 (2016: US$113,639,179).

	Silent contribution USD	Accrued profit participation USD	Net results from revised discounted cash flows USD	Fair value adjustments USD	Total USD
Balance at January 1, 2016	500,000,000	92,034,722	(139,142,404)	(302,024,189)	150,868,129
Profit participation for the year	-	-	-	-	-
AG.8 and fair value movements	-	-	22,255,099	(59,484,049)	(37,228,950)
Balance at December 31, 2016	500,000,000	92,034,722	(116,887,305)	(361,508,238)	113,639,179
Profit participation for the year	-	-	-	-	-
AG.8 and fair value movements	-	-	(36,530,721)	183,305,150	146,774,429
Balance at December 31, 2017	500,000,000	92,034,722	(153,418,026)	(178,203,088)	260,413,608

(stated in United States dollars)

4. Loan receivable

On June 17, 2005 the Company entered into a term loan agreement, (the "Loan Agreement") with the Bank under which the Company has made a US$553,000,000 term loan facility in the form of a German law governed *Schuldscheindarlehen* available to the Bank.

Interest is charged on the loan at a rate of 6.56% p.a. and the loan will mature on December 31, 2036. At December 31, 2017 the balance of interest receivable was US$ 9,069,200 (2016: US$ Nil)

5. Class B preference shares

The Company issued 500,000 Class B preference shares to the Fiduciary. The purchase was funded from the issuance of US$500,000,000 SPHERE Securities.

At December 31, 2017 the balance of the Class B preference shares was US$ 321,955,951 (2016: US$395,765,194) comprising the initially issued amount of US$500,000,000 and the net adjustments due to IAS 39.AG8 of US$(178,044,049) (2016: US$(104,234,806)).

	Class B preference shares USD	Net results from revised discounted cash flows USD	Total USD
Balance at January 1, 2016	500,000,000	(131,058,919)	368,941,081
Result of revised discounted cash flows for the year	-	26,824,113	26,824,113
Balance at December 31, 2016	500,000,000	(104,234,806)	395,765,194
Result of revised discounted cash flows for the year	-	(73,809,243)	(73,809,243)
Balance at December 31, 2017	500,000,000	(178,044,049)	321,955,951

5. Class B preference shares (continued)

Rights attaching to Class B preference shares:

i. Each Class B preference shareholder has a right to receive an annual dividend on each Class B preference share held, calculated, declared and paid based on the specification in the Articles of Association. Dividends are paid in cash.

ii. On winding–up of the Company or other return of capital (other than purchase or redemption of Class B preference shares), the Class B preference shareholders will be entitled to share in the Company's rights to interest accrued under the Loan Agreement, repayment amount under the Participation Agreement, interest on the repayment amount and the Company's rights to funding of the Luxembourg gross-up amount (the "Class B Ring-Fenced Assets"). No other holders of shares in the Company will be entitled to the Class B Ring-Fenced Assets. If the value of claims of the Company's creditors exceed the Company's assets (minus the Class A Ring-Fenced Assets and the Class B Ring-Fenced Assets), the rights of the Class B preference shareholders in the assets of the Company will rank junior to the rights of Class A preference shareholders up to an amount equal to the sum of the loan repayment amount under the Loan Agreement (plus amounts which have actually been received thereunder and minus amounts which have been received and passed on to Class A preference shareholders), but senior to the holders of other shares in the Company up to an amount equal to the Class B Ring-Fenced Assets (plus amounts which have actually been received thereunder and minus amounts which have been received and passed on to Class B preference shareholders).

iii. The Class B preference shareholders shall be entitled to receive notice of general meetings of the Company but shall not be entitled to attend and vote thereat.

iv. The Company will, forthwith upon becoming aware that the Class B preference shares will be redeemed, notify the Class B preference shareholders of (A) the date on which they will be redeemed, and (B) the amount of payment in cash.

v. The Company shall make all payments to the Class B preference shareholders pursuant to terms of the Articles of Association without any tax deduction, unless a tax deduction is required by law.

(stated in United States dollars)

6. Share capital

		2017	2016
Authorised:			
10 Ordinary Shares of US$1,000 each		10,000	10,000
1,050,000 Class A preference shares of US$1,000 each		1,050,000,000	1,050,000,000
	US$	1,050,010,000	1,050,010,000
Issued and fully paid:			
10 Ordinary Shares of US$1,000 each	US$	10,000	10,000

During the year ended December 31, 2017 and 2016, there were no changes to issued and fully paid Ordinary Shares.

