

DIRECTORS' REPORT

For the six months ended June 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)
Michael Carter (appointed November 30, 2015) (resigned August 22, 2017)
Laura Chisholm (appointed January 29, 2013).

The Directors held no interests in the Company as at June 30, 2017.

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 June 30, 2017 amounted to US\$1,054,776,324 (June 2016 US\$1,027,080,565)

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\$18,138,400 (June 30, 2016: US\$18,138,400) as scheduled interest income from its asset classes during the period and paid dividends on the Class B Preference Shares of NIL (June 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 2015 to 2017 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.

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.

Results and Allocation

The Company reported a profit for the period of US\$15,567,595 (June 30, 2016: US\$15,968,226) 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

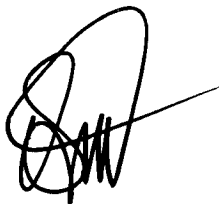
The financial statements of the Company have been prepared by management. Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining 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 June 30, 2017, 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 31 August, 2017

A handwritten signature in black ink, appearing to be 'C. Stewart', written over a horizontal line.

Cleveland Stewart, Director

Financial Statements of

HSH N FUNDING II

June 30, 2017

(compiled without audit or review)

HSH N FUNDING II

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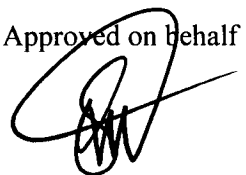
Statement of Financial Position

June 30, 2017 and December 31, 2016 *(compiled without audit or review)*
(stated in United States dollars)

	Note	June 30, 2017	Dec 31, 2016
Assets			
Available-for-sale financial assets			
Silent Contribution	3,7,8	124,048,131	113,639,179
Loans and receivables			
Loan receivable	4,7,8	553,000,000	553,000,000
Cash and cash equivalents	7,8	27,411,194	9,272,794
Total assets	US\$	704,459,325	675,911,973
Liabilities and Equity			
Liabilities			
Class B preference shares	5,8	409,742,796	395,765,194
Other liabilities		1,528	1,528
		409,744,324	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)	(362,506,083)	(361,508,238)
Retained earnings/(accumulated loss)		12,177,084	(3,390,511)
		294,715,001	280,145,251
Total liabilities and equity	US\$	704,459,325	675,911,973

See accompanying notes to financial statements.

Approved on behalf of the Board of Directors on 31 August 2017



Director



Director

HSH N FUNDING II

Statement of Comprehensive Income

For the six months ended June 30, 2017 and 2016 (*compiled without audit or review*)
(*stated in United States dollars*)

	Note	2017	2016
Income			
Net change in revised discounted cash flows (Silent Contribution)	2(c)(viii),3	11,406,797	10,933,310
Interest income on loan	4,7	18,138,400	18,138,400
		29,545,197	29,071,710
Finance costs			
Net change in revised discounted cash flows (Class B preference shares)	2(c)(viii),5	13,977,602	13,103,484
		13,977,602	13,103,484
Net income for periods	US\$	15,567,595	15,968,226
Other comprehensive (loss)/income			
Net change in fair value of available-for-sale financial assets	2(c)(viii),3	(997,845)	(25,631,864)
		(997,845)	(25,631,864)
Comprehensive income/(loss) for the period	US\$	14,569,750	(9,663,638)

See accompanying notes to financial statements.

HSH N FUNDING II

Statement of Changes in Equity

For the six months ended June 30, 2017 and 2016 (compiled without audit or review)
(stated in United States dollars)

		Note	Share Capital	Class A Preference Shares	Revaluation Reserve	Retained Earnings	Total
Balance at January 1, 2016	US\$		10,000	645,034,000	(302,024,189)	1,178,503	344,198,314
Net income for period			-	-	-	15,968,226	15,968,226
Net change in fair value of available-for-sale financial assets		3	-	-	(25,631,864)	-	(25,631,864)
Balance at June 30, 2016	US\$		10,000	645,034,000	(327,656,053)	17,146,729	334,534,676
Net income for period			-	-	-	15,739,560	15,739,560
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	-	-	(33,852,185)	-	(33,852,185)
Balance at December 31, 2016	US\$		10,000	645,034,000	(361,508,238)	(3,390,511)	280,145,251
Net income for period			-	-	-	15,567,595	15,567,595
Net change in fair value of available-for-sale financial assets		3	-	-	(997,845)	-	(997,845)
Balance at June 30, 2017	US\$		10,000	645,034,000	(362,506,083)	12,177,084	294,715,001

See accompanying notes to financial statements.

HSH N FUNDING II

Statement of Cash Flows

For the six months ended June 30, 2017 and 2016 (compiled without audit or review)
(stated in United States dollars)

	2017	2016
Cash provided by/(applied in):		
Operating activities		
Net income for period	15,567,595	15,968,226
Add/(deduct) net changes in non-cash operating balances:		
Net change in revised discounted cash flows (Class B preference shares)	13,977,602	13,103,484
Net change in revised discounted cash flows (Silent Contribution)	(11,406,797)	(10,933,310)
Increase in cash and cash equivalents during period	18,138,400	18,138,400
Cash and cash equivalents at beginning of period	9,272,794	9,272,794
Cash and cash equivalents at end of period	US\$ 27,411,194	27,411,194
Supplementary information on cash flows from operating activities:		
Interest received	18,138,400	18,138,400

HSH N FUNDING II

Notes to Financial Statements

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

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 assumption of the Bank as a going concern for accounting and measurement purposes and the assumption of the continued survival of significant group companies is based in particular on the fact that:

- (i) the agreements required for the implementation of the decision taken by the EU Commission in the EU state aid proceedings on the replenishment of the second loss guarantee are entered into comprehensively and on a timely basis and that the decision will be implemented by HSH Nordbank AG and its shareholders in full and on a timely basis,
- (ii) the operating company, HSH Nordbank AG, is sold at a positive sale price in an open, non-discriminatory, competitive and transparent process not involving state aid until 28 February 2018 and the EU Commission grants its approval for the acquisition following a viability assessment of the new corporate structure.

SH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

1. Incorporation and background information (continued)

Should the divestment procedure not lead to offers not requiring state aid with a positive price being offered before the expiry of the deadline, or should the EU Commission in the course of its viability assessment come to the conclusion that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business and manage its assets as far as legally permissible with the aim of a structured winding down of its business. In the event 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 during the privatisation period, then this could trigger outflows of short-term funds and fundamentally restrict HSH Nordbank'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.

(iii) as part of the ongoing privatisation process of HSH Nordbank AG, HSH Nordbank AG will be sold in full as a whole bank, i. e. the shares in the Bank held by the seller will be disposed of, including all assets and liabilities, without any material early disposals of assets or sub-segments at prices below the carrying amount in the case of offers for the entire business having been received. If extensive sales of loan portfolios, particularly in the Non-Core Bank, are required, then this could result in significant additional loan loss provision expenses that are not compensated for by the guarantee, and could require the material depreciation of deferred taxes.

(iv) the minimum capital requirements at all regulatory levels can be adhered to in accordance with the corresponding SREP resolutions passed by the European Central Bank and the statutory provisions during the forecast period. If there is a need for significant additional loan loss provision expenses and the material depreciation of deferred taxes (e.g. in the scenario described above) or if the recovery of the shipping market that has been assumed in the Bank's corporate planning does not materialise as planned, or if the regulatory treatment of the second loss guarantee as a securitisation position is no longer approved by the banking supervisory authority, this could put considerable pressure on the capital ratios and additional measures may need to be taken by the owners and/or third parties to strengthen the capital ratios in order to be able to adhere to the minimum capital requirements, particularly at the level of the financial holding group. If such measures are not taken, this could result in the winding down of HSH Nordbank.

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

In addition, the Company issued 553,000 Class A preference shares to the Bank in the aggregate nominal amount of US\$553,000,000 and used the proceeds to extend a loan documented in the form of a German law governed *Schuldscheindarlehen* to the Bank. The purpose of the loan is to enable the Company to meet its obligations in relation to the Class B preference shares if and when they arise under the Class B preference shares terms.

The Company's registered office is located at Ugland House, George Town, Grand Cayman.

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

1. Incorporation and background information (continued)

The operations of the Company are conducted primarily in United States dollars. Consequently, the functional currency of the financial statements is United States dollars and not the local currency of the Cayman Islands.

Operating expenses of the Company are paid by the Bank, with no obligation for the Company to repay. Accordingly, the Company is economically dependent on the Bank.

The financial statements are presented in United States dollars.

Daily activities of the Company are administered by MaplesFS Limited ("MFL").

2. Significant accounting policies

These financial statements are prepared in accordance with International Financial Reporting Standards ("IFRSs"). 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 IFRSs 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 Article 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, 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.

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(ii) 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.

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

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(iii) Measurement (continued)

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.

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

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(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 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 2015 to 2017 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 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, 2016, HSH Nordbank further announced that the next coupon payments on Silent Contributions will only take place in the year 2020 for the fiscal year 2019.

(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).

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(vii) Fair value disclosures

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.