Rights attaching to Ordinary shares:

i. Income: Each Ordinary Shareholder has right to receive such profits of the Company available for distribution as determined by the Directors after the payment to the Preference Shares of their dividends.
ii. Capital: On a winding-up or other return of capital, the holder of each Ordinary Share shall be entitled, following payment to the holders of the Preference Shares, to repayment of the nominal amount of the capital paid-up thereon and thereafter any surplus then remaining shall be distributed pari passu among the holders of the Ordinary Shares.
iii. Voting: Each Ordinary Shareholder has right to receive notice of general meetings of the Company and to attend and to vote thereat either in person or proxy.

Issued and fully paid Class A preference shares:

	2017 Number of shares	2017 US$	2016 Number of shares	2016 US$
Balance at beginning of year	645,034	645,034,000	645,034	645,034,000
Balance at end of year	645,034	645,034,000	645,034	645,034,000

6. Share capital (continued)

Rights attaching to Class A preference shares:

i. Each Class A preference shareholder has a right to receive annual interim and final dividends on each Class A preference share held calculated based on the Articles of Association. Interim dividends are not paid by cash but by issue of such number of Class A preference shares, the aggregate par value of which equals the amount of such declared interim dividend. Final dividends are paid in cash.

ii. On winding–up of the Company or other return of capital (other than purchase or redemption of Class A preference shares), the Class A preference shareholders will be entitled to share in the Company's rights to the loan repayment amount under the Loan Agreement (the "Class A Ring-Fenced Assets"). No other holders of shares in the Company will be entitled to the Class A Ring-Fenced Assets. If the value of claims of the Company's creditors exceed the Company's assets (minus the Class A Ring-Fenced Assets and the Class B Ring-Fenced Assets), the rights of the Class A preference shareholders in the assets of the Company will rank senior to the rights of holders of other shares in the Company, up to an amount equal to the Class A Ring-Fenced Assets (plus amounts which have actually been received there under and minus amounts which have been received and passed on to Class A preference shareholders).

iii. The Class A preference shareholders shall be entitled to receive notice of general meetings of the Company and shall be entitled to vote thereat.

iv. Class A preference shares may only be redeemed contemporaneously with redemption of the Class B preference shares or after the Class B preference shares have been redeemed. Class A preference shares may be redeemed at the option of the Class A preference shareholder or the Company by notice to the other. The Class A preference shares will be redeemed in an amount equal to the loan repayment amount under the Loan Agreement and aggregate profit participations under the Participation Agreement. The Company may set off its obligation to pay cash dividends in accordance with the terms of the Articles of Association against obligations owing to the Company by the Class A preference shareholder in respect of interest accrued and due but unpaid under the Loan Agreement.

(stated in United States dollars)

7. Related party balances and transactions

The Company is controlled by the Bank, which is considered as related party.

The following transactions and balances with the bank are disclosed below:

	Note	2017	2016
Statement of Financial Position:			
Silent Contribution	3	260,413,608	113,639,179
Loan receivable	4	553,000,000	553,000,000
Interest receivable	4	9,069,200	-
Cash and cash equivalents		203,594	9,272,794
Statement of Comprehensive Income:			
Interest income on loan	4	36,276,800	36,276,800

The Bank's audited financial statements for the year end December 31, 2017 and 2016 contain an emphasis of matter paragraph in the audit opinion regarding the Bank's ability to continue as a going concern.

8. Disclosure of Fair Values in Accordance with IFRS 7

For each financial asset and liability, the fair values are disclosed and compared with the respective carrying amount (IFRS 7.25):

December 31, 2017	Note	Carrying Amount	Fair Value	Difference
Silent Contribution	3	260,413,608	260,413,608	-
Loan Receivable	4	553,000,000	708,396,234	155,396,234
Interest Receivable	4	9,069,200	9,069,200	-
Cash and cash equivalents		203,594	203,594	-
Class B preference shares	5	321,955,951	260,060,000	(61,895,951)
Other Liabilities		1,528	1,528	-

(stated in United States dollars)

8. Disclosure of Fair Values in Accordance with IFRS 7 (continued)

December 31, 2016	Note	Carrying Amount	Fair Value	Difference
Silent Contribution	3	113,639,179	113,639,179	-
Loan Receivable	4	553,000,000	714,517,374	161,517,374
Cash and cash equivalents		9,272,794	9,272,794	-
Class B preference shares	5	395,765,194	115,110,000	(280,655,194)
Other Liabilities		1,528	1,528	-

9. Credit, liquidity and market risk

The Company's investment activities expose it to various types of risk that are associated with the financial instruments and markets in which they invest. The most significant type of financial risk to which the Company is exposed is credit risk.

The nature and extent of the financial instruments outstanding at the date of the statement of financial position and the risk management policies employed by the Company are discussed below:

Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Company. Credit risk is generally higher when a non-exchange traded financial instrument is involved because the counterparty for non-exchange traded financial instruments is not backed by an exchange clearing house.

The Company is potentially exposed to credit risk on the Silent Contribution, loan receivable, interest receivable and from its exposure on its cash and cash equivalents.

The counterparty of these items is solely the Bank. The carrying amounts of financial assets best represent the maximum credit risk exposure at the statement of financial position date.

(stated in United States dollars)

9. Credit, liquidity and market risk (continued)

Credit risk (continued)

As at December 31, 2017 and December 31, 2016 the Company's financial assets exposed to credit risk amounted to the following:

	Note	2017	2016
Silent Contribution	3	260,413,608	113,639,179
Loan receivable	4	553,000,000	553,000,000
Interest receivable	4	9,069,200	-
Cash and cash equivalents		203,594	9,272,794
	US$	822,686,402	675,911,973

The Class B preference shareholders bear the risk of the Silent Contribution and the Class A preference shareholders bear the credit risk of the loan and its interest receivable. The balance of the Silent Contribution comprises of a current year fair value adjustment of US$183,305,150 and an IAS39.AG8 adjustment of US$(36,530,721) (2016: US$(59,484,049) and US$22,255,099 respectively).

Liquidity risk and refinancing risk

Liquidity risk is the risk that the Company will encounter difficulties in meeting obligations associated with financial liabilities. The timing and terms of cash inflows from Silent Contribution and loan receivable are similar to cash outflows on accounts of Class A preference shares and Class B preference shares. As such, the Company is deemed to have insignificant exposures to liquidity risk and refinancing risk.

Market risk

Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market, whether those changes are caused by factors specific to the individual instrument or factors affecting all instruments in the market.

Market risk represents the potential loss that can arise as a result of adverse changes on market positions. Relevant for the company are interest rates and credit spreads (interest rate risk). The Company is not exposed to foreign exchange risks, stock prices, indices and fund prices or commodity prices. As explained in Note 1 the limited purpose of the company as an investment company is to provide funding to the Bank.

9. Credit, liquidity and market risk (continued)

Market risk (continued)

The terms of the Loan Agreement and Participation Agreement are similar to terms of Class A preference shares and Class B preference shares. All proceeds received from the Bank under the Loan receivable and the Silent Contribution are distributed to Class A and Class B Shareholders. Hence, the entire market risk of loan receivable and Silent Contribution are passed onto Class A preference shares and Class B preference shares. As such, the Company is deemed to have insignificant exposures to interest rate or credit spread risk. Changes in interest rates or credit spread risk do not have any significant impact on profit or loss and equity of the Company.

10. Taxation

There are no taxes on income or gains in the Cayman Islands and the Company has received an undertaking from the Governor in Cabinet of the Cayman Islands exempting it from all local income, profits and capital taxes until 2025 should such taxes be enacted. Accordingly, no provision for income taxes is included in these financial statements.

11. New pronouncements

New Accounting Standards, amendments to existing Accounting Standards and/or interpretations of existing Accounting Standards (separately or together, "New Accounting Requirements") adopted during the current year

The Company has assessed the impact, or potential impact, of all New Accounting Requirements. In the opinion of the Company, there are no mandatory New Accounting Requirements applicable in the current period that had any material effect on the reported performance, financial position, or disclosures of the Company other than those listed below. The Company has not adopted any New Accounting Requirements that are not mandatory.