Pursuant to the EU Commission's requirements, HSH Nordbank 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, 2016, HSH Nordbank announced that the next coupon payments on Silent Contributions will only take place in the year 2020 for the fiscal year 2019.

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

2. Significant accounting policies (continued)

(c) Financial instruments (continued)

(viii) Specific instruments (continued)

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 HSH Nordbank.

(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).

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(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 June 30, 2017 the fair value of the level 2 investments, comprising solely of the Silent Contribution, was US\$124,048,131 (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 period	-	-	-	-	-
AG.8 and fair value movements	-	-	11,406,797	(997,845)	10,408,952
Balance at June 30, 2017	500,000,000	92,034,722	(105,480,508)	(362,506,083)	124,048,131

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(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.

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 June 30, 2017 the balance of the Class B preference shares was US\$409,742,796 (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\$(90,257,204) (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 period	-	13,977,602	13,977,602
Balance at June 30, 2017	500,000,000	(90,257,204)	409,742,796

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

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.

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(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 period ended June 30, 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 period	645,034	645,034,000	645,034	645,034,000
Balance at end of period	645,034	645,034,000	645,034	645,034,000

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

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.

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(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	June 30, 2017	Dec. 31, 2016
Statement of Financial Position:			
Silent Contribution	3	124,048,131	113,639,179
Loan receivable	4	553,000,000	553,000,000
Cash and cash equivalents		27,411,194	9,272,794
Statement of Comprehensive Income:			
Interest income on loan	4	18,138,400	36,276,800
Other interest income		-	-

HSH Nordbank AG's audited financial statements for the year end December 31, 2016 and 2015 contain an emphasis of matter paragraph in the audit opinion regarding the Bank's ability to continue as a going concern. The Bank's plans with regard to being able to pay future profit participations are documented in note 12.

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):

June 30, 2017	Note	Carrying Amount	Fair Value	Difference
Silent Contribution	3	124,048,131	124,048,131	-
Loan Receivable	4	553,000,000	711,665,956	158,665,956
Cash and cash equivalent		27,411,194	27,411,194	-
Class B preference shares	5	409,742,796	128,035,000	281,707,796
Other Liabilities		1,528	1,528	-

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(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 equivalent		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 receivables and from its exposure on its cash and cash equivalents.

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

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

9. Credit, liquidity and market risk (continued)

Credit risk (continued)

As at June 30, 2017 and December 31, 2016 the Company's financial assets exposed to credit risk amounted to the following:

	Note	2017	2016
Silent Contribution	3	124,048,131	113,639,179
Loan receivable	4	553,000,000	553,000,000
Cash and cash equivalents		27,411,194	9,272,794
	US\$	704,459,325	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 period fair value adjustment of US\$(997,845) and an AG8 adjustment of US\$11,406,797 (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.

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

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

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

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

11. New pronouncements (continued)

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 likely change from available-for-sale financial assets to financial assets measured at fair value through profit or loss and it is likely that 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. It is likely that 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 likely continue to be measured as at amortised cost and therefore be subject to the new impairment requirements/expected credit loss model.

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.

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

12. Current market condition

As detailed in note 1 the Company benefits from a support undertaking agreement from the Bank and is economically dependent on the Bank. There are several events or likely future events directly affecting the Bank and indirectly the Company as enumerated below.

On June 2, 2009 the federal state of Schleswig-Holstein and the Free and Hanseatic City of Hamburg granted the Bank a guarantee facility in the amount of €10 billion via the HSH Finanzfonds AöR in order to secure the future of the Bank. The agreement on the provision of a guarantee facility as well as a related recapitalization of the Bank are subject to approval by the European Commission in line with the law regarding state aid.

The EU Commission concluded these state aid proceedings at the end of September 2011 and entered into an agreement on conditions and commitments with all the parties involved. This means that the measures to support the Bank have been approved in a legally binding manner.

Due to the progress made in the winding-down of risk positions, the Bank was able to reduce the second loss guarantee issued by the federal states of Hamburg and Schleswig-Holstein. The guarantee amount was reduced from the initial €10 billion to €7 billion in September 2011 through a total of three partial reductions made during the course of the year 2011. With the reduction in the guarantee, the fee payable for the guarantee was also reduced.

The federal states of Hamburg and Schleswig-Holstein re-increased the second loss guarantee for the Bank from €7 billion to the original facility of €10 billion at the end of June 2013.

The guarantee increase was provisionally approved by the EU Commission in June 2013 after the consent of the parliaments of the federal states of Hamburg and Schleswig-Holstein had been given. At the same time the EU Commission initiated a formal investigation to determine whether the measure is in accordance with EU rules on state aid and within the framework of the measures already approved in 2011.