Standards and amendments to existing standards effective from January 1, 2017.

Investment entities: Applying the consolidation exception – Amendments to IFRS 10, IFRS 12 and IAS 28

Amendments made to IFRS 10 Consolidated Financial Statements and IAS 28 Investments in associates and joint ventures clarify that:

- The exception from preparing consolidated financial statements is also available to intermediate parent entities which are subsidiaries of investment entities.
- An investment entity should consolidate a subsidiary which is not an investment entity and whose main purpose and activity is to provide services in support of the investment entity's investment activities.

11. New pronouncements (continued)

- Entities which are not investment entities but have an interest in an associate or joint venture which is an investment entity have a policy choice when applying the equity method of accounting. The fair value measurement applied by the investment entity associate or joint venture can either be retained, or a consolidation may be performed at the level of the associate or joint venture, which would then unwind the fair value measurement.

The standard is effective for annual periods beginning on or after January 1, 2017. The standard has not had a significant impact on the Company's financial position or performance.

There were no other standards, interpretations or amendments to existing standards that are effective during 2017 that have a significant impact on the Company.

New standards, amendments and interpretations issued but not effective for the financial year beginning January 1, 2017 and not early adopted

IFRS 9 'Financial Instruments: Classification and Measurement'

IFRS 9 deals with recognition, derecognition, classification and measurement of financial assets and financial liabilities. Its requirements represent a significant change from the existing requirements in IAS 39 Financial Instruments, 'Recognition and Measurement'. The standard introduces new requirements of classification and measurement, impairment, and hedge accounting. The standard is effective for annual periods beginning on or after January 1, 2018, with earlier application permitted. Retrospective application is required but comparative information is not compulsory. The Company does not plan to adopt this standard early.

Upon adoption of IFRS 9, the classification of the Silent Contribution will change from available-for-sale financial assets to financial assets measured at fair value through profit or loss and the classification of the Class B preference shares will change from financial liabilities measured at amortised cost to financial liabilities measured at fair value through profit or loss. The Class B preference shares will be designated as financial liabilities measured at fair value through profit or loss in order to eliminate or significantly reduce the measurement inconsistency that would otherwise arise from measuring the Silent Contribution at fair value through profit or loss whilst measuring the Class B preference shares at amortised cost. The Loan receivable will also be assessed for any impairment upon adoption of IFRS 9.

(stated in United States dollars)

11. New pronouncements (continued)

Please see below the effect of initial application of IFRS 9 on January 1, 2018:

December 31, 2017	Note	Carrying Amount	Fair Value	Difference
Silent Contribution*	3	260,413,608	260,413,608	-
Class B preference shares	5	321,955,951	260,060,000	(61,895,951)

December 31, 2017	Note	Carrying Amount	Impairment	Total
Loan Receivable	4	553,000,000	13,870,371	539,129,629

* Due to the change in classification of the Silent Contribution from available-for-sale financial assets to financial assets measured at fair value through profit or loss, the Revaluation reserve amount of US$178,203,088 will reduce to US$Nil and be recorded in Accumulated loss.

There are no other standards, interpretations or amendments to existing standards that are not yet effective that would be expected to have a significant impact on the Company.

12. Subsequent events

On February 28, 2018, a share purchase agreement was signed whereby the shares of the Bank were sold to a consortium of private equity investors.

As part of the restructuring the Bank has incurred a one-time negative effect with regards to the valuation of its loan portfolio.

In light of this as well as other effects of the privatization, the Bank will not be able to make distributions in respect of the Participation Agreement for the fiscal year 2019 as originally expected but at the earliest from the fiscal year 2024 for the fiscal year 2023.

The financial statements were approved and authorised for issue by Directors on April 30, 2018.

Positive business development overshadowed by one-off effects relating to privatisation

In the 2017 financial year, the Bank showed positive development overall, making a significant contribution to the positive development of the privatisation process. Operating business development was characterised first and foremost by the significant winding-down of legacy burdens, positive earnings and cost development and satisfactory key management indicators. At the same time, significant one-off effects arose in the context of the privatisation process, overshadowing the business results at the reporting date. In particular, the Bank will be relieved of a large part of the non-performing legacy burdens in connection with the portfolio transaction concluded as part of the privatisation process. This will result, on the one hand, in a fundamental improvement in credit quality. On the other hand, the portfolio transaction results in considerable burdens in loan loss provisions as at the reporting date. In addition, new assessments of interest and principal repayments for the hybrid instruments had to be taken into account.