Formal decision in the EU state aid proceedings

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

The EU decision is based on a list of conditions and commitments, under which the Federal Republic of Germany as representative of HSH Nordbank's federal state owners and the EU Commission agreed measures to provide legacy asset relief to the Bank. These measures are generally in line with the informal agreement already announced in the 2015 financial year.

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

12. Current market condition (continued)

These include in particular the reduction in guarantee fees, formation of a holding structure and sale of non-performing loans in an initial amount of € 5 billion to the federal state owners and in the amount of up to € 3.2 billion in the market as well as a one-off payment of € 210 million from HSH Nordbank to the holding company in connection with the premium obligations taken over by the holding and the provision of liquidity in the amount of € 50 million to the holding company to ensure its operations.

Furthermore, it is intended to sell HSH Nordbank by 28 February 2018. In this regard, the list of conditions and commitments provide for the option of selling business divisions or parts thereof with the consent of the federal state owners. Consequently, a sale of HSH Nordbank as a whole or in parts is possible. The divestment deadline is met upon the signing of a purchase agreement and may be extended by up to six months with the consent of the EU Commission where there are delays in the technical implementation of the model for reasons outside the control of the federal states.

The planned structural measures and resulting expected effect on the net assets, financial position and earnings situation are taken into account in the Bank's new plan for the coming years. Key structural measures were implemented in line with the plan in the previous year and first half of 2017, such as the formation of the holding structure to relieve the operating HSH Nordbank from guarantee obligations, sale of non-performing shipping loans of € 5 billion as at 30 June 2016 to hsh portfolio management AöR (federal state owners), sale of a portion of the market portfolio in January 2017 and further sales in the market over the further course of the year.

Following the relief recognised in the 2015 annual and Group financial statements, a large proportion of the long-term structural improvements for the Bank's financial and risk situation has been achieved, primarily due to the significant reduction in the base premium and noticeable improvement in the NPE ratio. This will improve the conditions for a sustainable long-term business model for the Bank. It is expected that the reduction of the currently significant level of impaired legacy assets covered by the guarantee facility provided by the federal states as the reference portfolio will be accelerated. Nevertheless, the targeted improvements are restricted given the complex settlement conditions, particularly with regard to the options for winding down legacy assets based on purely economic criteria as part of an active portfolio management and aimed at counteracting the build-up of a high NPE volume.

Up to 94.9 % of the shares held directly by HSH Beteiligungs Management GmbH ("HoldCo") are to be sold as part of the intended sale of the overall Bank. The federal states of Hamburg and Schleswig-Holstein and (to a much lesser extent) other (indirect) shareholders of HSH Nordbank AG stand behind the HoldCo. The acquisition of the remaining 5.1 % of the shares held by the fund managed by J.C. Flowers & Co. LLC is also possible under certain conditions. Under the EU decision the federal states are entitled to retain their investment in the holding company up to a maximum of 25 % of the shares in the operating company for a period of up to four years following completion of the sale.

The owners are responsible for the sale of the shares, HSH Nordbank's Management Board supports the sale accordingly.

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

12. Current market condition (continued)

From the shareholders' standpoint, the sale of HSH Nordbank as a whole, i.e. the sale of all shares held by the seller in a share deal, is the objective of the sale process. Preference is to be given in assessing the bids of those bidders whose bid is based on the acquisition of the Bank as a whole at a positive price. In order to ensure the maximum degree of flexibility, the federal state owners have also allowed the option of transaction structures that differ from the preferred sale of the Bank as a whole in the sale announcement as a precaution. Accordingly, the list of conditions and commitments also provides for the possibility of the sale of divisions or parts thereof with the consent of the federal state owners. In this way, the maximum interest of potential investors is sounded out and it is ensured that all available solution options are considered. Against this backdrop and as a highly precautionary measure, alternative privatisation options are also being discussed in addition to the preferred sale of the Bank as a whole. The sale of a bank structurally relieved of legacy assets is therefore being discussed in addition to the preferred sale of the Bank as a whole to one or several investors (bidder consortium). In this case, the scope of the risk transfer offered by potential investors would be a key assessment criterion for the sellers. Any potential downsizing of legacy assets as part of the sale of the bank as a whole does not represent an isolated portfolio transaction of the Bank, but could form part of the bidder's concept and therefore the sale process. The Management Board will only agree to an alternative transaction structure if it is ensured that the Bank's continued existence remains guaranteed by the sale. In the event of such a scenario, this means that a sale of individual portfolios before or during the privatisation would only be executed if it is ensured that the remaining bank is regarded as being in an improved economic condition better after such a sale.

In their announcement of 2 July 2017 with respect to the submission of expanded indicative bids by 30 June 2017, the federal state owners stated that bids expected by the federal states had been submitted on time and, after an initial review, form a good basis for successfully continuing the sale process.

Based on the available information the Bank remains of the opinion that a sale as a whole in accordance with its plans will take place. Following the successful completion of the sales process resulting in an offer that does not require state aid and an offer price that is positive (while retaining the guarantee), the intended acquisition and related corporate structure will be subject to a viability assessment by the EU Commission prior to implementation and is subject to approval by the EU Commission. Should the divestment procedure not lead to offers not requiring state aid (while maintaining the guarantee) with a positive price being offered before the expiry of the deadline, or should the Commission come to the conclusion in the course of its viability assessment that the integration of the operating company into the new corporate structure will not lead to a viable business model that is profitable in the long term, the operating company will cease new business according to the list of conditions and commitments and manage its assets as far as legally permissible with the aim of a privately managed orderly winding down.

HSH N FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

12. Current market condition (continued)

Under the list of conditions and commitments, the recapitalisation of existing restructured loans, certain transactions entered into for liquidity management purposes, prolongations at the same terms or to avoid losses, as well as derivative transactions entered into to manage the Bank's overall market risk positions are still permitted in this connection.

Regarding the prohibition of dividends and distributions, the EU decision stipulates that the operating company may not make any payments during the divestment period on profit-related equity instruments (such as hybrid financial instruments and profit participation certificates), unless these are contractually or legally owed. These instruments are also required to participate in losses, to the extent that the balance sheet of the operating company was to disclose a loss excluding the release of reserves. Furthermore, the operating company will not pay any dividends until the sale is completed, with the exception of dividend payments in the amount legally permitted from the operating company to the holding company to be formed.

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

According to the list of conditions and commitments, provisions regarding the reduction in total assets and regarding the business model are also to be complied with during the restructuring phase, which ends with the sale of the operating company, and the restriction on external growth through the acquisition of control in other companies is also to be observed.

The privatisation process is proceeding at a rapid pace.

Under the formal decision reached in the EU state aid proceedings, HSH Nordbank is to be sold by 28 February 2018. Against the backdrop of this privatisation, the Bank has been systematically implementing structural, organisational and personnel measures for about a year. All these measures contribute to an improvement in the Bank's financial and risk situation and should form the basis for a sustainable structure and viable business model to be characterised by increasing capital ratios, good liquidity ratios and increased efficiency.

The official part of the privatisation of HSH Nordbank started with the announcement of the sale by the federal state owners, which was published on 23 January 2017. Since then the privatisation process has been proceeding at a rapid pace in line with the plan. After an initial data room phase, interested investors submitted expanded indicative bids on 30 June 2017, thereby reaching a decisive milestone in the privatisation process. In this regard, the federal state owners stated in their announcement of 2 July 2017 that bids expected by the federal states had been submitted on time and that, after an initial review, these bids form a good basis for a successful continuation of the sale process. The bidders who have successfully reached the next stage of the privatisation have been provided with more detailed information in the data room. Binding bids are to be submitted in the autumn of 2017, on the basis of which the final agreement negotiations are to be conducted.

HSN FUNDING II

Notes to Financial Statements (continued)

(compiled without audit or review)

For the six month period ended June 30, 2017

(stated in United States dollars)

12. Current market condition (continued)

The present exchange of information between potential investors and the federal state owners will be further intensified over the coming weeks. Of particular importance in this regard are key issues such as significant aspects of the capital structure, the guarantee and related legacy assets on the one hand and a sustainable outlook for the Core Bank on the other hand, which will need to be discussed between potential investors and the federal state owners.

A large number of possible privatisation solutions, which could include structured sub-bank solutions (where a sale of the Bank as a whole cannot be achieved) in addition to the envisaged sale of the Bank as a whole, will therefore have to be assessed in the discussions between the federal state owners and interested investors to achieve a successful privatisation from the viewpoint of all stakeholders. This is of particular relevance not least in view of the requirement that the viability review of the new corporate structure to be carried out by the EU Commission at the end of the privatisation process is positive.

13. Subsequent events

There are several events directly affecting the Bank and indirectly the Company which are disclosed in the Note 1 and Note 12. There have been no other material subsequent events up until the date this report was authorised for issue except for those disclosed in these financial statements elsewhere

The financial statements were approved and authorised for issue by Directors on 2017.

31 August