The purchase agreement signed on February 28, 2018, provides the basic prerequisite for the successful conclusion of the privatisation process, which has been ongoing for around 2.5 years. The Bank contributed to this process with its systematic restructuring strategy and its solid operating development, laying the necessary foundation for its successful privatisation.

In the 2017 reporting year, the following aspects are particularly noteworthy:

- Good operating development within the Core Bank: The new business volume developed largely in line with the plan in the reporting year and amounts to € 8.5 billion (around € 2.3 billion with new clients), down only slightly on the value for the previous year (€ 8.9 billion). In 2017, the Bank once again succeeded in operating successfully on the basis of existing and new client relationships in an environment characterised by intense competition over all, concluding new business with an appropriate risk profile.

- Significant reduction in wind-down portfolio: Even without the portfolio transaction, the Bank wound down around € -11.6 billion EaD in the Non-Core Bank taking currency effects into account, i.e. more than planned, winding down non-performing legacy loans in the amount of € -7.0 billion. The NPE ratio in the Group fell considerably as a result to 10.4 % as at the reporting date (December 31, 2016: 17.5 %).

- Portfolio transaction agreed: In order to achieve the final elimination of a large part of its legacy burdens, the Bank sold further 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 February 28, 2018, giving rise to one-off negative valuation effects as at December 31, 2017. This means that the NPE ratio is expected to drop to around 2 % (after the closing of the transaction).

Positive business development overshadowed by one-off effects relating to privatisation (continued)

- Systematic implementation of the cost programme: Planned potential for cost savings was exploited in line with the requirements, with administrative expenses being cut considerably from € -634 million in 2016 to € -515 million in 2017.

- Capital and liquidity ratios at a high level: Key management indicators for capital and liquidity were still at a very solid level. The pro forma CET1 ratio, which is calculated excluding the regulatory RWA relief effect of the second loss guarantee (for explanatory information, see the section entitled "Management system") showed very positive development. It came to 15.4 % as at December 31, 2017 (December 31, 2016: 12.6 %). The LCR came to 169 % (December 31, 2016: 172 %).

Privatisation process on the home stretch

The signing of the share purchase agreement satisfied in a timely manner the central commitment set out in the formal decision of May 2, 2016, in the EU state aid proceedings.

In light of the share purchase agreement that has been concluded, the Bank expects the privatisation process to be finalised in the third quarter of 2018 at the latest, once all of the necessary conditions have been met. Within this context, the Bank is confident that it can forge ahead intensively with the necessary realignment of the Bank by continuing with its current restructuring course, allowing it to do everything in its power to contribute to an ultimately successful change of ownership. In addition, the Bank will provide constructive support in all matters that are to be discussed further among the relevant stakeholders in order to systematically promote the transformation process initiated by the Management Board to create a new bank that is geared to the private sector.

In connection with an imminent multi-year transformation phase, which will be characterized by the move from the public-sector to the private-sector deposit guarantee fund, but also by restructuring measures to create a new and sustainable bank, as well as other risks, such as a further increase in capital requirements due to more stringent regulatory standards, the Bank expects, from today's perspective, that, contrary to past plans, it will only be possible to make distributions on the hybrid capital instruments that have been issued at the earliest from the 2024 financial year for the 2023 financial year.

Satisfactory new business

During the reporting period, the Bank worked intensively on forging ahead with its operating business activities. The focus was on generating new business with an appropriate risk profile in a market environment that remains challenging. The Core Bank's new business showed positive development in the reporting year and falls only just short of the ambitious target. It amounted to € 8.5 billion, only just shy of the prior-year level (€ 8.9 billion). A total of around € 2.3 billion in new business was concluded with new clients. Further details on new business, in particular regarding the development of the individual segments, can be found in this Group management report in the section entitled "Segments".

Satisfactory new business (continued)

The ratio of new loans disbursed to new business concluded (disbursement ratio) is more or less on a par with the prior-year level. The interest margins achieved are falling significantly due to the competitive environment and fall short of the ambition level due to higher liquidity costs. Cross-selling net income generated by various banking services over and above loan financing showed encouraging development in the reporting year. Investment products, loan commission and income from derivative business transacted with clients made a key contribution to this trend.

Successful reduction of legacy assets due to the Bank's regular winding-down strategy
The Bank significantly accelerated the implementation of its focused winding-down strategy in the 2017 reporting year and implemented it successfully. This is largely due to three factors:

- after a pronounced market slump in 2016, developments on the shipping markets have been pointing for several quarters now towards a recovery trend that is better than expected. This trend was particularly evident in the container vessel and bulker segments in 2017 and is based first and foremost on a revival in demand for transportation capacities, brisk scrapping activities and the consolidation of shipping lines.

- Taking the favourable market environment in 2017 into account, the Bank has been adjusting its restructuring principles since the second half of 2017 and is focusing its restructuring strategies more on specific recovery prospects for each individual commitment. The implementation of the winding-down strategy, which has been accelerated by the factors set out above, also serves to reduce historical concentration risks and was facilitated mainly by the high coverage ratio of the non-performing legacy portfolio.

- The development of the EUR/USD exchange rate also had a pronounced positive impact on the marked reduction in the portfolio of legacy burdens. This effect contributed € -0.7 billion in the reporting period.

The Bank wound-down a total of € -11.6 billion EaD in non-performing and non-strategic loans in the Non-Core Bank in 2017. € -7.0 billion of this amount is attributable to the NPE legacy portfolio. The winding-down measures continued to focus on reducing non-performing ship financing transactions dating from the years before 2009 that were secured by the second loss guarantee of the federal state owners. As well as reducing the portfolio by implementing recovery strategies, receivables with a volume of € 2.7 billion EAD relating to continental European real estate financing, as well as aircraft, solar and shipping financing, were sold in the reporting period as part of market portfolio transactions. The winding-down measures reduce the NPE ratio significantly to 10.4 % (December 31, 2016: 17.5 %). In addition to the market portfolio transactions described above, the legal transfer of the loan portfolio sold to hsh portfoliomanagement AöR in the 2016 financial year ("federal state portfolio transaction") was largely concluded as a structural measure in connection with the EU decision.

Additional substantial winding-down of legacy burdens as part of privatisation process

In light of the future viability of the Bank and the good portfolio quality that it is aiming to achieve in this regard, 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) within the context of the privatisation process. Broken down by asset classes, € 4.3 billion of the portfolio is attributable to shipping, € 1.0 billion to real estate, € 0.6 billion to corporate clients and € 0.4 billion to other loans. This allows the Bank to continue with its stringent winding-down strategy and to achieve, as a result of the sale, far-reaching relief from a large part of the non-performing legacy loans, as well as a smaller volume of other legacy portfolios of the Non-Core Bank.

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.

In light of the portfolio transaction, the Bank has changed its commitment strategy for the individual loan receivables in the transaction portfolio from the previous individual single commitment-specific strategy (e.g. Realisation of collateral and workout) to a strategy involving the short-term sale of the loan receivable in question as part of a loan portfolio sale. On the basis of these sale strategies, the loan loss provisions for the loan receivables in the transaction portfolio were calculated on the basis of an independent expert opinion based on the IDW S1 principles, which formed the basis for the agreed purchase price of the portfolio for the Bank. This resulted, in particular, in additional unplanned specific loan loss provisions in an amount of € 1.1 billion.

Stringent cost programme

The increasing pressure on earnings and margins in the highly competitive banking market and increasing costs for regulatory requirements are being countered by the ongoing cost reduction programme. In addition, substantial additional expenses were incurred in connection with the privatisation process (e.g. for legal and advisory services, data rooms) and the restructuring of major commitments in the Non-Core Bank.

In the course of 2017, the Bank made the progress it planned to make in implementing measures for controllable operating expenses. The potential for cost savings expected, based on the optimisation of the organisation and processes that has been implemented, was largely realised accordingly and, in some cases, actually exceeded slightly. The targeted management of operating expenses has resulted in a reduction in project costs, building costs and other personnel-related operating expenses in particular. As far as personnel expenses are concerned, 90 % of the planned reduction has already been contractually agreed with employees as part of the 2018PLUS programme, and the Bank continued to implement its ambitious targets for personnel expenses in a systematic manner.